Knowledge, evidence and learning for development

Mitigating the economic impacts of epidemics and financial crises: A focus on middle-income countries

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Introduction

As governments around the world seek to respond rapidly and effectively to the impacts of COVID-19, responses to prior global epidemics and financial crises can reveal relevant lessons. Investing in health capacity and pandemic preparedness is one of the most productive investments for health and inclusive economic growth. It is also generally recommended that international trade should be preserved during epidemics. During the global financial crisis, central banks mitigated the impacts of the crisis with expansionary monetary policies. In the case of the COVID-19 crisis, monetary policy has been less effective as the main shock is coming from the real economy, rather than the financial sector. Fiscal policy and social protection measures will play a greater role.

Forms of mitigation and sources of resilience

Health capacity and preparedness	Global and regional action	Monetary policy and financial sector support	Fiscal policy and social protection
Planning, disease and risk monitoring, and primary care	Preserving international trade and investment	Expansionary - interest rate cuts, support to liquidity	Support to SMEs, larger firms and the self-employed
Transparent and timely public communications	Maintaining food export markets	Support to financial institutions to keep viable firms afloat	Support to specific sectors – e.g. service industries
Collaboration with the private sector	Support for LMICs to implement fiscal stimulus packages	Support to credit facilities to restart work and production	Unemployment insurance and public works
			Cash transfers and In-kind transfers

Source: author’s own

Health capacity and preparedness (1)

Investing in health capacity and pandemic preparedness can mitigate disastrous health and economic impacts.

The health sector has a high growth rate and large employment effect (WHO, 2016).

Four key lessons from the SARS epidemic implemented by East Asian countries have helped to mitigate the effects of COVID-19:

1. Invest in preparedness systems (e.g. contact tracing)
2. Centralise decision making in well-resourced institutions
3. Strengthen investment in public health and research
4. Be transparent and timely in public communications

(Revenga & Galindo, 2020).

Health capacity and preparedness (2)

Persistent underinvestment in planning, disease and risk monitoring, and primary care must be reversed.

Underinvestment may be due to (IWG on Financing Preparedness, 2017):

- Few macroeconomic assessments of pandemic risk
- Failure to systemically link assessments to country policy and budgeting processes
- Limited engagement with the private sector, which needs to be sensitised to risk and preparedness measures and to implement them (Ebola, Zika).

Global and regional action (1)

International trade should be preserved during epidemics and financial crises.

- Trade policies should address the short- and long-term (SARS) (Stephens, 2017).
- Global food security must be protected with coordinated action to keep food export markets open (Hendrix, 2020).
- FDI should be promoted during outbreaks to minimise disruptions and post-outbreak to support recovery (Ebola, China post-COVID outbreak) (Huang et al., 2020).

Global and regional action (2)

The international community must mobilise resources and support for low- and middle-income countries (LMICs) to engage in immediate responses to COVID-19 and longer-term recovery.

- Lessons from the Asian financial crisis resulted in a shift from structural adjustment policies to fiscal stimulus packages.
- Evaluations of interventions during the global financial crisis find that the impact in most countries was not as severe as expected, partly because of international efforts (IBRD, 2017).
- In the absence of support to LMICs, there will be a massive reversal in development gains stemming from COVID-19 (Gelpern et al., 2020; Patel et al., 2020).

Monetary policy and support to the financial sector (1)

Central banks effectively mitigated the impacts of the global financial crisis through expansionary monetary policies.

- Cutting interest rates
- Maintaining the country's liquidity
- Targeting assistance to financial institutions

The central banks of many middle-income countries (Argentina, Brazil, India, Indonesia and South Africa etc.) provided significant support to local banks. This helped to mitigate the global decline in output and trade flows, and stimulated confidence in the outlook of individual countries (Chauffour & Malouche, 2011).

Monetary policy and support to the financial sector (2)

A key threat to the economy is if *viable* businesses become illiquid, producing a chain of bankruptcies, job losses and drops in spending – resulting in a negative feedback loop.

- Such impacts during prior pandemics transformed temporary disruptions into permanent effects.
- Propping up *non-viable* businesses through credit market policies can undermine longer-term recovery (East Asian crisis, 1980s debt crisis in Mexico and Chile) (Paci et al., 2010).
- Longer-term economic recovery can be promoted post-disease outbreak (e.g. China now) by helping affected populations and industries to restart activities through greater access to credit and lower interest rates (Huang et al., 2020; Guinea, 2014).

Fiscal policy and social protection (1)

Mitigating the negative impacts from COVID-19 disruptions requires extensive fiscal stimulus as the main shock is coming from the real economy.

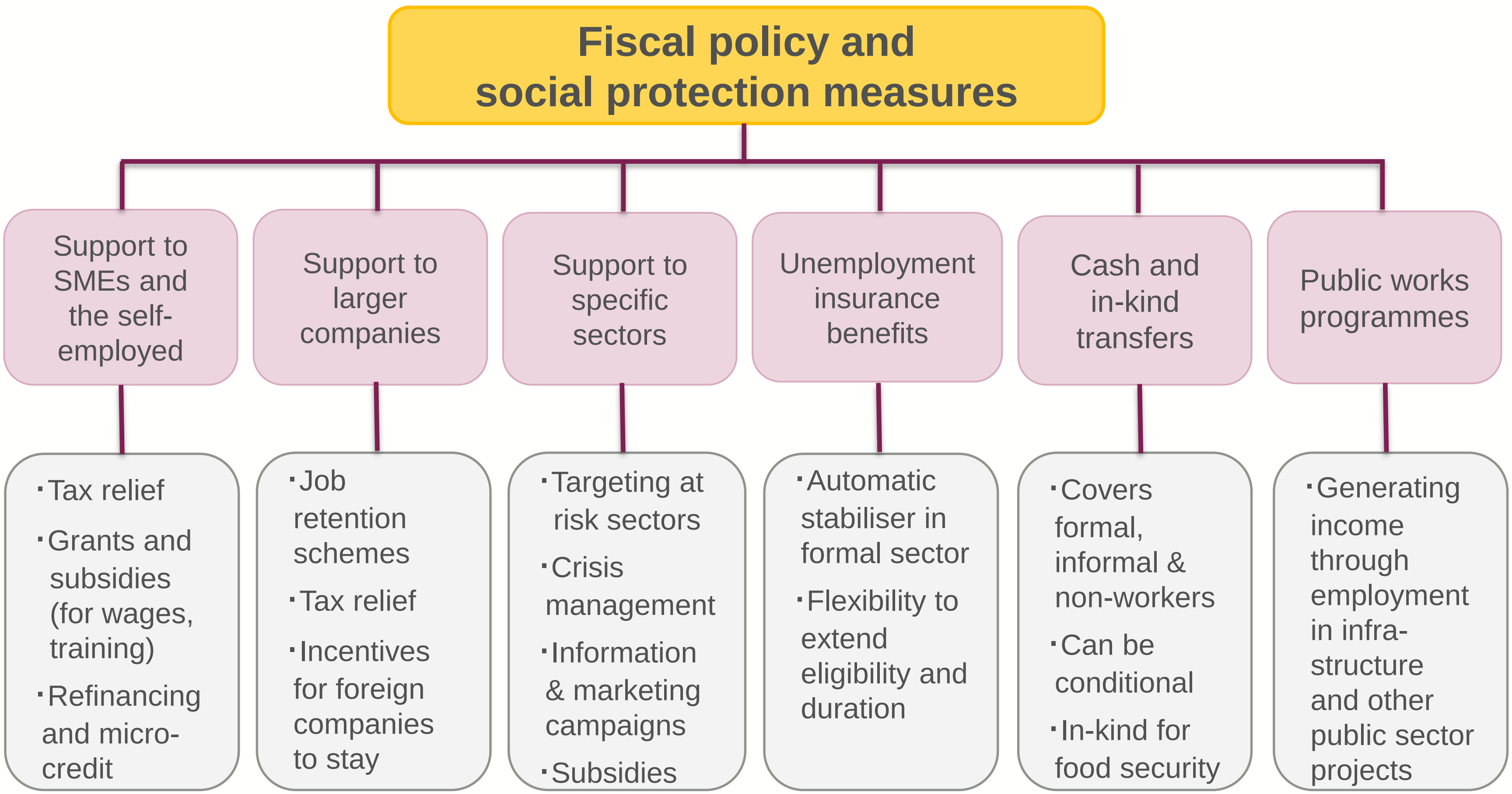
- Sufficient **fiscal space** to adopt expansionary countercyclical stimulus measures are a key source of economic resilience – resulting in smaller recessions and lower output volatility (Mexico's peso crisis, East Asian crisis and global financial crisis) (IBRD, 2010; Ortiz et al., 2009).
- Post-crisis **reversibility of short-term programming** is also important such that countries do not experience deteriorating fiscal deficits in the long-term (IBRD, 2010; Paci et al., 2010).

Fiscal policy and social protection (2)

Social protection systems can be significant sources of resilience, providing support to vulnerable, affected populations and to a demand-led recovery.

- Lack of social protection measures in the context of health epidemics aggravates poverty, unemployment and informality, resulting in greater fragility (Ebola) (ILO, 2020).
- The existence of social protection programmes allows for flexible scale up and reach of crisis-affected and vulnerable populations (Brazil-Zika, global financial crisis) (IEG, 2012).

Fiscal policy and social protection (3)



Source: author's own

Support to SMEs and the self-employed

Support to small and medium enterprises (SMEs), key to economies in LMICs, is crucial to mitigation and longer-term economic recovery.

- SMEs can be supported through microfinance institutions, vocational training and grants (Ebola) (Guinea, 2014).
- Priorities during COVID-19: tax relief, subsidies and refinancing to avoid bankruptcies (Blanchard, 2020).
- Requirements for collateral to take part in enterprise development can be exclusionary (East Asian crisis) (Betcherman & Islam, 2001).
- Identifying SMEs owned by women can allow for tailored support (UNDP, 2020).
- Digital technologies could facilitate targeted credit support (Huang et al., 2020).

Support to larger companies and job retention

Governments in middle-income countries have adopted new job retention schemes amidst the COVID-19 epidemic or expanded existing ones.

- Similar to provisions for SMEs during COVID-19, larger firms may need support to cover wage bills amidst drops in production, in order to protect employment and productivity (Gerard et al, 2020).
- Tax cuts for businesses may have less of an immediate impact on aggregate demand than tax cuts for the poor (global financial crisis) (Green, 2010).
- International companies could be given incentives to maintain their overseas presence, as their departure can undermine employment and growth (Ebola) (Stephens, 2017).

Support to specific sectors

Employment and other interventions to protect specific sectors most affected and most vulnerable during an epidemic or financial crisis may yield relatively higher returns than economy-wide support.

- Identifying the particular jobs, sectors or geographic areas through which the economic downturn is transmitted is a pre-condition for effective targeting of policy interventions (Paci et al., 2010).
- Losses in affected sectors, such as tourism, can be mitigated by pre-existing crisis management systems, information and marketing campaigns, and fiscal support (SARS, H1N1) (Rassy & Smith, 2013; Gu & Wall, 2006).
- Support to service industries affected by COVID-19 will also target women who are overrepresented in services (UNDP, 2020).

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Unemployment insurance benefits

Countries with effective unemployment insurance systems that act as ‘automatic stabilisers’ have greater options during crises to support formal workers.

- Formal employees constitute a major employment category in middle-income countries, despite a large informal sector.
- In response to job losses during the COVID-19 pandemic, various countries have expanded benefits in terms of eligibility and duration, which proved effective during the global financial crisis (Khanna et al., 2010).
- Severance payments, adopted in East Asia in the absence of such benefits, suffered from weak enforcement. Special funds to guarantee payment were later established (Betcherman & Islam, 2001).

Cash transfers

Cash transfers can protect affected workers in the absence of unemployment benefits, or where adjustments occur in the informal sector or through reduction in hours.

- Cash transfers can also stimulate the economy through greater consumer spending and aggregate demand (global financial crisis) (ILO, 2020; Green, 2010).
- Countries with pre-existing cash transfer programmes (e.g. in Latin America, Zika) can expand benefits and eligibility to mitigate economic and social impacts of crises.
- Transfers can target support to the earlier phase of disease outbreak and to restart economic activity post-outbreak (Ebola, global financial crisis) (Patel et al., 2020).

Conditional cash transfers (CCTs)

By contributing simultaneously to investment in human capital (e.g. education and health requirements), CCTs can contribute to the longer-term potential of the economy.

- Countries with programmes already in place can experience greater resilience in the immediate and longer-term term.
- Successful implementation of such schemes require substantial administrative capacity, which may not be possible during crises where rapid response is necessary (Paci et al., 2010).
- In the current COVID-19 environment, conditions that may not be compatible with social distancing (e.g. attendance in school) need to be temporarily removed (Gerard et al., 2020).

Cash transfers - targeting

Targeted support can be more effective in mitigating economic costs than large indiscriminate programmes, as epidemics and financial crises often impact certain groups disproportionately.

- Transfer programmes need to be relied upon during crises even if targeting is not perfect, with inclusion errors (Gerard et al., 2020).
- While established CCT programmes are well suited to addressing chronic poverty (e.g. in Latin America), they may be less able to reach the near poor and/or transitory poor during crises (IEG, 2012).
- Innovative methods of identifying and reaching target populations in need during crisis include phone surveys and street polling (Ebola; Colombia and Peru-COVID-19); and digital payment structures (Gerard et al., 2020; Revenga & Galindo, 2020).

In-kind transfers

In-kind transfers may be most effective where supply chains are impacted or prices rise.

- Social protection programmes may provide cash, in-kind assistance (e.g. food, fuel) or subsidised access to essential goods and services (e.g. housing) (Gerard et al., 2020).
- Food security was a key issue during the Ebola epidemic. Similarly, during the COVID-19 crisis, governments in many middle-income countries are implementing short-term measures to help vulnerable populations access food through in-kind transfers (Patel et al., 2020).

Public works programmes

Public works programmes can provide unemployed workers with much needed-income, while contributing to longer-term growth.

- In the absence of unemployment insurance, labour market interventions during crises in East Asia have often focused on jobs through infrastructure investment (Betcherman & Islam, 2001).
- Public works programmes may fail to promote short-term economic activity due to delays (global financial crisis) (Samphantharak, 2019).
- Women risk being underrepresented as beneficiaries as construction is traditionally considered a ‘male’ sector in some countries, such as in Central America (global financial crisis) (Espino, 2013).
- Such programmes can be adopted during post-disease outbreak periods, such as in China now with COVID-19 (Huang et al., 2020).

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