Opinion Coronavirus economic impact

Pursue self-interest by helping other economies too

Industrialised Europe and east Asia have contained the virus but elsewhere prospects are bleaker

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Industrialised Europe and east Asia seem to have contained the first wave of the virus. News elsewhere is bleaker. Brazil is an unfortunate standout, vying with the US for the largest number of identified new cases. Cases in south Asia, Latin America and, increasingly, Africa, are climbing. Death rates in these less-industrialised countries are still relatively low. But the economic damage they will suffer is higher.

Given actual or perceived fiscal constraints, few of these countries supported poor households or small and medium-sized businesses significantly during lockdown. Many also opened up before they contained the virus, in order to prevent further economic damage. But their recoveries are weak. Fear and uncertainty have kept domestic consumers at home. Disrupted trade, foreign investment and tourism have curbed overseas demand.
The longer this persists — and rising infections suggest that worse is still to come — the more that even viable, large domestic corporations will have to borrow to stay afloat. If lenders do not write down corporate loans, many of these over-indebted firms will then be unable to finance their recoveries when demand improves. Yet lenders may also lack the capital to absorb accumulating loan losses. As a result, corporate over-indebtedness will restrain growth long after the virus subsides. Massive unemployment will in turn drag many households back into poverty, increasing the risks of social and political conflict. Unlike industrial countries that may lose a year or two of growth, these countries risk losing a decade or more.

What can these struggling economies do? The faster they control the virus, the less damage there will be to fix. Beyond this, their governments must expand the resources they can devote to economic repair and recovery.

The poorest countries should negotiate lower sovereign payments to external creditors, including private ones. The rest should expand sovereign borrowing capacity by committing to return to fiscal viability over the medium term, for instance via legislated debt reduction targets. They should shelve unnecessary spending and, where feasible, sell state-owned assets.

The resources thus raised should be used where needed most. Instead of bailouts, governments should encourage debt renegotiation outside of bankruptcy by strengthening mediation structures, and reforming bankruptcy systems that take too long or are biased toward liquidation.

Corporate and bank capital will be depleted as losses are realised. So limits on domestic investors, such as pension funds, investing in such capital should be relaxed within broad prudential norms. Foreign investment in risk capital should also be welcomed. If viable firms still need capital, especially in the crucial financial sector, governments should provide it on fair terms. This is a high value use of funds.

Another is support for the poorest households, especially if the pandemic drags on. Targeted transfers, sufficient to support life, are morally right, supportive of demand, and may keep anger from exploding into social conflict. Brazil’s recent programme offers a model.
Repair will do little, though, without a rapid recovery of demand. With fiscal resources limited, governments will be unable to stimulate much. So recovery will depend on external demand, be that from exports, investment or tourism. By the time these countries tame the virus and reopen, the more developed and industrial countries—assuming no second wave of infections—will be on their way to economic recovery, which the rest can then piggyback on.

Yes, the poorest countries will benefit from debt relief, while others will need multilateral loans. But most of all they will need uninterrupted trade and investment flows to help them build on domestic policies.

Is this wishful thinking? US trade policy looks ever less predictable as its presidential election nears. Europe plans a carbon border levy to protect industries from being undercut by overseas polluters, which could become a protectionist nightmare. Uncertainty over trade policy makes multinational firms reluctant to invest abroad. Developed countries may also constrain outward flows of capital, as financial repression becomes more attractive as a way of financing growing public debt.

Yet, out of self-interest, the world’s more industrialised countries need to avoid beggaring the rest. What happens elsewhere will not stay there. A decade of lost growth in the industrialising world would affect more developed countries severely. Mass long-term unemployment will also prompt mass emigration. Perceptive leaders should persuade less-farsighted colleagues that closing borders to trade and investment will only subject them to endless flotillas and caravans of the desperate. Sharing growth is in everyone’s interest.