

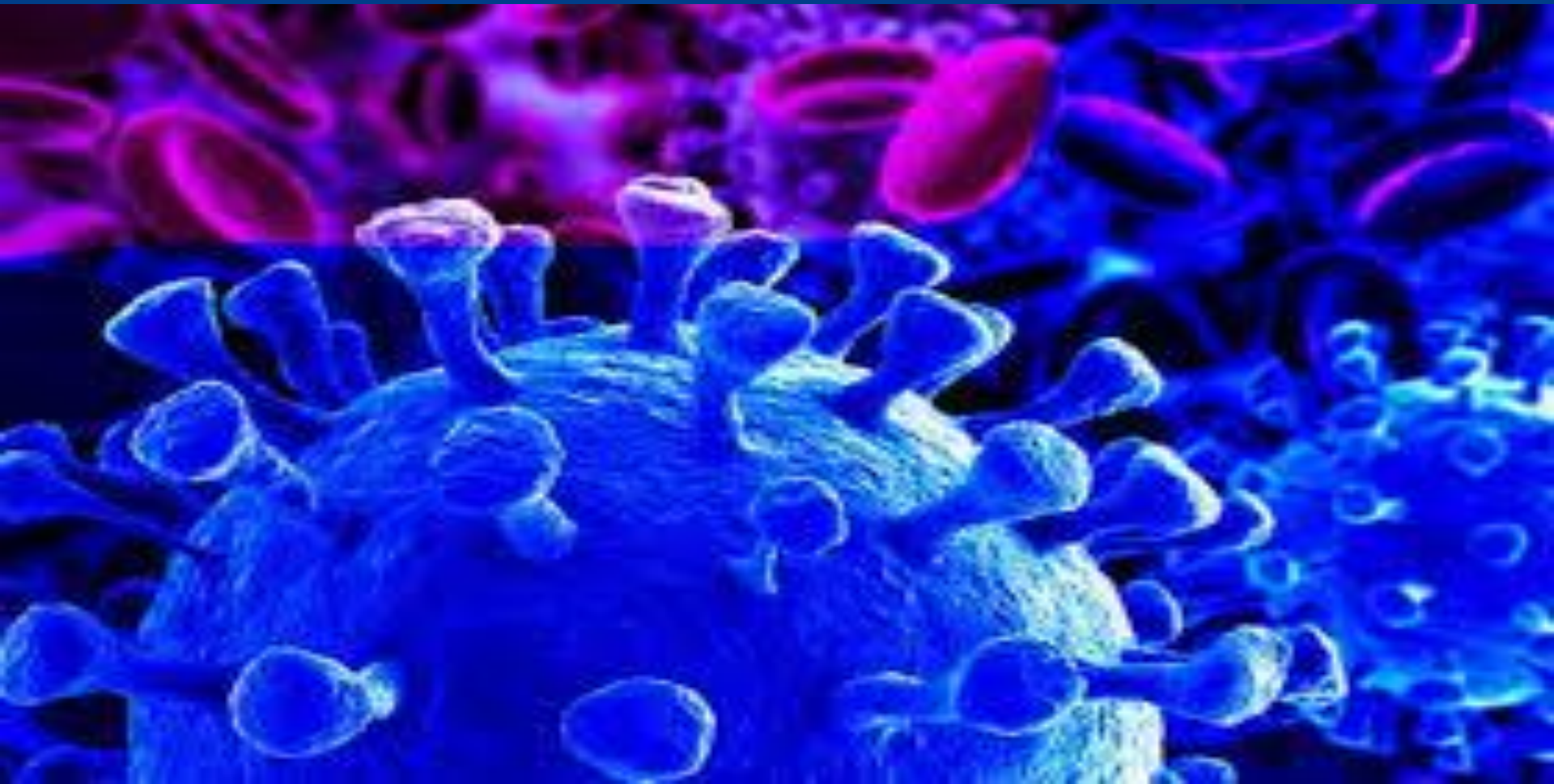
LONG TERM CONSEQUENCES OF COVID-19

May 2020



European Bank
for Reconstruction and Development

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GLOBALIZATION

Not the first shock to GVCs but this time is different

- Uncertainty about **trade policy**
 - US-China trade war
 - Weakened WTO
- COVID exposes **excessive concentration of suppliers**
- Both types of shocks likely to **come back**



Rethinking of global value chains

- More focus on **resilience**
- Building in **redundancy**
- Move **away from zero-inventory** approach
- Greater weight given to resilience by **credit rating agencies**
- Some **reshoring** thanks to automation
- Opportunities for **lesser known investment destinations**



Will globalization be rolled back?

- Contrary to popular fears, it **did not happen during the financial crisis**

Limited scope for tariff hikes under the WTO and Preferential Trade Agreements rules

Country	MFN Tariff	Bound Tariff	Tariff Water	Smoke in the Water	Meaningful Water
All Countries	0.05	0.15	0.11	0.04	0.07
High Income	0.04	0.11	0.07	0.02	0.05
Middle Income	0.08	0.24	0.16	0.06	0.10
Low Income	0.09	0.45	0.36	0.11	0.25

Source: Foletti et al. (2009)

MFN tariff = tariff actually applied

Bound tariff = maximum tariff allowed under the WTO commitments

Tariff water = bound tariff – MFN tariff

Smoke in the water = meaningless policy space (applied tariff is already prohibitive or most trade occurs under preferential trade agreements subject to different rules)

Meaningful water = economically meaningful policy space

Will globalization be rolled back?

- **Weakened WTO**
- **Export restrictions** on medical supplies even within the EU
- Export restrictions on **agricultural products**
- **Security concerns** could be used to **justify protectionism**
- Possible under WTO rules
 - US paved way to using **National Security Exceptions** (Article XXI)
 - **Counterveiling** (anti-subsidy) **duties**

Resurgence of protectionism possible, even if trade is needed to stimulate the recovery

Inability to insure trade contributed to the Great Trade collapse of 2008/9

Quintile of TII index	1st	2nd	3rd	4th	5th	Total
Trade value 2007 (\$B)	1361.3	1314.2	1226.9	1070.4	1833.8	6806.6
Trade value 2009 (\$B)	1247.2	1019.5	1018.0	872.1	1473.3	5630.2
Trade collapse (\$B)	114.1	294.7	208.9	198.3	360.5	1176.5
Trade collapse (% of 2007 trade)	8.4	22.4	17.0	18.5	19.7	17.3

Counterfactual: Trade collapse due to insurance channel

Based on estimated coef. in col. (4)

Billion US\$	-	7.9	12.9	18.2	79.2	118.1
% of trade collapse	-	2.7	6.2	9.2	22.0	10.0

Crozet, Demir and Javorcik (2020)

PROBLEM: too conservative treatment of trade finance in prudential regulations

CLIMATE CHANGE

Climate Change Mitigation

Threats

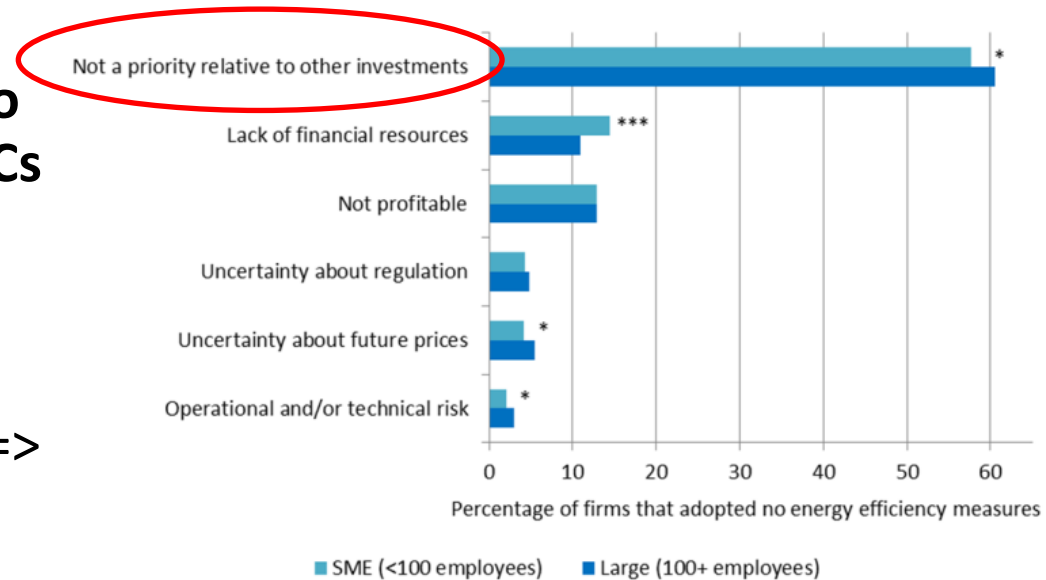
- **Risk that the COVID-19 crisis will eclipse the climate action,** which is desperately and urgently needed
- The COVID crisis risks to cause a **dangerous 'pause' in the drive to green**
- **Low oil prices** lower incentives for energy-saving measures and investment in renewables
- Industry pressure to **lower standards**

Climate Change Mitigation

Opportunities

- Remote work & less business travel => less emissions
- Signal strong **commitment to green** => impact on **new GVCs**
- Climate change likely to lead to extreme weather events and new disease outbreaks => **now is the time to build public support for action**
- **Tilting to Green**

Reasons for not adopting energy efficiency measures vary



Source: *Transition Report 2019*

Tilting to Green

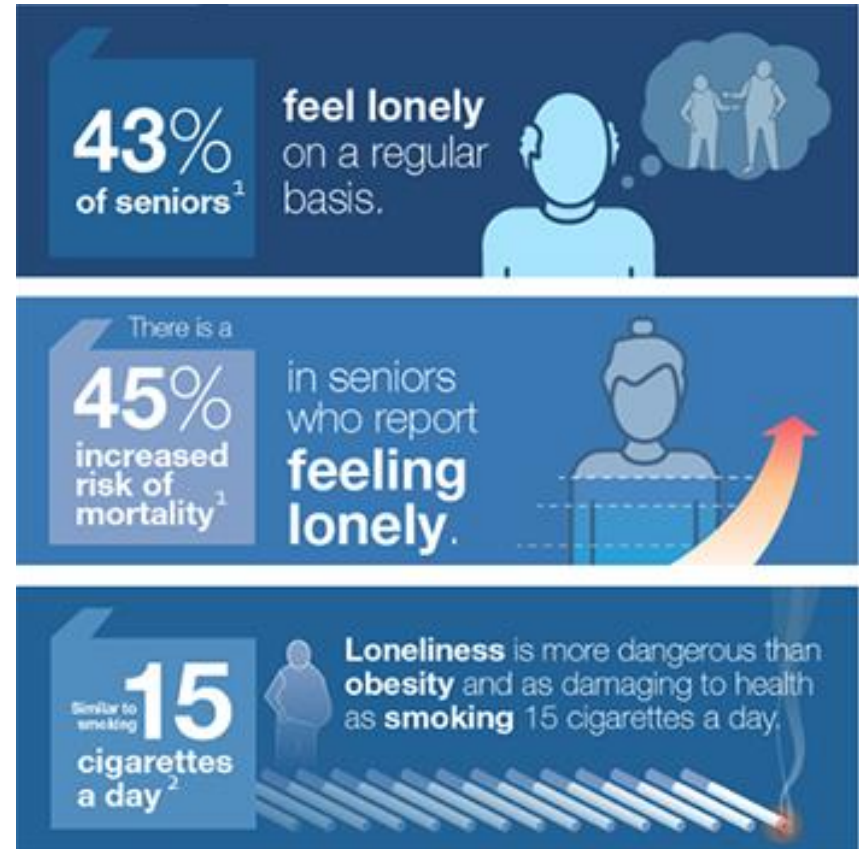
- An immense amount of money is being spent to counteract the COVID-19 crisis.
- This creates **an opportunity to ‘tilt to green’** the government’s funds currently dedicated to COVID-19 and **turn this stimulus into the key accelerator to a low-carbon economy**



REMOTE WORK

Remote working is here to stay

- Less demand for office space => impact on **real estate market**
- In some occupations, more **monitoring** via **software**
- **Epidemics of loneliness?**
- **More involvement in local community?**



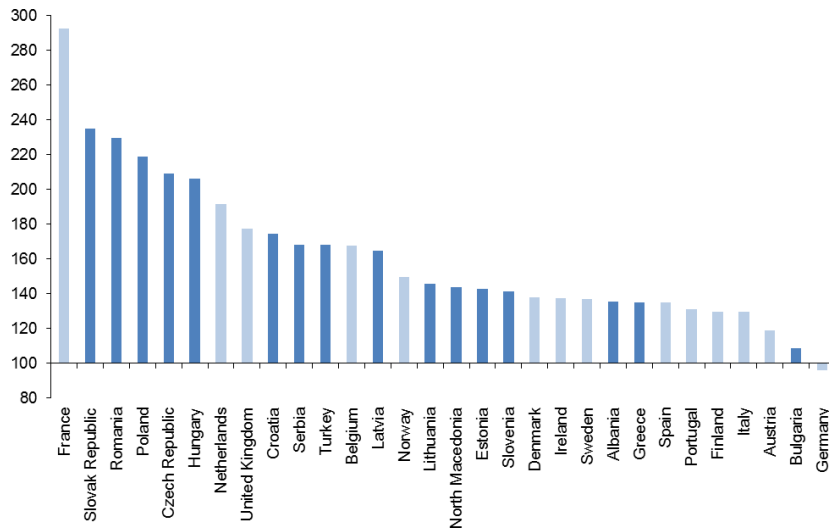
Remote working is here to stay

- Less frequent visits to the office => longer commute is feasible => **decoupling of where we live and where we work**
- **Home office** => demand for more space at home => greater attractiveness of cheaper locations
- **Less incentive for firms to locate in the capital city**
- **Boost to medium-sized and smaller cities**

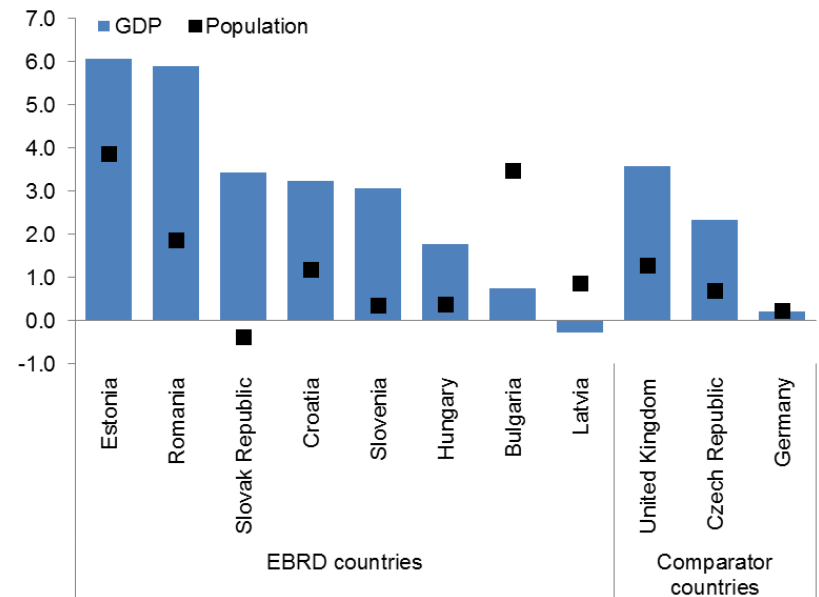


Boost to secondary cities

GDP per capita in the largest city's metropolitan region, 2017
(National average=100)



Change in GDP share and population share of the largest city's metropolitan area, 2000-2017
(Percentage points)

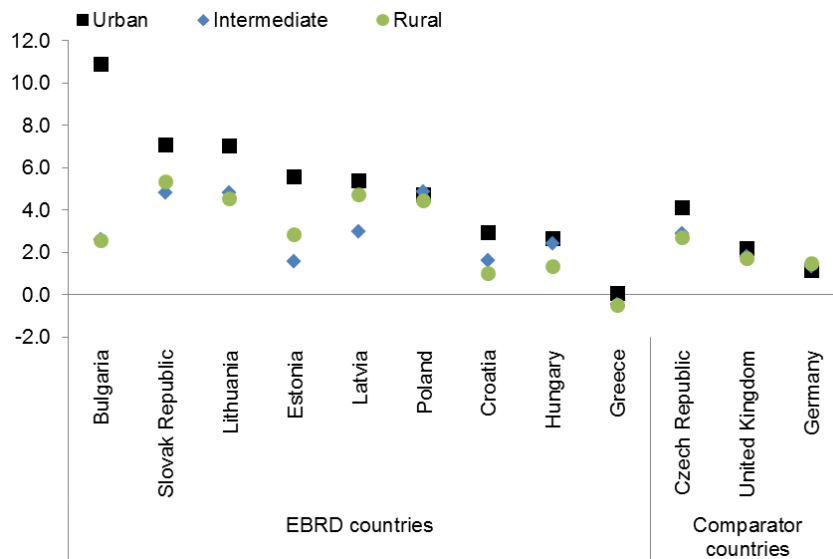


- Sources: Liveable Cities Report (2019). Eurostat and authors' calculations.
- Notes: 2016 data for Ireland, France, Croatia, Italy, Latvia, Lithuania, the Netherlands, Norway, North Macedonia and Albania.

Sources: Liveable Cities Report (2019). Eurostat and authors' calculations.

Boost to secondary cities

Average annual GDP growth, 2000-2016
(Per cent)



Sources: Liveable Cities Report (2019). OECD Regions at a Glance 2016 and authors' calculations.

Notes: 2000-2015 data for Croatia, Greece, Latvia, Lithuania, Poland and Germany.

With implications for

- **Density of ideas => innovation**
- **Spatial inequality**
- **Politics** (spatial inequality less of a source of discontent?)
- **Low carbon transition**

Global gig economy

Opportunity for ECA countries



THE STATE STRIKES BACK

The State strikes back

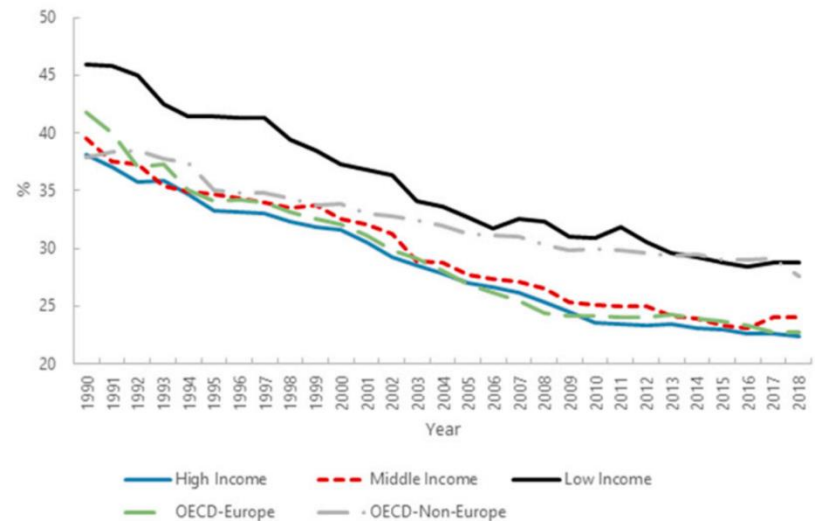
- The COVID crisis exposed weaknesses of gig economy & zero hour contracts => **rethinking of the labour market rules**
- More expected of the state => **rethinking of the social contract** => **acceptance of higher taxes** as long as taxation perceived as fair
- **Increased indebtedness & higher expenditure**



Where to find tax revenue?

- Steadily **declining corporate tax rates**
- High profile **tax avoidance** cases
 - Apple's tax rate of 0.005% in Ireland in 2014
- **Tightening rules on multinationals** popular with voters
 - France & Denmark made firms with HQs or subsidiaries in tax heavens ineligible for state aid

Trends in statutory CIT rates



Will COVID-19 cure tax ailments?

- G20/OECD initiative on **Tax Base Erosion & Profit Shifting**
- Nov 2019 OECD's proposal to allow countries to **tax** operations in their jurisdiction **even if** companies have **no physical presence** there
- A **global minimum corporate tax rate?**



Populism & Democracy

- Mixing of anti-crisis response **with politics**
- **Open power grab** justified by the outbreak
- **Erosion of privacy** protections
- Stimulus creates **opportunities for corruption**



Populism & Democracy

- Will the outbreak **expose incompetence of some populist leaders?**
- Will **trust in experts** be restored? More delegation to technocrats?
- Or will **propaganda** manage to counteract that?



Planning for post-Covid world

URGENT ISSUES

- How will **international travel** be regulated? Impact on migration, remittances, tourism, exports of goods & services
- Global health **monitoring** and **early warning system**
- **Commitment to free trade**
- Treatment of **trade finance** in prudential regulations



Planning for post-Covid world

LONG-TERM ISSUES

- Dealing with **tax base erosion** and **profit shifting**
- Agreement on **not offering tax holidays** to MNCs
- **Debt accumulation** in developing countries
- How to make the **case for foreign aid** in the post-COVID world?

Need a “Bretton Woods” conference to think about the post-Covid international cooperation and economic order

