



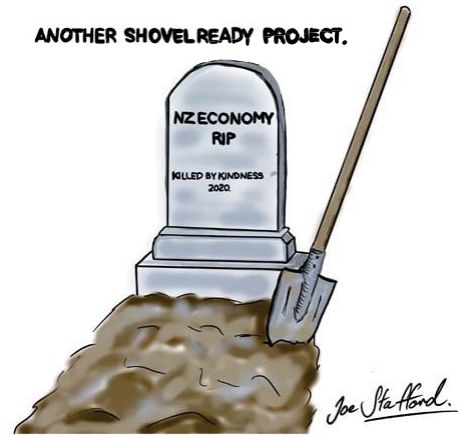
SEPTEMBER, 2020

## The economic impact of a pandemic

Country-Wide, Feidling

**BUSINESS** | COVID-19

# The economic impact of a pandemic



Covid-19 will have extreme consequences for the global economy. **Murat Ungor** of the University of Otago’s Economics Department looks at the impact the pandemic will have on debt, economic growth, and what it means for those entering the workforce.

**W**e live in a world of scarcity. We are all consumers and we always enjoy consuming more.

However, most of the time our wants exceed the resources we have.

How do we overcome this problem?

We borrow against future income. If a farmer borrows money to develop land or irrigation and spending exceeds income, the money borrowed will be expected to be repaid out of improved efficiency and production.

Governments also borrow against future income. To pay for their deficits, governments borrow, which increases their debt. Governments all around the world spend money on a variety of programmes for the wellbeing of their citizens. When a government spends more than it collects in taxes, it has a budget deficit, which it finances by borrowing from the private sector or foreign governments.

### GOVERNMENT DEBT

Government borrowing had been increasing tremendously before the pandemic struck. Total global debt reached US\$188 trillion at the end of 2018, according to the International Monetary Fund, up by US\$3 trillion compared to 2017.

Rising debt across the world has been a big concern for investors. Figure 1 shows total debt as a share of gross domestic

product (GDP) in the Group of Seven largest industrialised nations and in New Zealand.

Gross government debt excludes private debt held by businesses and individuals. Gross domestic product, or GDP, measures a country’s annual production and is often considered the best measure of how well an economy is performing.

The government debt of five of the seven G7 countries accounted for more than 45% of global GDP in 2019.

Government debt in countries like in Japan and Italy was already high by historical standards before the pandemic. Debt in Japan and Italy exceeds annual GDP. Government debt in NZ is much lower, but was still up from 21% of GDP in 2005 to 30% in 2018. In comparison, Germany, with a share of 62%, had the lowest debt-to-GDP ratio among all the G7 countries.

The pandemic is likely to lead to further increases in borrowing by governments around the world. In early April the IMF projected global output would shrink by 3% in 2020. The IMF now believes the global economy will contract by 4.9% this year. This is a major revision. According to the World Bank, the global recession will be the most severe since the end of World War II.

A definition of a recession is two consecutive quarters of falling GDP. European countries have already started to report falling production for the first two quarters of 2020. Germany’s GDP fell by 2% in the first quarter of 2020 and by 10.1% in the second.

The figures are much worse for Italy and France. Italy’s GDP fell by 5.4% in the first quarter of 2020 and the Italian economy contracted by 12.4% in the second quarter. France’s GDP fell by almost 6% in the first



Money borrowed to fund irrigation is expected to be repaid through increased production and profits.



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quarter of 2020 and the French economy contracted by almost 14% in the second quarter. Many other countries have yet to post second-quarter results.

New Zealand's GDP fell by just 1.6% in the March quarter of 2020 – the first quarterly fall in GDP since 2010 when the economy contracted by 0.5%. It is very likely NZ will record another contraction in the June quarter which is still to be reported.

Governments around the world have already pledged to spend trillions of dollars to contain the coronavirus and shore up financial markets and businesses. NZ was not an exception. The Government in March announced an initial \$12.1 billion response package to protect the health and wellbeing of Kiwis.

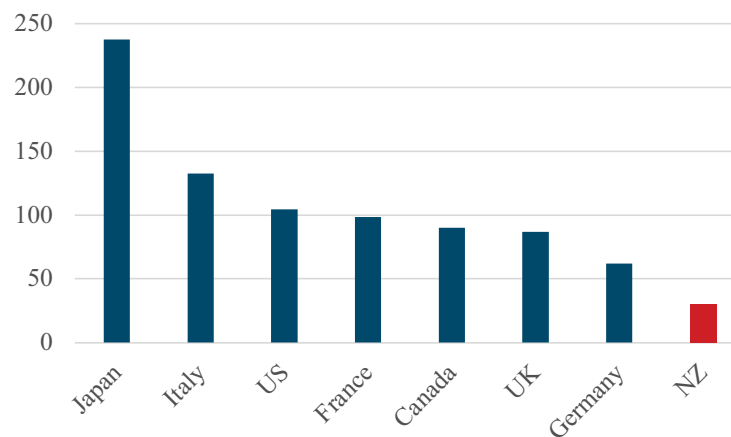
More debt now could be good or bad for future generations, depending on the implementation of policy.

Borrowing allows government to spend money today while foisting the tab on future taxpayers.

### WHAT ABOUT TOMORROW?

Spending on infrastructure can have positive impacts on future economic growth by removing constraints on productivity such as transport bottlenecks. In this case, future generations of taxpayers will benefit from these improvements, higher economic growth and improved tax receipts. Therefore, in theory, government

Figure 1. Total gross debt as a share of GDP (%) in 2018, G7 vs. NZ <sup>§</sup>



<sup>§</sup> Gross debt represents total liabilities of all levels and units of government. Source: International Monetary Fund, World Economic Outlook, October 2019.

Japan and Italy have accumulated a debt that exceeds annual GDP. NZ has been doing better than all G7 countries. NZ's total gross debt as a share of GDP was about 30 per cent in 2018. This is way lower than the corresponding figure for Germany (62%), which had the lowest debt-to-GDP ratio among all the G7 countries.

investment in public sector infrastructure can have a beneficial effect for future taxpayers – even if there is a short-term increase in government borrowing.

Key to weighing up the value of increased government spending is quantifying the subsequent rounds of spending in the economy it stimulates.

However, there is no rule of thumb and policymakers should bear in mind that the second-round effect of government spending can vary across countries.

The pandemic will also cause younger people anxiety about their financial future and whether there will be a job for them when they enter the workforce. 