More eyes on COVID-19: Perspectives from Economics

The economic costs of the pandemic – and its response

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From an economics perspective, the COVID-19 shock is unprecedented and very different from other global financial shocks. For the first time since the 1918 Spanish flu epidemic, the South African economy has been hit by real supply and demand shocks that have struck both domestic production and global supply chains, and simultaneously depressed demand in both the domestic and global economies. Lockdown halted consumption (e.g. in retail) to promote social distancing. Productive activities in most sectors ceased with consequent loss of jobs, workers furloughed or salaries cut – all of which induced a massive demand shock and loss of business and consumer confidence. There is a very real danger that these shocks to the real economy will morph into a financial crisis at a time when the South African economy has already been bedevilled by a secular decline in output growth, high unemployment (especially among the youth), precarious informal sector livelihoods, abject poverty and obscene inequality. The scenario is one of pure uncertainty rather than one of estimable probability.

It is crucial to distinguish the economic consequences of the health impacts from the pandemic itself, and the economic consequences of COVID-19 lockdown policy responses. There is no doubt that the public health imperatives must take centre stage during such an emergency. But it is ironic that, from an economic perspective, the economic costs of the COVID-19 response are likely to exceed the economic costs of the pandemic itself by several orders of magnitude. The quantum of these economic costs would be determined by the trajectory of infections (as contagion surges in 'hotspot' locations and subsequently ebbs in waves), the effectiveness of government's response strategy, the duration and coverage of a lockdown, and the phased exit strategy employed. Some of these costs would be felt immediately, others would manifest more in the medium term and beyond. It has been argued that the pandemic, left unchecked, would affect working adults, reducing their productivity for a month or two, probably keeping many away from work while killing a small number of persons, mainly the aged who are out of the workforce. This rationale has driven the more laissez-faire approaches based on 'herd immunity' once 60–70% of the population had already been infected.

Direct costs of the pandemic would include funding the public health response (borne by both the public sector and private sector businesses) and loss of productivity due to illness and death of economically active workers, which would undermine production and reduce consumption and exports. Lockdown responses acknowledge that it is the movement of people which spreads the virus. In order to slow the infection rate as much as possible early on in order to prevent the public health system from being overwhelmed, the lockdown responses aim to promote social distancing through the complete cessation of economic activity, bar a few essential services, such as health care and financial services. The costs of infection control are the incomes lost, both now and in the foreseeable future, as a result of control measures

The gross domestic product (GDP) – the aggregate production of a country – encompasses the value of final outputs of all its businesses, households, individuals, and its public sector. As the virus infects individuals and families, it impacts on the household sector, the business sector, labour markets, the public sector, the balance of payments, foreign investment, prices and money supply. All these impacts could converge to cause a decline in economic growth (a contraction in GDP), the magnitude of which is difficult to forecast at present, with forecasts ranging from 6% to 16%.

As households, firms and government in lockdown reduce their production, they also reduce exports (especially in sectors such as mining and agriculture) and their imports. The effect of COVID-19 on the balance of trade is ambiguous: both imports and exports are likely to decline, but which will fall more is still uncertain. With loss of investor confidence and sovereign credit downgrade, foreign investment might come to a sudden stop, or substantial risk premiums would be required to induce investment, mainly from volatile speculative investors ('hot money'). Trade partners which would have imported South African products and services are also hit by the pandemic, and exports decline. If trade partners develop relationships with other suppliers when South African export supply chains are disrupted, the decline in export losses may become permanent. These interacting supply and demand shocks will impact on the prices of final goods and services. They will also affect input prices and costs of intermediate inputs, inflation rates, wages, exchange rates, and financial, residential and other asset prices as firms and individuals are forced to divest assets in order to remain liquid or to survive.

The above exposition of some of the economic transmissions and contagion mechanism of the COVID-19 pandemic is highly simplified – but it does illustrate the magnitude and complexity of the shocks which virtually simultaneously hit South Africa and the world, and how economics as a discipline can shed light on how the pandemic shock was transmitted throughout the economy, and its differentiated impact on workers, consumers, firms, the fiscus and more.

Although there may have been public health benefits from an early pre-emptive lockdown strategy, it is clear that the longer the duration of a lockdown, the less effective it is likely to be from a public health perspective. Social distancing and self-isolation during lockdown is only possible in middle-class suburbia. It is simply not practical in the overcrowded informal settlements and townships where access to water and sanitation has shamefully been lacking for decades. On the other hand, the economic costs of a lockdown increase the longer lockdown continues. Extending the lockdown beyond a certain point runs the risk of still being able to contain the pandemic *and* paying the full economic costs of the lockdown.

Government has designated a system of lockdown levels ranging from Level 5 (most restrictions on social and economic activities) to Level 1 (normal, unconstrained operations), with certain services designated as essential or protected. By 28 May 2020, government had already announced a risk-based lockdown exit strategy, with sectors like mining soon becoming operational. Sector-specific health protocols will have to be negotiated – and more importantly enforced – to ensure that workers' lives are not put at preventable risk (e.g. provision of personal protective equipment and appropriate training).[1]

While many of the lockdown regulations were sensible from both a public health and economic perspective, in other cases they appeared to be irrational. Examples include the ban on e-commerce, alcohol sales (including wine exports) and tobacco sales, attempts to microregulate winter clothing sales and attempts to restrict NGOs rolling out feeding schemes when government itself was unable to reach all the needy and excluded groups like foreign nationals, unlike the NGOs. After popular backlash, these regulations were reversed. On the other hand, the Competition Commission was quite proactive in combatting price gouging. For managing the risks to the livelihoods and laying the foundations for inclusive, environmentally sustainable and digitally equitable growth and innovation, effective regulation which enables civil society and the private sector to co-create a post-COVID future would be a prerequisite.

Public discourse on immediate responses to the pandemic's economic impact centre on borrowing, drawing down cash reserves, reprioritising spending, credit guarantee schemes and judicious application of the South African Reserve Bank's balance sheet.[2] These responses can be only short term at best. In the medium term, the tax system can be the only sustainable bedrock for financing post COVID-19 reconstruction. Inclusive growth is the only way South Africa can dig itself out of this economic hole. Such a recovery cannot simply be focused on increasing the rate of growth but must also shift the direction and nature of growth to a more employment-intensive, equitable, climate friendly and digitally smart trajectory.

Charting the way forward calls for a fundamental reconceptualisation of the roles and relationships between the public sector, private sector and civil society to forge new social compacts. This will require evidence-based analysis from a range of sub-disciplines of economics, such as fiscal policy and public economics, intergovernmental fiscal relations, municipal finance, monetary policy, exchange rate policy, trade policy, industrial policy, labour market policy, social policy and social security, regional development, innovation systems and R&D, political economy, institutional analysis, energy policy, infrastructure financing, health and education financing, financial economics (banking and credit markets), development finance, and network industries regulation (e.g. information and communication technology and game theory). The pandemic will spawn a thousand PhDs in Economics. This modest contribution has attempted to sketch the broad outlines of that research agenda.

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