OSCE PA Webinar

The Economic Security Fallout of the COVID-19 Pandemic

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The Covid-19 pandemic started the worst world economic crisis since the Second World War. For the first time after the Great Depression of the last century (1929) both advanced economies **and** emerging and developing economies are in recession. Particularly hit will be the countries most integrated in the transnational global supply chain. That is to say, countries that depend on intermediate inputs produced around the world and, especially, in emerging, affected countries, or countries that are suppliers of intermediate inputs, commodities, raw materials and oil.

This crisis arises from an almost simultaneous shock of supply and demand, created by a sort of freezing of the economies due to lockdown and social distancing measures, which, possibly will continue even after the worst of health emergency is over. This means that the economic consequences of the Covid-19 will depend how widespread and lasting is the pandemic and, consequently, on the duration of the interruption of the productive and consumption chains motivated by the need to halt the epidemic. This is what IMF called the Great Lockdown.

For this reason, we face tremendous uncertainty on how deep and how long will be the recession and how big is the risk of an economic global depression.

Estimates on the potential direct impact of the lockdown measures taken worldwide on global economic growth reflect a high degree of uncertainty also because they are conditioned by the uncertainty on the insurgence, virulence and duration of the epidemic across the different regions of the world. The national and global economic consequences of Covit-19 will also crucially depend on how fast the economic policies of all the major countries will be able to anticipate the negative expectations of citizens and companies by announcing, and also quickly implementing, expansive fiscal and monetary measures.

If nothing is done quickly, we do not face a simple recession but the risk of a collapse of the economies.

The goal we must all have in mind is to find a way to immediately finance necessary spending on health and the fiscal measures necessary to ensure that people are able to meet their needs. At the same time we have to support disrupted production systems, by compensating the losses of the companies caused by the economic shutdown.

Immediately afterwards, it is necessary to finance a massive recovery plan of economies, that is, investments mainly on health and infrastructures.

To prevent companies' bankruptcies many European countries have adopted the mechanism of the temporary transfer to the government of the largest part of the wage bill of companies forced to halt their production. These measures - together with credit guarantees, liquidity facilities, granting of grants - should avoid that firms go out of business creating unemployment that risk to become permanent or long lasting. These measures are essential because we know from previous crises that firm/industry-specific skills of workers quickly depreciate.

In other words, while the pandemic does not destroy physical capital, it can destroy both human and entrepreneurial capital.

As a result of the measures that all countries are taking and must take in the near future, governments' debt, which is already very high in most countries, risks to grow even more with foreseeable pressure on financial markets. In fact, the use of financial markets by both sovereign debtors and companies will necessarily be massive and protracted over time.

Sovereign debt is the main tool that all countries will necessarily activate in order to feed resources into the economy and stimulate productive recovery, going beyond monetary expansion policies, which have already reached the limits of their effectiveness through the mere reduction of interest rates. The use of debt appears to be necessary, but at the same time its unlimited growth is probably not sustainable.

Under these conditions, the question arises as to whether and to what extent a global explosion of public debt can be avoided.

The answer can be to channel monetary resources created by central banks towards financing specific pandemic mitigation measures and targeted public investment programs. A monetization of the additional investment expenditure would allow governments to contain the growth of their debts in the recovery phase. This direct monetary financing of public expenditure can be achieved in different ways. In fact, all major Central Banks, including the European Central Bank, are already buying massively sovereigns bonds, although ECB purchases of sovereign bonds cannot be considered as monetization of debt or direct financing of government as in the case of other Central Banks.

However, the effectiveness of the health and economic measures aimed to contain the spread of the infection and to mitigate its economic impact requires international coordination and cooperation between countries and between multilateral organizations.

Monetary policy coordination between central banks is needed to stabilize financial markets and to ensure liquidity for economies and governments. The financial support to poorest countries is crucial, both by forgiving debts and by ensuring new financing necessary to face the health and economic emergencies.

Above all, it is important to avoid as much as possible that the asymmetric impact of the health emergency among countries and their different financial strength is exploited, during the lockdown, for a sort of beggar the neighbor policy, in other words, for aggressive restructuring of transnational production and commercial chains.

Global trade is a complex network of exchanges of intermediate inputs regulated by international commercial, financial and insurance contracts, in addition to national and international norms. What we need is that the private and financial sectors must find ways to sterilize, perhaps in innovative ways, the current risks on global value chains deriving from potential temporary interruptions of these numerous interconnections by adopting the necessary adjustment and compensation mechanisms. A private sector response may not necessarily be sufficient on its own, and may entail stability risks around the World, and for the long term.

It is an inadequate reaction for countries to cave in to demands to reduce the global connections between economies, under the psychological pressure of pandemics and in response to political arguments for achieving national self-sufficiency in the provision of essential goods. Indeed, restructuring the supply chains in ways that make production costlier would show limited awareness of the interconnections between national economies in the global market.

All the energies of governments and institutions seem today mostly focused on coping with the current danger and to imagine the immediate aftermath in the next 4-6 months, whilst the globalized world does not appear to be interrogating itself enough on the long-term perspectives at least in a public debate.

It must not be forgotten that one of the positive effects of an interconnected world is the production of global common goods, like the fight against climate change and pollution, the diffusion of knowledge and education, scientific progress, human rights, the conquests of medicine and the global fight against endemic illnesses. More attention and concern must be placed in addressing expectations and fears that could determine drastic changes in populations' sentiment and could condition the strategic investment choices on a global level.