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Special Review: Review of Economic Implications of COVID-19

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Abstract

The spread of the COVID-19 across the globe had created an unprecedented time to all. Governments' responses towards the pandemic had resulted abrupt halt to the economy. However, the magnitude and persistence of the economic implications from the crisis had remained uncertain. It is, as such, researches had raced against the time to analyse the global economic implications from the outbreak. In addition, there had been growing literatures that discuss on the governments' policies in response to the pandemic. This review article attempts to shed light on these emerging literatures and to find answers that can offer clear insight on the current challenges faced by economies across the globe. A clear understanding obtained from these literatures will assist policymakers in planning post-COVID19 economic recovery.

Keywords: COVID-19, Review, Economic Implications, Policies, Challenges.
JEL Classifications: O1, O2

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1. Introduction

Over the past few months, the COVID-19 pandemic resulted in the implementation of lock-downs and social-distancing practices across the globe. Social-economic activities comes to a halt bringing to a close collapse of the economy. News of impending financial crisis in Asia with the increasing global debt further created much uncertainty to the economy as whole. The situation is further aggravated with some industries badly affected by the pandemic, leading to the closure of many firms in these sectors. Many of these sectors such as tourism, travel, hospitality found themselves in tremendous pressure. The inability of these sectors to sustain their operation lead to serious unemployment problem with many of these firms forced to let go of their employees. Government across the globe have continuously provided firm support to their economy, in light of these challenging times.

Demand shocks coming from the fall of both the domestic demand and the foreign demand had indeed put a tremendous downward pressure on the economy. It is, as such, a proposition to have fiscal response policies plan for the next recovery stage would be highly critical. As the economy slowly reopens, policies should target on supporting demand, helping businesses rebound and giving incentives to firm hiring. Countries across the globe have also opted to give their citizens cash handouts to jump-start the aggregate demand and reviving the economy. While United States have been sending stimulus cheques to the Americans, China have been issuing online consumption vouchers to spur increase of spending. Thailand’s Finance Ministry proposed the tourism stimulus campaign to help boost the tourism industry by stimulating domestic travel. The Malaysia Government too have announced in giving out RM50 e-wallet credit to encourage consumption spending.

Although, it may be too early to pass a definitive judgement on how successful these various approaches have been. In the meantime, the deployment of the continuous policy responses should be rapid and well-coordinated to hasten the economy recovery. A good combination of fiscal, monetary policy and other stimulus approach could be hopeful in bringing the economy back on its right track. This article intends to explore by reviewing some of recent literatures on the global impacts of the COVID-19 pandemic. In addition, this paper also intends to explore the existing literatures that provide discussion on the policies adopted in containing the pandemic pernicious consequences and its challenges. Hence, this paper aims to join the rapidly growing body of literatures to review how the COVID-19 affected the economy and what were the policy responses implemented to such crisis.

2. Unprecedented Effects of COVID-19 to the Global Economy

The outbreak of the COVID-19 created an unprecedented health shock and economic shock across the globe. It is for fear that the mitigation effort to the spread of the outbreak involving social distancing and lockdown of a country may lead to a deep and prolonged global recession. As stated by Cochrane (2020), shutting down the economy is not like shutting down a light bulb. It is more comparable to the liking of shutting down a nuclear reactor that needs to be done cautiously. The profound consequences that arised with the mitigation efforts done by governments to minimise the negative impacts of the COVID-19 outbreak was therefore widely discussed in the fast-growing literatures.

According to Dev and Sengupta (2020), the precarious measures taken by government in response to the outbreak resulted in millions of jobs and livelihoods were at stake. The closure of national borders brought international trade to an abrupt halt resulting in severe disruptions to the supply mechanisms and distribution chains. The collapse of domestic demand due to the imposition of nationwide lockdown created an adverse effect to the economy. The degree of severity of the effect to the economy may very well be dependable upon the duration of the health crisis, the duration of the lockdown and the situations once the lockdown is relaxed.

The COVID-19 outbreak further disrupted many businesses, causing mass layoffs and closures. In a survey by Bartik *et al.* (2020), many small businesses seemed to be financially fragile. Many of these businesses temporary closed due to the reductions in demand and employee health concerns. The massive layoffs and shutdowns may also be due to the limited levels of cash at hand, making it extremely hard for firms to meet their payroll. The damage to the economy and the small businesses will be much greater if the crisis lasts longer. The implementation of policies that can safely lead to the reopening of the economy is necessary to generate large economic benefits.

With the end of the pandemic COVID-19 remains uncertain, there is loss of public confidence worldwide. The loss of both the consumer and producer confidence causes the macroeconomic impacts in an economy to likely worsen. This resulted in a massive demand shock coupled with supply shock across economies. This was clearly shown by Barua (2020) through a standard macroeconomic AD-AS model. Similarly, Fornaro and Wolf (2020) theoretically illustrated how the outbreak induces a demand-driven recession by negatively influence the agents' expectations of future productivity growth.

Unlike the other previous diseases outbreak, COVID-19 has caused significant unprecedented effect to the stock market. Baker *et al.* (2020a) pointed out that none of the outbreaks had impact on the U.S. stock market as strongly as COVID-19 did and provided arguments that it is very likely that the policy responses to the pandemic itself produced such impact. The interconnectivity of the modern economy with the shifting of the structure of the economy over time could perhaps be the underlying reason of the grave implications of COVID-19 to the economy. Mitigation measures such as social distancing practices lead to drastic decline of the demand for services that require face-to-face interactions. This is consistent with Baldwin (2020) who claimed that the pandemic COVID-19 and the containment policies directly and greatly reduced the output of goods and services. With a more extensive and widespread containment policies, it is not surprising that economic can be gravely inflicted and some expected damage being reflected in the stock market.

On a separate note, Baker *et al*.(2020b) presented an interesting finding that highlight on the changes to the households' consumption behaviour during the period of the COVID-19 outbreak. In an early respond to the outbreak, there was increase in the consumers' spending behaviour in their effort to stockpile durable goods in anticipation of the possibility of the need to stay at their home for the next few weeks. As the outbreak spread, there was a sharp decline to the consumption as people stay at home and most of the businesses are closed. A closer inspection on the transaction-level household financial data clearly indicated that the consumers' spending changes with the spread of the pandemic and the policy mitigation responses. The change of the consumption pattern created the demand shocks to the consumption of goods and services.

Although many literatures appeared to highlight on the economic impacts of the pandemic COVID-19, many of these studies seemingly neglected the issue of the poor who are suffering the most from this pandemic. The poor not just only worry about surviving the pandemic, but they will also have problems in surviving the lockdown as well. In view of this, Buheji *et al.* (2020) employed of the integrative review (IR) sought to provide focus on systematic literature review to obtain knowledge in definition of the study and contextualization of poverty in COVID-19. Buheji *et al.* (2020) targets to analyse the socio-economic impact in determining how pandemic is causing various problems to the impoverished. More people ended up trapped in the lower side of the middle class with the occurrence of the outbreak. With more transmission occurs in domestic workers, there is disparity between social classes caused by the COVID-19 pandemic.

In extent of this, Sumner *et al.* (2020) estimated the potential short-term economic impact of the outbreak on global poverty through the contractions of per capita household income or consumption. Empirical findings from their study pointed out that a relatively small contraction in household per capita income or consumption due to COVID-19 outbreak could lead to an increase in the incidence of income-based poverty. Regions such as Middle East and North Africa, South Asia and Sub-Saharan Africa were the most impacted regions due to their relatively slow progress in poverty reduction in the past and their existing high poverty levels. Thus, implying that in countries with more poverty–stricken citizens could have an amplified repercussion.

The precarious impacts of the outbreak had spread to the labour market as pointed out by Coibion *et al.* (2020) in a recent large-scale survey on the US households using the Nielsen Homescan panel. A great number of jobs was lost over this period with the evidence of about 20 million decline in the number of employed workers in the US itself. Even more alarming, they found that there was less than proportional increase in the unemployment rate. This suggested that many of the unemployed workers are not actively looking for new job. Their analysis further shed light on the early retirement which could be another major reason that explains the decline of the labour-force participation. The onset of the crisis had in fact led to a wave of earlier-than-planned retirements. The high vulnerability of the seniors to the pandemic could potentially lead to the decisions to have an early retirement.

Another prominent effect of the pandemic is the loss of income among the people as claimed by Douglas *et al.* (2020). As not all the sectors' employees are able to work from home, these workers may face precarious employment. The closure of the schools during lockdown caused many parents the need to stay at home to care for their children. As such, leading to the loss of income for these people. Those of lower income with lack of savings were much more severely affected as the loss of income caused them difficulties in paying their mortgage arrears or rent.

The banning of the international travel also affected the tourism industry severely. Gossling *et al.* (2020) presented an analysis on how the COVID-19 crisis badly affected the tourism industry through the restriction of travelling and the practice of social distancing. Meanwhile, Hevia and Neumeyer (2020) outlined the resulted economic impacts from COVID-19 outbreak in three main channels. These channels outlined consist of (1) direct adverse effects on industries and employment, (2) impacts on terms of trade resulting in sharp decline in the prices of exports which lead to the fall of government revenues and GDP, and (3) global financial shock with capital outflows which could cause increase in costs of funding and depreciation of currency.

Empirical analysis to quantify the macroeconomic impact of COVID-19 pandemic by Ludvigson *et al.* (2020) suggested that the effects from the crisis could last from two months to over a year. However, the shock arises from the pandemic as studied through the employment of VAR may vary based on the sectors. Ludvigson *et al.* (2020) further demonstrated that the COVID-19 disrupted labour market activities and harmed social physical well-being of individuals rather than capital. Loayza and Pennings (2020) similarly exposited COVID-19 as a massive and highly contagious global shock. In consistent with Barua (2020), they inferred that the outbreak simultaneously created both negative demand shock and negative supply shock to the economy.

In a simulation of the potential impact of COVID-19 pandemic on economy by Malizewska *et al.* (2020), a standard global computable general equilibrium model was employed. The simulation shed light on the four important transmission channels (1) direct impact of reduction to employment, (2) increase in the costs of international trade, (3) sharp decline to travel, and (4) reduction in demand for services which needed close interactions. Under the first channel, the mitigation response taken such as social distancing will lead to underutilization of resources. Secondly, there would be an increase in transportation and transaction costs in foreign trade due to the additional measures taken to curb the spread of COVID-19. Thirdly, there is a sharp decline to international tourism due to closure of borders. Lastly, there might be demand switch by consumers to purchase less goods and services that required close interaction. This largely affected certain sectors such as restaurants, recreational activities, and other services.

The high level of uncertainty created by the pandemic caused increasing difficulties for policy makers to formulate suitable macroeconomic policy in response to the resulting economic impact. By employing a global intertemporal general equilibrium model with heterogeneous agents known as G-Cubed Multi-Country Model, McKibbin and Fernando (2020) explored seven different scenarios of how the outbreak could evolve in the coming year by quantifying the potential global economic costs. They found that the quantitative magnitudes of the costs varies across countries. However, the pattern of the sharp shock was followed by a gradual recovery across the countries. This create a hopeful sign that the recovery of the global economy could eventually happen.

3. Policies Implemented to Counter the Effects and its Challenges

A wide range of mitigation responses from governments around the world had prompted literatures that studied these policies. Hale *et al.* (2020) introduced a systematic method to track government responses to COVID-19 across countries and time. A series of indices are employed to describe variation in government policies in response to the outbreak. It is fundamental for the policy makers to develop policy that would response to the negative impacts of the outbreak, to minimise the economic shocks and to pave way for a V-shaped economy recovery. In many countries, government injected their spending to minimise the economic fallout. However, the suspension of economic activities during the lockdown would have likely resulted in a huge decline to the government revenue. The decline of the savings rate among the firms and households due to the loss of income during this time of crisis left very little options for the government to increase its domestic borrowing. Hence, the biggest challenge to the direct fiscal injection policy may lie at the financing of the increasing government deficit.

Meanwhile, the monetisation of fiscal deficit will create inflationary pressures, lead to greater uncertainty about future inflation, increase long-term interest rates and adversely affect the economic growth as pointed out by Dev and Sengupta (2020). In another strand of literature, Hevia and Neumeyer (2020) pointed out that governments may face challenges as they will need to finance their fixed costs with lower fiscal revenues due to decline in economy activities and drop in commodity prices. Whilst, the social demands for additional government spending will be soaring high during this crisis. In addition, government may also face difficulty to place debt given the deterioration on global financial markets. This is in consistent with Hausmann (2020) which posited that the "flight to quality" in financial markets posed as difficulty for countries to borrow to cover their fiscal deficit.

It is paramount for the government to provide liquidity to firms so that the workers can be retained in their employment. The financing of such liquidity will also assist SMEs to encourage spending. Government could also allow firms and individuals to defer their income taxes payments to provide liquidity. Under fiscal policy, multinational development banks had a fundamental role to finance fiscally distressed governments. A rapidly targeted monetary transfer to those that suffer from negative income shock is in fact suggested to be more efficient. According to Loayza and Pennings (2020), the economic policy response should be paced first into relief and then to recovery. In the short term, the policy response should direct towards providing emergency relief to the affected firms and individuals. This measure is necessary to avoid mass layoffs and business closures. However, the macroeconomic policy should then focus on recovery measures in the medium term. The recovery measures should involve both monetary and fiscal instruments.

Monetary instruments involve setting of interest rate to influence short-term market rates, pursuing asset purchases to influence long-term market rates, providing liquidity and functioning as lender of last resort. These instruments could stimulate consumption and investment leading to increase of the aggregate demand. The weak institutional environment may pose as challenge to the monetary policy. Meanwhile, fiscal instruments through government expenditures and taxes could provide income support to the consumers and firms. This will help counter the demand shocks caused by COVID-19 to the economy. As postulated by Baldwin and Mauro (2020), fiscal measures could quickly be deployed as targeted help for people affected by the quarantines and income shortfalls. However, the fiscal policy may be less effective in developing countries because of larger informal sectors. Workers in a low-income informal sector will less likely to benefit from any tax deductions. Besides, fiscal instrument could lead to rapid rise in debt in relative to revenues. It is, as such, many developing countries may experience lack of fiscal space or sizable multipliers to be effective.

4. Conclusion

Covid19 pandemic led to countrywide lockdown and travel bans bringing nearly all economic activities to an abrupt halt. This crisis created economic implication with the disruption of the global demand and supply. The unprecedented outbreak caused widespread of economic implications ranges from supply chain disruptions, demand-side shock, rising unemployment rate, stock market decline, sudden halt to capital flows, decline of commodity prices and afflictions to multiple sectors. The growing literatures as reviewed in this paper had demonstrated interesting findings that centred on the economic implications of the pandemic. In the subsequent review of this paper, literatures that discussed governments' policy responses towards the pandemic provided additional insight. Other than exploring the governments' fiscal and monetary policies in response to the outbreak, these literatures had further shed light on the challenges of these policies.

In view of the quantitative magnitudes of the global economic costs varies across countries as highlighted by McKibbin and Fernando (2020), future in-depth studies should be extended and focussed to individual countries. How badly the economic will be affected will likely also depend on the extent and duration of the Covid19 crisis. Besides, the question on how the governments choose to respond to the pandemic will be crucial to determine the extent of the implications. It is equally significant to accentuate that in an integrated global economy, global cooperation becomes increasingly essential to address the latest pandemic crisis. As Baldwin and Mauro (2020) put forward in this manner, “the pandemic could create an ideal moment for policymakers to rebuild some trust and cooperative spirit to come up with a common crisis response that tackle this global crisis”.

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