Fighting COVID-19 – Key Trade-offs and Policy Implications

NPC Capacity Building Training

October 22nd, 2020
COVID-19: Government Response Stringency Index, Oct 17, 2020

This is a composite measure based on nine response indicators including school closures, workplace closures, and travel bans, rescaled to a value from 0 to 100 (100 = strictest). If policies vary at the subnational level, the index is shown as the response level of the strictest sub-region.

Source: https://ourworldindata.org/coronavirus


Note: This index simply records the number and strictness of government policies, and should not be interpreted as ‘scoring’ the appropriateness or effectiveness of a country’s response.

OurWorldInData.org/coronavirus • CC BY
Figure 1: Flattening the Pandemic Curve

Source: https://voxeu.org/article/flattening-pandemic-and-recession-curves
Fighting COVID-19 with Lockdowns

• Motives
  • Flatten the curve → ‘Herd immunity’
  • Wait for a vaccine
    • Test, trace and quarantine
    • ‘Hammer and dance’
  • Not a short-term phenomenon
Economic Costs

- Selective closures restrict parts of GDP
  - Harvard (especially Executive Education)
  - Theaters
  - Airlines
  - Bars, restaurants, gyms
- Lockdown impacts all activities
- Decisions percolate through the economy amplifying the initial effect
  - Lay-offs, bankruptcies, non-performing loans, supply-chain disruptions
  - Precautionary savings, delayed investment decisions cause a negative demand shock
Economic Costs

Source: Richard Baldwin
Economic Costs

Projection 2020 Real GDP Growth

Trade-off Between ‘Lives and Livelihoods’

- Fighting COVID-19 requires reducing social interactions, that is very costly for GDP
- Cost in terms of 'livelihoods' justified by threat to 'lives' from pandemic
- Even more so if accompanying economic policy

Source: https://voxeu.org/article/flattening-pandemic-and-recession-curves
Trade-off Between ‘Lives and Livelihoods’

Fiscal Deficit 2020 (% GDP)

Ministry of Finance Namibia
But…

• Economic shocks need to be absorbed at the individual and at the country level
• What if parts of society close to subsistence?
  • Stricter lockdowns may imply deprivation of vulnerable parts of society
  • Trade-off between 'lives and lives'
  • Global hunger may almost double in 2020 (WFP)
• Limited Fiscal Space?
• “Horrible Trade-Offs in a Pandemic: Lockdowns, Transfers, Fiscal Space, and Compliance” (w. Ricardo Hausmann)
Theoretical Model

- Households differ in their incomes
- Subsistence level of consumption
- Economy hit by a pandemic
  - Threat to lives
  - Recession
- Government can fight pandemic via lockdown
  - Deepens recession
  - Households comply up to subsistence
- Government can cushion blow via transfers
  - Financed via international borrowing, subject to constraint
Main Mechanisms

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- Compliance effect
- Subsistence effect

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- Pandemic deaths
- Economic deaths
- Cost of debt

- Subsistence effect
+ Subsistence effect
- Cost of debt
Key Insights

- Optimal lockdowns less strict in poorer countries where larger fraction of population in poverty
- Lockdown and transfer payments are complements
- Limited fiscal space is very costly in a pandemic
  - Particularly true for developing countries
Key Insights
Key Insights