# COVID-19: A Make or Break Moment for Global Policy Making

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## Abstract

The COVID-19 pandemic poses an unprecedented set of challenges to governments, policy makers and citizens; lockdowns and social distancing measures generate significant economic losses, fuel public expenditures and deficits and will no doubt significantly boost public debts. The burden of such measures is also likely to be disproportionately felt by the worse-off members of society and will weigh heavily on future generations. This is both unfair and runs the risk of politically destabilizing the recovery process. To avoid these outcomes unconventional policy measure such as taxes on private wealth and digital economic activities, but also public debt monetization, should be considered. From a political perspective, governments should realize that policy coordination is the only successful exit strategy following a systemic economic shock. While the EU is moving faster than we are accustomed to, it still seems unable to respond quickly enough given the nature of the circumstances. In this picture, the G-20, provided it acts quickly over the coming months, could emerge as the sole global policy forum left on the playing field that can avoid that national interests will prevail eventually producing collectively sub-optimal results in the long-run.

## The general picture: a qualitatively unprecedented shock

On 31 January 2020 the World Health Organization (WHO) declared the emergency status for 6 months due to the spread of the COVID-19 coronavirus; the province of Hubei in China (60 million inhabitants) has been the first to introduce highly restrictive social distancing measures to reduce the spread of the disease. All remaining G-20 countries followed suit over the course of a few weeks. According to WHO reports, the spread of the virus can be limited by imposing social distancing, by limiting persons' mobility and improving health care treatments; especially the supply of intensive care unit (ICU) beds. Taken together, these policy actions have severe consequences for economic activity. Such consequences are similar to the initial stages of a large scale war (Sears, 2020), effectively shutting down large swaths of the economy as a whole such as services to persons, face to face education, tourism, parts of manufacturing and industry more broadly (IMF, 2020).

The extent of the ensuing economic crisis is likely to be strongly correlated to the length of the aforementioned policy measures. The now famous Imperial College (MRC Centre for Global Infectious Disease Analysis, 2020) model estimates that the minimum time period necessary to stop the spreading of COVID-19 is 12–15 weeks (i.e., 3–4 months); after this period the reproduction number of the virus (R0) falls steadily below 1 and social distancing can be gradually relaxed. The lockdowns induced a severe supply and demand shock, compounded by deep uncertainty and the global economy is projected to contract 'sharply by –3 percent in 2020, much worse than during the 2008–09 financial crisis' (IMF, 2020). Incentives to free ride on public goods are also especially strong. While state spending on public health will necessarily go up in the short to medium term, revenues to pay for such spending will go down as a result of large macroeconomic shifts also dictated by changes in consumption habits. By favouring on-line purchases the pandemic will redirect cash toward businesses that pay significantly lower taxes (G-20, 2020b).

The stakes are very high: from the integrity of global supply chains, to the sustainability of sovereign debts, and the creation of monitoring mechanisms to reduce contagion, the temptation to 'go it alone' is increasing. The G-20 could be the sole global policy maker left on the playing field that can ultimately avoid that national interests will prevail eventually producing collectively sub-optimal results. Policy coordination will be critical to avoid the spectrum of a long-term collapse in world trade, permanently more closed borders, and, ultimately, lower freedom and welfare for most people around the globe.

If coordination is key, 'coordination on what?' seems like an important question to ask. The current crisis is very different from a garden variety recession, no matter how strong. Traditional countercyclical monetary and fiscal policies are likely to be of limited use given the sui generis features of our current predicament (more on this below). Speed, targeting, and recourse to unconventional economic measures will instead be crucial. Governments should act fast, direct aid to those who need it the most and/or can put it to its best use, and realize that private and public debts will need to be either restructured, partly inflated away, or paid via some kind of monetization coupled with higher taxes on wealth. A combination of these measures, appropriately calibrated to 'local' country circumstances is likely to be required.

Finally, the crisis has also highlighted an unprecedented set of ethical issues that both provide an independent lens to look at the pandemic, and clearly affect the very nature of its development. In other words, we cannot separate the ethics of the pandemic from its politics and economics.

## Ethical and distributive aspects

To see why these ethical aspects are a constitutive element of the crisis, consider the decision to impose social distancing measures, and especially their most extreme version such as a generalized lockdown. Given data on lethality rates and characteristics of the virus (such as the nature and speed of the spread), policy makers have to decide whether to shut down the country. According to which principles is the decision taken?

If the decision purely relies on economic considerations, then, and setting aside uncertainty about the data, policy makers are accepting a 'cost-benefit analysis' approach. Early discussions in the UK concerning the prospects of a 'herd-immunity' strategy suggest that the latter has been, at the very least, taken into consideration. In this kind of framework what needs to be balanced are the economic costs associated to social distancing and the imputed costs of losses of life and health (including its implications for production broadly defined). This is a standard, albeit seemingly 'heartless', feature of how most public national health systems operate when it comes to decisions pertaining to treatment availability (Orr and Wolff, 2015).

Cost-benefit analysis is by its very nature consequentialist and is often insensitive to both distributive and rights-based considerations. An alternative framework relies on ideas of rights, and their counterpart, duties (Venkatapuram, 2011). Most European countries, so far, have explicitly adopted these lenses to address the health emergency. Prime ministers in France, Italy, Spain and Germany have all publicly declared that 'cost' will not be a consideration in fighting the virus, or in making medical treatment available. Clearly, availability does not singly depend on cost (sufficient supply of medical equipment, personnel, and facilities being the main actual sources of shortages), yet the fact that care decisions are explicitly declared to be orthogonal to economic considerations strongly suggest that the analytical framework adopted by these governments accepts a fiduciary duty to protect their citizens' health.

Neither the rights-based framework nor cost-benefit analysis is, however, particularly useful in capturing one of the major moral issues highlighted by current events, namely, the distributive implications of social distancing. Lockdowns and social distancing measures more generally generate significant economic losses. If and when governments step in to avoid a downward economic spiral, this is likely to make their balance sheets more fragile by accumulating public debt. The key distributive questions are, diachronically, the extent to which we believe we should discount the welfare of future generations, and, synchronically, which socio-economic groups are bearing the largest share of the brunt given the circumstances. If governments accumulate debt, and assuming that such debt will be repaid, then, other things being equal, this is likely to imply a massive intergenerational transfer: future citizens will be asked to foot the bill for present ones. Yet the most macroscopic distributive effects are in the here and now. These can be sorted out into two broad categories, those that derive from: (1) the direct costs of social distancing; and (2) the availability of financial support by governments.

According to a recent study published about the US, 'workers in occupations that are more likely to be affected by social distancing policies are workers we would consider more economically vulnerable' (Mongey, et al., 2020, p. 1). The basic insights are that one's ability to work from home is strongly correlated to one's level of education and skills, and that, conversely, many of the occupations that require close physical proximity to be performed are strongly correlated to lower levels of education and skills. Clearly, there are exceptions. After all, dentists are highly educated and highly skilled but require physical proximity to work. Nonetheless, the general trend seems relatively clear.

To many who have followed the evolution of advanced economies over the past few decades, this should come as no surprise. Recent trends in technological innovation compounded by global economic integration have progressively hollowed out middle income manufacturing jobs and comparative low-skill service jobs favoring (in occupational terms) highly skilled white collar workers and comparatively less skilled personal services workers (Autor, 2015). Given the low elasticity of supply for sophisticated skills and given the skill endowment of displaced workers, this has also led to wage polarization. The aggregate result of these transformations seems to point us in the following direction: a relatively smaller group of highly skilled professionals who can more easily work from home and whether the economic storm thanks to saved income facilitated by higher wages in the recent past, and a comparatively larger group of low-skill workers who have been increasingly employed in personal care services and retailing which are more difficult to offer remotely and who have seen wages stagnate in real terms over the past few decades making it close to impossible to save.

Distributive effects are, however, not confined to the direct implications of social distancing measures. They also have an important role to play when it comes to government interventions. This kind of finding is, to be clear, less easy to generalize given differences in the nature of public policy responses to the crisis adopted by different countries. Yet, they should not be discounted. *Ceteris paribus*, the poorer people are, the less they tend to be connected to the financial system. And thus, to the extent that financial aid flows through the financial system, they will tend to be comparatively less able to access it (Baradan, 2020). To illustrate, in practically all countries government support requires one to have access to the banking system, (i.e. a personal bank account) as payments need to be traceable. Yet, the poorer one is, the more it is likely that they rely on cash and lack access to banking and other formal financial instruments. A similar problem can also be observed in connection to administrative capacity and/or banking dynamics: smaller firms will tend to be comparatively less able to navigate complex administrative procedures in order to access credit while private banks (which are crucial to channel government guaranteed access to credit) will tend to privilege larger commercial clients when they decide to allocate human and economic resources to help businesses.

The key point to bear in mind is the following. Perceptions of fairness are crucial to governments' ability to elicit continued support by their citizens. And, in turn, citizens' trust will be a key ingredient to allow for a more effective fight against the pandemic and its economic implications. Without the widespread support of ordinary people, social distancing measures are unlikely to work. Similarly, without the support of ordinary people the choices that will be required to effect a strong economic recovery are impossible to achieve. We thus believe that governments and policy makers more generally, ignore the distributive aspects of the pandemic at their own risk. The initial responses have, so far, provided mixed evidence with respect to their awareness of this concern. The political economy of state interventions suggests that more powerful actors are likely to control where the money really goes. However, governments should avoid taking a short term perspective on these issues and carefully think about the medium term consequences of their allocation decisions. Not doing so will threaten the stability and effectiveness of the recovery and will ultimately lead to sub-optimal results.

## The politics of COVID-19

The ability to look at the consequences of state actions beyond the remit of the current health emergency will also be crucial in the wider context of global policy making. History teaches us that policy coordination is the only successful exit strategy following a systemic economic shock. While the EU is moving faster, it still seems unable to respond quickly enough given the nature of the circumstances. In this picture, the G-20 could emerge as the sole global policy forum left on the playing field that can avoid that national interests will prevail eventually producing collectively suboptimal results in the long-run. Unfortunately, even when it comes to the G-20 response to the crisis, the initial evidence is mixed.

The EU is a perfect example of what the future might hold. In May 2020, EU countries have not yet agreed on how to tackle with the economic and financial effects of the pandemic. After more than 15 weeks of discussion the recovery fund that aims at 'providing funding through the EU budget to programmes designed to kick-start the economy in line with European priorities and ensuring EU solidarity with the most affected member states' (https://www.consilium.europa.eu/en/press/press-releases/2020/04/09/report-on-the-comprehensive-economic-policy-response-to-the-covid-19-pandemic/) has not yet come to reality. In the meantime, social distancing measures have been used to postpone elections and give full political power to the Prime Minister in Hungary, the Netherlands has made it abundantly clear that transfers to 'fiscally irresponsible' countries are unthinkable, and the German constitutional court has asked the ECB to offer a justification for past instances of QE under the tenure of Mario Draghi. If this kind of trend continues, if member states continue to address the present situation as a mere extension of their internal political disagreements, then, no progress is likely to occur. Yet, progress is indeed possible if policy coordination coupled with a long-term political outlook is understood to be central by key policy actors. To illustrate, the sharp increase in the German public debt after the Second World War or following the re-unification in 1991 has been managed at the European level without punishing the country. And the latter decision stemmed, one might surmise, from the received wisdom that the extent of the concessions, economic or otherwise, made to a country should be proportional to the severity of the circumstances it faces. The same spirit, we believe, should be adopted with respect to the present crisis.

In this context, the G-20 could emerge as an important player in global policy making. The G-20 brings together the world's major advanced and emerging economies, comprising the European Union (EU) and 19 country members. G-20 countries represent 82.5 per cent of global GDP, and 63 per cent of the world's population; their policy makers have met on a regular basis since 2009, when the Great Recession effectively required developed countries (G-7) to raise funding and liquidity to avoid a global credit crunch. At that time, the larger G-20 countries, like Russia, China and Saudi Arabia, the host of the G-20 in 2020, generously intervened to purchase public and corporate bonds, and to buy shares of strategic firms under the technical guidance of the IMF. These flows of funds helped G-7 countries to avoid a hard landing of their economics. That time is over, and global governance is at risk precisely when we need it the most. The severity of the risk is, in addition, made more acute by key institutional differences between the Great Recession and our current predicament. To wit, the institutional aspects of collective and cooperative actions are different in the COVID-19 crisis: neither the IMF nor the WHO can act as international facilitators, given the multidisciplinary and unconventional nature of the required responses.

Furthermore, the G-20 has never faced such an interlinked crisis, and, being a technical body, it does not have the political clout necessary to effectively tackle it in the short run. As a telling example, consider public health. Very few historical moments are more apt to sharpen our understanding of public health as a global public good than a pandemic. The latter remark notwithstanding, on 19 April, health ministers of the G-20 countries did not agree on a common statement after their virtual meeting. Widespread disagreement on the best approach to fight the pandemic and skepticism over data transparency by Chinese authorities are widely considered as key culprits explaining the lack of a shared policy stance. Recent tensions concerning the Chinese handling of the pandemic effectively mirror the 18 month-long US–China (so-called) 'trade war'; a set of events and policy decisions that, unsurprisingly, have not contributed to improve coordination in the global economic system. Needless to say, lack of agreement and coordination has generated further uncertainty, and the latter has clearly translated into lack of confidence at the global level.

A strong coordinated response is however necessary to restore confidence (of consumers and businesses), to avoid a hard landing of G-20 economies, and to sustain other fragile economies. During March and April 2020, leaders, labour ministers, finance ministers and central bank governors agreed on undertaking a number of relevant actions (G-20, 2020a). Policies include:

- A time-bound suspension of debt service payments for the poorest countries. An agreement has been undersigned, giving hope to low income over-indebted countries that have been hit by the pandemic, but are unable to cope. All bilateral official creditors will participate in this initiative.
- Access to research and treatments. The G-20 has committed to sharing timely and transparent information and materials for research and development and to support the full implementation of the WHO International Health Regulations 2005. Global health security is a shared responsibility; it requires a collaborative collective response based on transparency and trust (LiBassi and Hwenda, 2020).
- Global financial institutions (IMF, 2020; World Bank, 2020) will contribute to funding the economics of G-20 countries with exceptional resources; they will also facilitate trade, cooperation and debt rescheduling, will target small and medium size projects, also to compensate for the lack of remittances to poor countries.
- The European Central Bank (Eurogroup, 2020) and the other G-20 central banks will intervene in the economy with unconventional 'money from the helicopter' policies.

While these initiatives are clearly useful, they are still far less than what would be required to make a real difference. Furthermore, these global commitments are in tension with several domestic policy decisions by individual G-20 countries. To illustrate:

- Health care: the SOLIDARITY trial [ISRCTN83971151] of the WHO should make available to all countries the results of research (testing, vaccine), but political lobbying prevails in some countries, where the motto is 'cure your young citizen-voters first'. For example, the US administration decided to offer a substantial prize to global chemical firms to purchase the first million doses of the vaccine for its internal use; the administration is in fact trying to run a health organization with the same objectives of the WHO, and coherently with this aggressive policy, Donald Trump announced that the US will not continue funding the WHO because of the latter's 'unacceptable mistakes' in the management of the epidemic. An even more egregious accident took place on 21 March when officials of the Czech Republic effectively stole sanitary equipment purchased by the Italian government at the border; the populist government of the country never issued a formal apology to the Italian government.
- Digital services tax: the pandemic further underlined the pervasive role that digital services and firms have on our lives, but they do not contribute to finance the public expenditures; G-20-OECD countries have not yet agreed on a common framework to tax digital businesses and services, bringing the playing field at the same level in the global market; the pandemic can contribute to come out with a vote on the OECD proposal.
- Public debt: public debt is likely to boom after 2020 because of exceptional health care and social security spending in most countries; European Treaties have been relaxed by applying the general escape clause; yet a few smaller countries with populist majorities (e.g., Hungary) or so-called fiscally austere ones (e.g. the Netherlands), fearing the risk of a new sovereign debt crisis, and thus not agreeing with solidarity oriented policies, have tried to take advantage of consensus-based voting structures – they have done so by effectively exercising disproportionate power during Eurogroup meetings, and thus slowing down the approval of the recovery fund.

Allow us to conclude this section by more clearly emphasizing what is at stake. All recessions, whatever their causes, bring about human suffering and misery. Some of them are, however, special. They are because of the nature of the shocks that have caused them, and because of the potential consequences that these shocks could have for the wider political landscape that those affected will face in the future. Thus, while human welfare is, to some extent, always at stake in any economic crisis, more will be endangered by the present one if it is not addressed in the right way. The very foundations of the current global economic order, and many of the governance structures that we are familiar with, might flounder. Clearly, these political structures are far from perfect. The wider issue of how to reconcile global economic integration, technical change, and the interests of the lower middle classes in Western countries has also been neglected for too long. Yet, no progress on these fronts is likely to take place if the current system falls prey to an unplanned form of collapse. And this is, we believe, precisely what we are likely to get if we fail to respond appropriately. There is no need to be champions of further global economic integration to see that disorderly deviations from established trends are not going to deliver the results desired by those who, often correctly, have criticized those dynamics.

## Policy implications: unconventional – the time is now!

While coordination is key, it cannot, by itself, deliver an effective management of the current crisis unless specific policy actions are undertaken. In other words, coordination is a necessary but not sufficient element of a sustainable recovery. Governments worldwide are likely to face stark choices in the coming months. When a crisis occurs, we are used to reaching for the Keynesian toolkit: in the short run, monetary policy interventions (i.e. increasing the money supply), and fiscal stimulus (i.e. government purchases and tax cuts) are deployed to boost aggregate demand and thus avoid collapses in output. Following Robert Skidelsky, it is fair to say that 'we're all Keynesians in the foxhole'. Yet, the Keynesian cross and the theory of liquidity preference are unlikely to be of much help right now. Or at the very least, they will have to be used in unconventional ways. This is for two reasons. The first is intimately related to the very nature of a pandemic. The second is connected to general economic conditions entering the crisis.

Let us tackle them in order. As many commentators have observed, a pandemic is not a typical fluctuation of the business cycle. (Krugman, 2020) aptly described the situation by labelling it 'coma economics': the choice has been, overwhelmingly, to put economies on life support – to allow individuals, and businesses, to survive doing as little as possible. The real problem is that traditional stimulus packages are unlikely to be useful when what we really want is for people not to work. So long as the viral reproduction rate is greater than 1, and so long as we lack a credible cure or vaccine, social distancing measures are likely to stay in place in one form or another. Yet, such measures either require less work or require costly adjustments to unconventional production structures (from increased safety measures to smart working). Traditional stimulus measures, while necessary, are unlikely, in the short run, to help output grow back to its natural levels. At best, they might allow it to collapse less quickly.

The second reason to be wary of conventional measures depends on an overall assessment of economic and political conditions entering the crisis. The main features we wish to highlight are high leverage, both in the private and public sectors, and low interest rates prevailing globally. These characteristics of the current environment allow less space for traditional countercyclical economic measures in the medium run (or, more accurately, in the longer version of the short run). Put differently, as social distancing measures are progressively relaxed, governments and central banks will be tempted to intervene much more strongly than they have done in the very short run. This is for the simple reason that they will correctly anticipate spending and liquidity to do more good, ceteribus paribus, when social distancing is less strict. The question, then, is whether they can afford it.

Clearly enough, what one should ideally do, and what one can afford to do are distinct. Many commentators have, for example, highlighted that the cost of public inaction would be catastrophic. That much, we believe, is undeniable. The issue, in our view, is whether all governments can afford to become even more indebted than they currently are, whether the majority of medium and large enterprises can take on more debt, and whether central banks working near the zero lower bound can sufficiently increase liquidity using some of what we might call 'conventional unconventional' tools (i.e. QE programmes).

Concentrating on governments, it seems obvious that not all countries will face the same set of circumstances. The US is likely to face extremely low borrowing costs given its position and prevailing market conditions. In addition, it entered the crisis with high but far from unsustainable public debt to GDP ratios and deficits. The weight of its future debt repayments, overwhelmingly determined by the interest rates at which it will borrow during the crisis, is likely to be sustainable.

Not all countries, however, are like the US. Developing countries, for example, will face structurally different conditions: they will be able to borrow less or at higher cost on capital markets, and the spectre of capital flight will no doubt populate the dreams of many a central banker in the developing world. *Mutatis mutandis*, the same applies to several European countries, especially in the Mediterranean. European countries that have been hit harder by the pandemic (e.g., Italy, Spain) also have relatively high public debts. Yet, the costs of further public debt accumulation seem to exceed its long-term benefits. Italy is the poster child for this kind of predicament. Entering the crisis with 140 per cent debt to GDP, with a projected loss of national income over 9 per cent and a soaring budget deficit (over 10 per cent of GDP), it is unlikely to be able to repay future debts. The reason being that, even before the crisis, the cost of refinancing its public debt was already extremely high at roughly $90 billion, or 10 per cent of public expenditure. This has, among other things, determined a halt to public investment over the past 15 years (and more so after the Great Recession). Adding more structural pain to its annual debt servicing would not be in the long-term interest of the country and would likely prove politically and financially unsustainable.

Remember that there is no global restructuring process for public debts (Oldani, 2018), what then? First and foremost, we need to accept our current predicament. Talk of a 'V-shaped' recession is unhelpful: it tends to invite more caution than is warranted. The proportion of economic downturn engendered by the pandemic is likely to be similar to the Great Depression; the more we realize that this is the case the sooner we can act accordingly. And, to be fully clear, there is much that can be done. In the very short run, the main concern should be to allow the 'patient' not to die while on life support. Unconventional solutions are needed, including the use of special drawing rights (SDRs) issued by the IMF without unnecessary austerity and political conditionality (O'Neill and Lombardi, 2020). Put differently, governments need to try and rebalance their help for citizens and the private sector away from loans and debt-guarantees toward transfers. In addition, targeting and speed will prove essential. More attention needs to be given to small businesses, which are structurally less able to negotiate support via the banking system and which are less likely to be able to withstand sharp economic losses given their low margins. Special attention should also be given to the lower parts of the income distribution. Most recessions hit the poor harder. The current one is no exception. A targeted income guarantee programme is likely to be required. Both measures, and especially the second one, are likely to be welfare improving from a social point of view. This is due to their relative cost (lower, given that, by definition, the poorer make less money) and their relative welfare return (higher, given that we have good evidence that the poor have a higher propensity to consume).

This is the very short run. What happens next? If governments rebalance their interventions away from debt-creation, then, what is likely to happen is that they become more indebted in turn, which, as we have argued above, is unlikely to be a sustainable recipe for all public purses. The next step is then to realize that we cannot deal with the looming debt crisis in the same way we have been used to up until the recent past. While some additional public debt is inevitable, two main forms of policy agendas need to be resurrected. The first pertains to private wealth mobilization. For those who can afford it, the state should ask for more than they are currently doing. This could take the form of a wealth tax, and, where such taxes prove unfeasible (including for political reasons), it could take the form of a so-called digital services tax; base erosion and profit shifting are in fact no longer sustainable given the size of digital businesses in the G-20.

The second form of policy tool that we should resurrect is monetization. The 'm word' has been the closest thing to a taboo for central bankers and economists over the past few decades. Things are starting to change, and even some mainstream macroeconomists are openly discussing the possibility (Galì, 2020). Printing money cannot be a long-term solution: if it were, billions of people in human history would have got it wrong when they worked, saved, and invested in capital formation and technological change. Yet, even accepting that monetization cannot be the new normal, the alternatives are clearly worse. One way to see this is to ask what risks we would incur by monetizing some of our present and future debts. Inflation comes to mind. However, most observers agree that the risks of sustained inflation as a result of monetization are presently low: what we are likely to face in the near future is deflation, rather than hyperinflation. To be effective and thus avoid long-term damages to the economy, monetization would have to be limited (e.g. 2 to 3 quarters), and its size and form largely controlled by central banks themselves in order to keep their formal independence intact (Baldwin, 2020).

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