The Macro-Economic Implications of COVID-19 in developing countries

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Caveats

• First time I give this talk
  • Hoping to learn from your comments
• It covers topics I know little about
  • Ignorance is daring
• It deals with horrible moral trade-offs
  • Do no shoot the messenger
• It focuses on developing countries
  • Too much of the discussion in the US has been inward looking
  • Growth Lab projects in Ethiopia, Albania, El Salvador, Venezuela
What is happening?

• When it rain, it pours
• Coronavirus COVID-19
  • How to think about it from an economics perspective?
• Collapse in access to foreign income
  • Collapse in commodity prices
  • Collapse in tourism
  • Expected collapse in remittances
• Collapse in access to capital markets
Some countries rely on very few commodities
Different countries, different combinations

- Commodity exporters vs. commodity importers
  - Oil prices declined to the lowest levels since 2003!!!
  - Bad news for Nigeria, Colombia, Venezuela
  - Good news for Ethiopia, Albania and El Salvador
Some countries are highly dependent on remittances

- Haiti
- Kyrgyz Republic
- Tajikistan
- Nepal
- Lesotho
- El Salvador
- Honduras
- Moldova
- Jamaica
- Kosovo
- Gambia, The
- West Bank and Gaza

2017
Some countries are highly reliant on tourism

- COVID-19 may represent a huge shock to tourism
Bond prices have collapsed
All of these are shocks we have seen before

• We know, in principle, how to handle them
• Three ingredients
• Increased external (official) finance
  • To make adjustments more gradual
• Adopt expenditure reducing policies
  • Cuts to public and private deficits through fiscal and monetary contraction to bring spending in line with lower long-term income
• Expenditure switching policies
  • To make more of the spending go to local output through e.g. real exchange rate depreciation
• This approach works less well when many countries are in the same boat
  • Like now
But what about Coronavirus COVID-19?

What kind of a shock is this?
The logic of flattening the curve

Figure 1: Flattening the Pandemic Curve

Source: Pierre-Olivier Gourinchas
Things to notice

• Flattening the curve means that there will be fewer cases at any point in time
• ...but it does not directly affect the total number of people who eventually get the disease
  • Unless it gives time to develop a vaccine
• Prevents the health care system from being overwhelmed
  • This should lower the death rate, as patients would have ventilators and ICUs
• It delays the peak of the crisis
  • Makes the process longer
• Increases the chances that by then we would have better treatment and/or a vaccine
But how do you flatten the curve?

- By restricting human activity
- But this restricts GDP
  - Harvard (especially Exec Ed)
  - Broadway
  - Airlines
  - Bars, restaurants, gyms
- Lockdown impacts all activities
- But these decisions percolate through the economy amplifying the initial effect
  - Lay-offs
  - Bankruptcies
  - Non-performing loans in the banking system
What does this mean?

• The fight against COVID-19 starts as a supply shock
  • You cannot produce

• But as it percolates through the economy, some are hit by supply shocks
  • You cannot make X because somebody did not make input Y

• Others are hit by negative demand shocks
  • Laid-off workers spend less
  • Bankrupt firms will not invest and will not be there when the crisis is over

• This amplifies the initial contraction

• While the initial shock may be hard to avoid, this amplification could be addressed
  • Protect workers, firms, banks

• ...using fiscal (i.e. public resources, capacity to borrow)
This is different from a garden-variety recession

• It is a supply shock, not a demand shock
• It percolates through both supply and demand channels
• Traditional Keynesian policies have limited effectiveness
  • More demand for Broadway plays does not cause more plays in a lockdown
• Lay-offs and bankruptcies make the recovery much slower
  • Hard to hire, hard to form new ventures
• So fiscal policy can help but not through the standard channels
  • By helping people and firms withstand the shock
The difference between the shock with and without fiscal protection

Source: Pierre-Olivier Gourinchas
Flattening the epidemic curve worsens GDP

Source: Richard Baldwin

Source: Author’s elaboration, inspired by illustrations in the chapter by Gourinchas.
So the solution seems to be clear

• Social distancing and lockdown to prevent infections
  • Bad for GDP
• Fiscal action (with monetary accommodation) to prevent the amplification and long term damage of the lockdown
  • Good for people short term
  • Good for the eventual recovery of the economy
• Typical instruments
  • Maintain payment of payroll or provide unemployment insurance
  • Provide special loans to business
  • Provide regulatory forbearance to banks so that they can reschedule loans
But what if countries have no fiscal space?

• Many countries are fiscally weak in good times
• With the COVID-19 shock, their fiscal space may disappear
  • tax revenues decline
  • Especially if they get a terms of trade, tourism or remittance shock
  • The crisis requires more health expenditures and ideally spending to cushion the blow
• None of this is good for the country’s creditworthiness
• But if, in addition, financial markets shut down, the government may not be even forced to cut back!
• So fiscal policy cannot play the same role as in the standard recommendation, say for the US
In other words

• Without fiscal space, flattening the epidemic curve is costlier
• So countries may be forced to / “choose” not to fight the virus by as much
• ...leading to faster spread,
• more deaths because of lower capacity to treat
• ... and a faster end to the epidemic, assuming no re-infection
• In other words, lack of fiscal space costs lives
But many countries are trying to avoid this

• Some countries without much fiscal space have nevertheless opted for lockdowns
  • Albania and El Salvador, in our network
• How should they manage it?
• How should they prioritize the use of their fiscal space?
  • Health system
  • Livelihoods
  • Firm survival
What to use the lockdown for?

• A lockdown promises to bring the trajectory of cases / deaths down, *relative to a counter-factual*

• But a lockdown is not sustainable
  • Eventually, people will have to decide between dying of the virus and starving to death

• Unsustainable situations cannot last

• So you will eventually need to resume production, but how?

• How can the cost of the lockdown be lowered?

• ... and how should it be shared?
How do you get out of a lockdown?

• Wait for a treatment or vaccine?
  • May be too long
• Wait for cases to go down and your testing and ICU capacity to go up
  • But then, use the lockdown time efficiently
  • Markets for medical inputs may become congested
• Re-open activities gradually
  • Starting with the most critical and least “networky” activities
  • Test frequently and quarantine only the affected as opposed to everybody
• Adjust speed of the re-start as more information is revealed
  • On cases, treatments, capabilities
What should the international financial community do?
Increase fiscal space by expanding the availability of official finance

• Recirculate the flight-to-safety money that is flowing to the US
  • And causing undesired US$ appreciation

• Quantitative Easing
  • Should Central Banks buy IFI bonds? Emerging Market bonds?

• Increase the number of countries with access to FED swap lines
  • The FED announced this policy this morning but it included only Australia, Brazil, Denmark, Korea, Mexico, Norway, New Zealand, Singapore and Sweden.

• Why only those?
  • If the concern is credit risk, maybe have those swap lines intermediated by the IMF

• Expand the use of existing credit facilities
  • IMF’s Rapid Finance Instrument, Stand-by arrangements, other IFIs

• Support for dollarized economies
  • They do not have a lender of last resort
  • El Salvador, Panamá, Ecuador in my part of the world
Thank you!