The Geoconomic Impact of COVID-19 on the Global Economy

Oana Iuliana Rujoiu
The Bucharest University of Economics Studies, Doctoral School of Law, Romania
rujoiuoana@yahoo.com

Abstract

This article aims to contextualize the economic impact of the COVID-19 pandemic and highlight the different monetary policies and their social and geopolitical effects at the global and European levels. The first part of the article demonstrates that the current global crisis cannot be attributed to the effects of the coronavirus and containment measures alone, but to structural weaknesses in the world economy, which have not been corrected after the 2008 crisis. Then, starting from the available data on the pandemic and the financial crisis's economic impact, the following considers the possible economic policies to overcome the crisis and their social and geopolitical effects level of Europe and the world.

Key words: pandemic, covid19, financial crisis, economy
J.E.L. classification: G01

1. Introduction

As in previous global shocks, many commentators speak of a new post-covid 19 era that would permanently change the way our societies works. The visible impacts of the economic crisis that erupted at the start of 2020 are unprecedented since World War II. Consider the production downturn and the unemployment rise that simultaneously affected the globe or the financial aid injected by governments and banks to support the economy we can arguably affirm that we're living the most severe crisis since 1929.

The Covid-19 pandemic is linked to the Lehman Brothers bankruptcy milestones from 2008, the 9/11 attacks, or, if we further look back, the 1973' oil shock. Like the pandemic, the economic and political impact of the events are considerable. However, many analysts have magnified their longer-term importance, which remain more difficult to identify. It is dismissing the current crisis on an exogenous factor such as the COVID-19 pandemic is convenient because it avoids the severe problems linked to the economy, which affects even industrial groups and not just finance to the opaque financial flows deregulation. The political leaders and the big companies responsible for this precarious global financial situation prefer to attribute the pandemic's effects to Chinese authorities management or the WHO. These evils strike the world economy in 2020. The political leaders do this to hide their carelessness, their dodges in the face of the growing economic contradictions that engendered the 2008 crisis and have still not been fundamentally solved. Large firms also prefer to blame an exogenous factor for escaping regulatory policies and obtaining big amounts of financial aid under the guise of overcoming the crisis. These two things would be more difficult to justify if their responsibility in the current crisis. It is likely that the Trump's "China-bashing" has cynically electoral aims, or even that it is part of the toolbox in the bilateral trade negotiation with the United States. As a result, China would later announce American products' imports, an agreement desired before the November's presidential elections to increase Trump's re-election chances.

However, an April poll shows that 77% of Americans polled (and 90% of those who say they favor the Republican Party) believe the Chinese government is responsible for spreading the epidemic. In this context, the hundreds of thousands of deaths that this epidemic causes in the United States risk sustaining an anti-Chinese current in the population, limiting the future American administrations' tactics in their diplomatic and economic relations with China. Many analysts consider that the common phenomenon will not fail to occur in China either, reinforcing the climate of a new cold war between the world's leading power and that which could weaken its hegemonic position (OECD, 2020).

2. Theoretical background

Economic thought among the classics and neoclassical has revealed several explanatory economic crisis theories. On the other hand, the term "financial crises" began to germinate and take on meaning only after the 1929 crisis, where we see serious studies and analyzes. From the Asian crisis of 1997, this term finds particular interest following the many theoretical and empirical models explaining the phenomenon. In this presentation, the study of this section will lead to distinguish three different periods (Kates, 2011).

The economic of the classical and neoclassical literature on crisis phenomena is not very broad. This literature considers that crises are economic phenomena that the classics qualify as "transient crises" and limited in time and that the neo-classics qualify as periods of "economic turbulence". The classics think that crises affect a well-defined sector, such as agriculture, textiles, railways, or credit, and cannot be presented as astonishing phenomena on which to study and entire theories. They define the phenomenon as "adjustment mechanisms carrying new progress by cleaning up the mistake made or unforeseeable changes of all kinds, especially in techniques". This general interpretation of the crises of the classical school was not specially called into question but reinforced by the questioning of its relevance. Classical economists are attached to the idea that the crisis is the result of the relative insufficiency of consumption in the face of a suddenly bloated supply, due either to the excessive savings of individuals or too rapid technical progress (Desai, 2014).

Oldani et al. (2013) defends the idea of the consumption implication in the crises onset. He considers the most credible opinion to be that which asserts that "the unproductive rich' consumption is necessary to give employment to the poor". This idea of saving is also formulated by Adam Smith who denounced the excessive use of savings to the detriment of consumers. On the other hand, the orthodox doctrine of neoclassical theory considers that crises result from a shock associated with a certain element whose origin is exogenous and which causes strong imbalances in the functioning of the various markets that make up the economic system. Therefore its duration is, variable and dependent on the nature of this shock which disrupts the proper functioning of the markets by causing an adjustment towards a new equilibrium. This crises conception stems from the fact that the neoclassical conceive of the economic system, in its natural state, as a set of markets where individuals, always rational, carry out their consumption and production plans. In this world, individuals seek to maximize the expected value of their utility by freely choosing an optimal basket of goods. According to this logic, the crisis presents itself as cyclical events, which come up against this natural balance. Faced with this, an adjustment process involving changes in relative prices is set in motion and involves the transition from one equilibrium system to another. This is a process that is triggered by price fluctuations leading to the disruption that is not expected to last long. Neoclassical theory predicts, moreover, that if the excess demand and supply disappear with price fluctuations, the system will become stable again and the period of adjustment after a disturbance should not last too long (Braga et al, 2010).

Kolb (2010) addressed "this theory" to the British Association in 1862 as an essay on the mathematical theory of political economy which was accompanied by a statistical study of trade fluctuations entitled "on the study of periodic commercial fluctuation". It is limited to drawing up statistical series with seasonal variations concerning discount rates, bond prices, number of bankruptcies, wheat prices, etc. In this analysis, Kolb preferred to treat price movements as long-term movements rather than cycles phenomena. Halm (2010) links crises to phenomena of imbalance. He considers that "we can better prevent them when we could better understand the ideal conditions for equilibrium".

In his view pure economy consists in the construction of a mathematical model making it possible to precisely define the situation in which an economy based on the products free exchange, on the free sale of labor power, tends to establish itself capital free movementand land free rental (Ibid.).

3. Research methodology

This research subject will require a methodology made up of several research stages:

- Study and analyze the countries affected by the financial crises from the 2008 and 2020 financial crisis. In this study, we will use statistics from the IMF, World Bank, and OECD databases.
- Observe and analyze external manifestations and possible crises causes. This analysis will aim to highlight the macroeconomic elements likely to shed light on possible macroeconomic mismanagement.
- Study these macroeconomic elements as a whole. It will be a question of determining links, of the "cause and effect" type, between these elements which can give a logical and homogeneous explanation on the macroeconomic management of the period before the crisis and the crisis period.
- Establish explanatory models of external manifestations and possible scenarios that illustrate the possible links existing between the possible effects of the Covid 19 crisis. This helps to understand how these crisis-affected countries exhibited macroeconomic mismanagement before and during the crisis.

This research theme aims to understand why pandemics hit countries' economies and which will be the possible outcomes of this crisis. From this analysis, the hoped-for idea is that crises are frequently triggered in emerging countries because the development model of them is based on exports and foreign capital flows. As a result, this model of emergence is thus called into question in the frequency of crises in these countries.

4. Findings

4.1. The economic impact of the coronavirus

It is still too early to have any idea of the full impact of COVID-19 on the entire world economy. The pandemic shock and containment measures are by themselves sufficient to cause a significant production drop. However, the combination of the financial crisis, the States's low public finances situation that has not recovered from the 2008 crisis, and the pandemic disruptive effects on the real economy will most likely lead to a recession such as the one during the World War II. Some analysts forecast that OECD countries would have a GDP drop of more than 15%. On May 6, 2020, European Commissioner Gentiloni officially admitted a contraction of more than 7% for the 2020' EU. In May 2020, the unemployment rate in the United States reached 14.7%, a level not seen since the 1930s depression. This can be explained by the increase in precarious jobs over the past thirty years; companies have quickly eliminated these jobs. Part of the fall comes from deferred consumption, which could revive demand when the situation returns to normal or when production and distribution are better suited to containment measures that could continue or resume in the coming months. The duration of these containment measures and both firms and states' ability to adapt to the new context will determine the crisis severity. The crisis is expected to be more devastating than in 2008 for several reasons. As Joe Biden points out, this is a more global crisis than in 2008. In 2009, following a very ambitious stimulus plan of 500 billion dollars from the Chinese government, China's growth exceeded 9% in 2009 and 10% in 2010. This supported global demand for raw materials, and indirectly the economies of less developed countries exporting them. In 2020, in addition to very severe recessions in most OECD economies, averaging more than 6%, most analysts forecast Chinese growth of 1.2% for 2020, a figure not seen in four decades. No demand from a major emerging economy will compensate for the demand collapse from OECD countries, explaining why the energy products prices fall, and minerals are already the strongest in years (Mallya et al., 2020).

In addition to the financial crisis effects, a real liquidity problem arises following the cessation of certain activities, both for people on technological unemployment and for companies that cannot repay their creditors. The States of the most developed economies can undertake to advance this liquidity and to freeze specific commercial and banking maturities, provided that the period of containment does not extend too long because public deficits are widening at an unprecedented speed since 1945, probably even faster than in 2008-2009. In addition to advancing liquidity and exempting firms and individuals from certain tax obligations or postponing them, States must also support a financial sector weakened by the stock market fall and the proliferation of bad debts caused by the pandemic's effects in the real economy. Of course, it must be added to the rapid increase in public spending on health and social assistance as tax revenues collapse.

The projections for the widening of fiscal deficits within the OECD are very worrying. On average, the states' public debts had already increased during the 1970-1980 years, another following the 2008 crisis (although some states such as Germany had managed to return to a level of indebtedness below 2008). The explosion of public deficits can generate macroeconomic imbalances. States have benefited from low real interest rates to refinance themselves. States as Italy, Spain, Portugal, France, and Belgium risk reaching huge debt levels that are terrifying the bond markets, raising the rates at which they can refinance each other, and trigger a chain reaction like the one that the southern euro-zone countries. The so-called "snowball" public debt effects could lead to cases of bankruptcy and debt restructuring of some over-indebted countries. Highly indebted states such as Italy will see their balance sheets deteriorate, in many cases limiting their capacity to finance from the rest of the financial system that could result in some country very serious banking sector crises (Gans, 2020).

Unlike countries such as Japan or countries from northern Europe, the ones with underdeveloped economies are more dependent on international markets for their refinancing, which makes their situation very precarious if more states are in default. Therefore, their public finances could be under extreme pressure. Without external support, this could lead to the abandonment of state subsidies to its citizens and businesses affected by the lockdown or cause massive use of money printing, generating hyperinflations with catastrophic social effects. While this global crisis will not spare any region of the world, the economic impact could vary widely between different economies, depending on three factors types. First, it will depend on the role of this national economy in the international labor division. Some economies such as Spain, Croatia, Dubai, or Morocco are very dependent (for more than 10% of their GDP) on heavily affected sectors such as tourism and transport. Others are highly dependent on their energy products and minerals exports, in particular for the balance of their public finances (World Bank, 2020).

Second, the state of their public finances and their external debt at the time of the outbreak of the pandemic will be decisive. Their prior budgetary situation will determine the maneuver room of their governments to financially support the lockdown victims. States like Venezuela, Argentina, the Congo Republic, and Lebanon already have catastrophic ratings with almost no external credit capacity. Others have a better tax base but they do not have alternatives to avoid snowballing effects like Greece, Portugal, and Italy. Third, a destabilizing factor will be the degree of dependence on food imports. As in 2008, the crisis could affect food prices. Although food stocks in 2020 are considered high, many state interventions aimed at limiting their food products exports for strategic reasons and speculation movements could generate price spikes that would generate situations of malnutrition and possible hunger riots as in 2008.

4.2. Crisis outcome scenarios

1) Macroeconomic policies to overcome the crisis

On the macroeconomic level, many States will see a very sharp deterioration in the situation of their public finances. For some countries like Italy or the United States, we will come to situations never seen since the Second World War. According to the European Commission, EU governments have advanced up to 22% of GDP in cash and guarantees to support businesses and individuals affected by the financial crisis and containment (Gans, 2020), the amount that already reaches the rescue of 2008-2009 after only a few weeks of the crisis. States such as Italy and Spain are expected to see their deficits exceeding 10% of GDP, figures that are similar to those of Greece at the eurozone crisis began.

The Italian government predicted that its 2020' public debt would climb from 134.8 to 155.7%, a level even higher than the Greek public debt in 2010, at the start of the catastrophic crisis that the country experienced. Faced with this deterioration in public finances, we can expect several policies depending on each country gravity situation and probably a policy mix comprising different policies in different proportions. Countries that see a rise acceleration in their refinancing costs due to the increased load risk and the interest rates snowballing effect will attempt to run budget surpluses for years to come. This implies very harsh austerity policies, similar to those imposed after 2008 in

Ireland, Portugal, Spain, Greece or Latvia. These austerity policies will be achieved through cuts in public spending or increases in taxes on consumption (including water and energy), land, and personal income. These austerity policies will increase the poverty level and weaken the states functioning and their public services and generate significant social and political instability. The austerity policies are also expected to weaken the economies due to budget cuts in research, phenomena similar to what many EU member states already have suffered during the 2010s. These effects should further widen the technological gaps between the most advanced regions of developed countries and their semi-peripheries.

Some countries could even find themselves in a situation similar to Greece but with higher debt. 2020 Italy's debt is set to approach € 3 trillion, a level five times higher than Greece at the euro crisis worst time. The financial markets got carried away making the refinancing of these unsustainable states, and we can not rule out the possibility of restructuring their debt without affecting the balance sheets of Italian banks that held nearly 700 billion euros. The 750 billion Italian debt would be held by other European banks and funds, which could lead to a major international shock wave, especially if other countries fail at the same time. Another solution to the growing debt that will affect governments, but also many businesses and individuals, is to let inflation ease the debt. Also, in a context of deflation and low demand, this would require printing money. Moreover, it would take a new balance of power to impose it on national creditors, especially the financial sector and other bondholders, which would mean lower lobbying capacities of finance and an alliance of powerful social and economic forces. It would also require that the debt is denominated in national currency, which is not always the case (some countries have dollarized or euroized; other countries borrowed in foreign currencies).

Finally, this solution of absorbing the debt through inflation requires the government to exercise control over its national currency, which seems excluded within the eurozone since some member states will be the creditors of other debtor member states. The solution to inflation will generate complex redistribution phenomena that would cause dramatic consequences for the population reliant on a fixed income such as pensioners and the civil service, which would generate greater political instability. The most rational solution would be the exceptional tax on capital to stimulate public spending and promote a technological transition towards environmentally sustainable growth and strengthening public health, education, and housing services. This would require a radical break with the fiscal policies followed for half a century and a major political transformation given the increasingly close links between the current political ruling circles and the major capital holders. This scenario would only be possible in the event of major social explosions that would threaten the very existence of the current economic system, the premises of which we do not yet see.

2) Trade and Industrial Policies to Overcome the Crisis

As in previous crises, one can expect more protectionist measures from many struggling economies. Multilateral institutions have been weakened by the inability to produce a substantive trade agreement within the WTO framework. The Trump's presidency underlined the legitimacy of multilateralism and the WTO settlement body dispute and by the trade clash and political diplomacy of the world powers, such as the United States and China. If the state of their public finances and the size of their national economy allow it, governments can be expected to try to save their national champions in order to avoid the disappearance of industrial or financial sectors strategic for the national economic sovereignty. We can therefore expect a greater degree of state intervention in trade and industrial policy within the major economies of the world (United States, China, Japan, Germany, UK, France) and even some medium-sized economies (Italy, Russia, Turkey, South Korea). As in previous crises, we can expect nationalizations in defense of national champions in difficulty, more discrimination in favor of national firms in the award of public contracts, the emergence of new technical barriers, or unilateral tariff increases. The difference is that political currents in favor of protectionism and reshoring have never been so strong since 1945 in developed countries and since the 1970s in many large emerging countries.

It is still too early to see how far certain states will support mercantilist and sovereignist policies aimed to promote to reduce the international interdependence. The American and Japanese governments have already offered subsidies to companies, regardless their industry, which would like to relocate the production units they own in China. However, the amounts advanced remain modest, and surveys of American business executives have revealed that most of the project to continue their existing activities in China. There is certainly a drastic drop in foreign direct investment (FDI) around the world, but this is not offset by an increase in investments at the national level, the latter also falling. At this stage, we cannot speak of substitution phenomena which would highlight the existence of a significant wave of reshoring. This is impossible, given the limited amount of data available, to see whether the policies aimed at promoting reshoring pursued by governments aim at conservative short-term electoral logic. The effects of this reshoring in terms of job creation should not be overestimated because many subcontracted activities in Asia are already capital intensive (pharmaceuticals, electronics, machine tools) and the continuous shift towards greater automation is taking place. that even a significant reshoring will not bring back the percentage of labor working in the industrial sector that the developed economies experienced before the globalization of production processes that began in the 1960s and 1970s. The effects of this reshoring job creation should not be overestimated because many subcontracted activities in Asia are already capital intensive, and the continuous shift towards greater automation is taking place. So, the unemployment rate will not meet the level experienced from the 1960s and 1970s when the globalization of production processes began.

Moreover, despite the importance of Chinese subcontractors, many production processes are more regionalized (at the level of the European Union and its neighborhood; at the level of North America and Central America with NAFTA and CAFTA + D: at the level of East Asia with ASEAN + 3) than globalized. It would therefore take a strong political impetus from the State to strongly accelerate the reshoring phenomena which would create a decoupling (a reduction in economic interdependence) between on the one hand East Asia, where even only China, and other parts of the Western economies. However, it should be noted that recent initiatives and statements by American, Chinese, Japanese and even European authorities on this subject have never been so important for decades and are much stronger than at the time of the 2008 crisis. The liberal movement in favor of multilateral trade liberalization has been weakened by the rise in protectionism and by the adoption of industrial and mercantilist policies since 2008, more particularly since the administration of Trump, and to a lesser extent by Xi Jinping. There have been attempts by some large economies, mainly the European Union, and revive Japan multilateralism. This is due to their geopolitical weakness which prevents them from openly playing the unilateralism card and which makes them fear a US-China G2 which would decide the future of the world economy without consulting them. Despite these initiatives in favor of the defense of multilateralism, we should continue to witness the pursuit of trade diplomacy when major economic powers impose bilateral agreements on their smaller partners. The least developed countries will be fragile and also find themselves in a bad negotiating position vis-à-vis the major economic powers.

With the catastrophic economic effects of COVID-19, this situation of competition between great powers, and mainly between the United States and China, is becoming more and more worrying, not only commercially, but also geopolitically, as in has witnessed for several years the increase in military budgets around the world.

5. Conclusions

Going back in the process of globalization in an attempt to achieve national self-sufficiency through the reshoring or substitution of raw materials is a costly chimera which would result in a radical drop in the standard of living of the populations but also in environmental deterioration, and a considerable increase in energy consumption. The COVID-19 pandemic has demonstrated how utterly inadequate rivalry between states is to counter the spread and heal the population in an interdependent global economy. The situation of low-income countries left to fend for themselves becomes even more dramatic and the chaotic situations which should follow will make it more difficult to control the pandemic. Choosing to exit the crisis through a mercantilist policy is not an issue. The global recession generates protectionist surges that will make it more difficult to pull the growth of the national economy through exports, regardless of the country considered. In the case of the eurozone, the countries of southern Europe which would choose to exit the euro or which would be pushed out would suffer a strong shock, similar to the effects suffered by Third World countries during the 1980s debt crisis and structural adjustment plans.

Their new national currency would be devalued, increasing the external debt and the price of imported goods for which there is no substitution in terms of national production. This would make national exports more competitive but in the face of generalized protectionist policies of many economies for the relatively poorly differentiated goods they can produce, it is unlikely that the additional growth in goods and services exports can offset the shock. And this without even taking into account the increased risks of speculative attacks against their new small and fragile national currencies and the flight of capital that will result. It is also difficult to see how these countries will then be able to launch policies to modernize their infrastructure and their productive apparatus as well as to raise the level of education to break with the low productivity and the low capacity for technological innovation of these economies. Desperate by monetary instabilities and the lack of capital, it is very possible that these states that left the eurozone would end up attracting investors (and facilitate the movement of capital by certain local economic elites) will eventually link their currency to the Euro, even for the smallest economies, their economy will be euroized. This "sovereignist" break would only be a facade that would not change the standard of living of the populations concerned. Within the two great world powers that are the United States and China, fears among political and economic elites of serious destabilizing social crises can launch these two countries into a conflictual headlong rush. Nationalist and xenophobic rhetoric could give the illusion to part of the population and to certain leaders that their financial, technological and military capacities will enable them to follow mercantilist policies of the imperialist type where the balance of geopolitical and military power will serve to guarantee outlets for their national firms.

6. References

- Braga, P., Carlos, A., Vincelette, G., A., 2010. *Sovereign Debt and the Financial Crisis: Will This Time Be Different?,* Washington: World Bank.
- Desai, P., 2014. *Financial Crisis, Contagion, and Containment: From Asia to Argentina.*New Jersey: Princeton University Press.
- Gans, J., 2020. *Economics in the Age of COVID-19*. Cambridge: MIT Press.
- Halm, A. D., 2010. *The 2008 Financial Crisis: The Death of an Ideology*. Pittsburg: Dorrance Publishing.
- Kates, S., 2011. *The Global Financial Crisis: What Have We Learnt?* Cheltenham: Edward Elgar.
- Kolb, W. R., 2010. *Lessons from the Financial Crisis: Causes, Consequences, and Our Economic Future.* New Jersey: Wiley and Sons.
- Mallya, P. D., D’Silva, R., 2020. *Impact Of Covid – 19 Crisis On The Global Economy And Other Sectors Worldwide.* London: Penguin Books.
- OECD, 2020. *OECD Employment Outlook 2020 Worker Security and the COVID-19 Crisis*. Paris: OECD Publishing.
- Oldani, C., Kirton, J. J., Savona, P., 2013. *Global Financial Crisis: Global Impact and Solutions*. Farnham: Ashgate Publishing.
- World Bank, 2020. *World Bank East Asia and Pacific Economic Update*, Spring 2020. Washington: World Bank Group.