

# Fiscal Challenges of Covid 19

---

**Alberto Cavallo**

Harvard Business School

City Leadership Initiative - August 2020



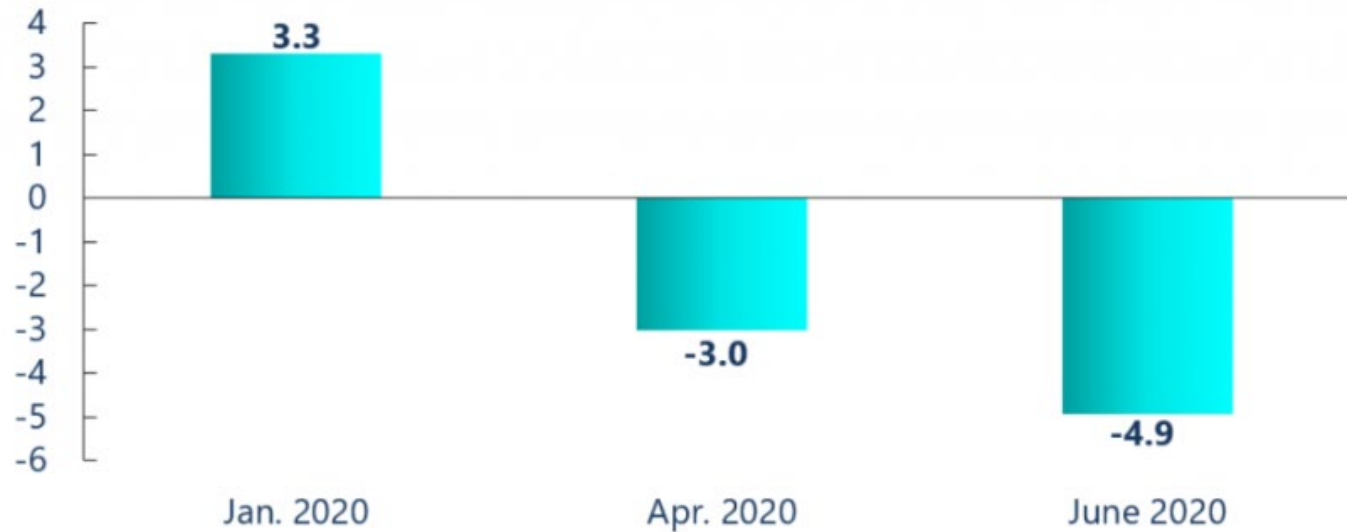
# Agenda

1. Overview of macroeconomic crisis
2. Discussion of impact on public finances
3. What to do about it?

# Worst global recession since the Great Depression

The Great Lockdown has triggered the worst recession since the Great Depression.

(global real GDP growth, 2020, year-on-year percent change)

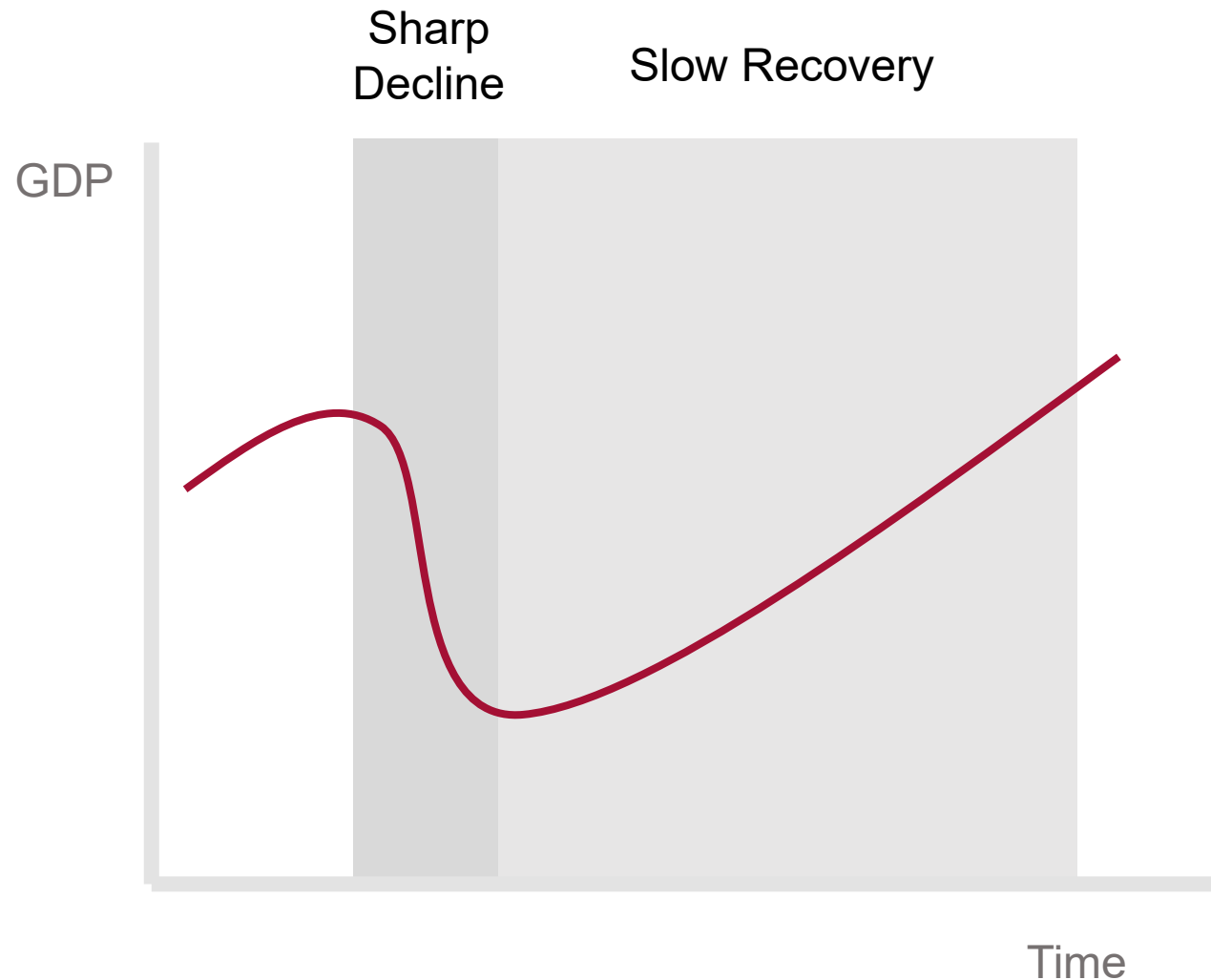


Source: IMF, *World Economic Outlook*.

- Projections are getting worse over time
- Loss is expected to be greater in emerging economies
  - Less diversified economies (tourism, commodities)
  - Limited fiscal capacity to respond
  - Capital outflows and trade disruptions



## A “Swoosh-shaped” recovery



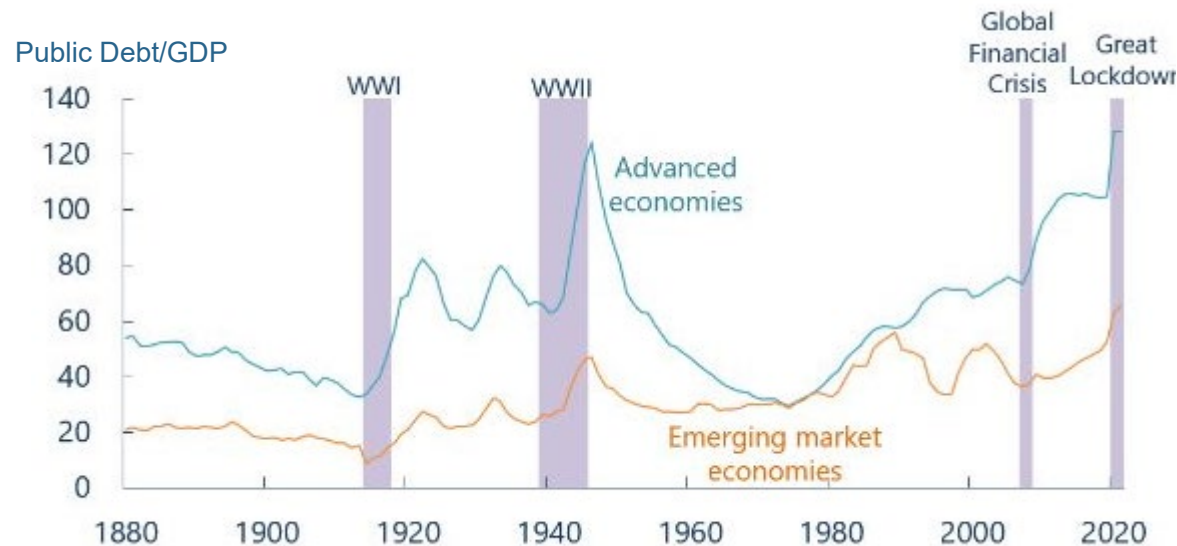
- Sharp decline now, followed by a slow recovery lasting many years
- Unprecedented uncertainty
- Multidimensional crisis
  - Health Crisis
  - Financial Crisis
  - Demand Collapse
  - Supply Disruption
  - Global Scale



# Impact on government deficits and debt are projected to be massive

**General Government Fiscal Balance and Gross Debt, 2018–21**  
(Percent of GDP)

	Fiscal Balance		Gross Debt	
	2019	2020	2019	2020
<b>World</b>	<b>-3.9</b>	<b>-13.9</b>	<b>82.8</b>	<b>101.5</b>
<b>Emerging Market Economies</b>	<b>-4.9</b>	<b>-10.6</b>	<b>52.4</b>	<b>63.1</b>
Brazil <sup>4</sup>	-6.0	-16.0	89.5	102.3
Mexico	-2.3	-6.0	53.7	65.9
Nigeria	-5.0	-7.3	29.1	36.5



Source: IMF World Economic Outlook – June 2020

- Increase in government deficits are expected to double those of the Global Financial Crisis
- Debt levels will surpass previous records (WWII for advanced economies, 1980s for emerging markets)

How is the Pandemic affecting  
your city's finances?

(chat your response  
or raise your hand to speak)



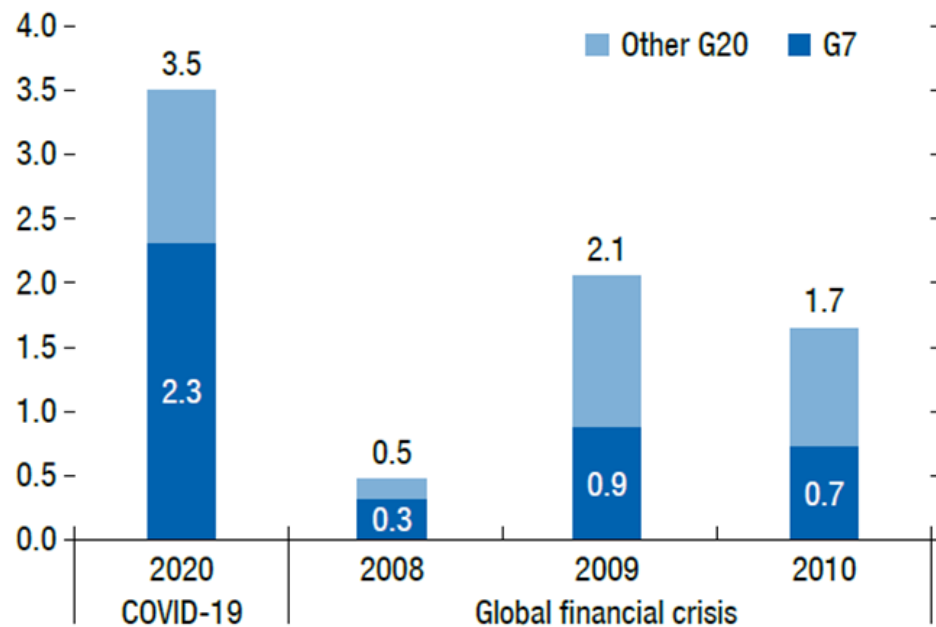
# Fiscal response has been massive

## G20 Fiscal Response to the COVID-19 Pandemic and the Global Financial Crisis

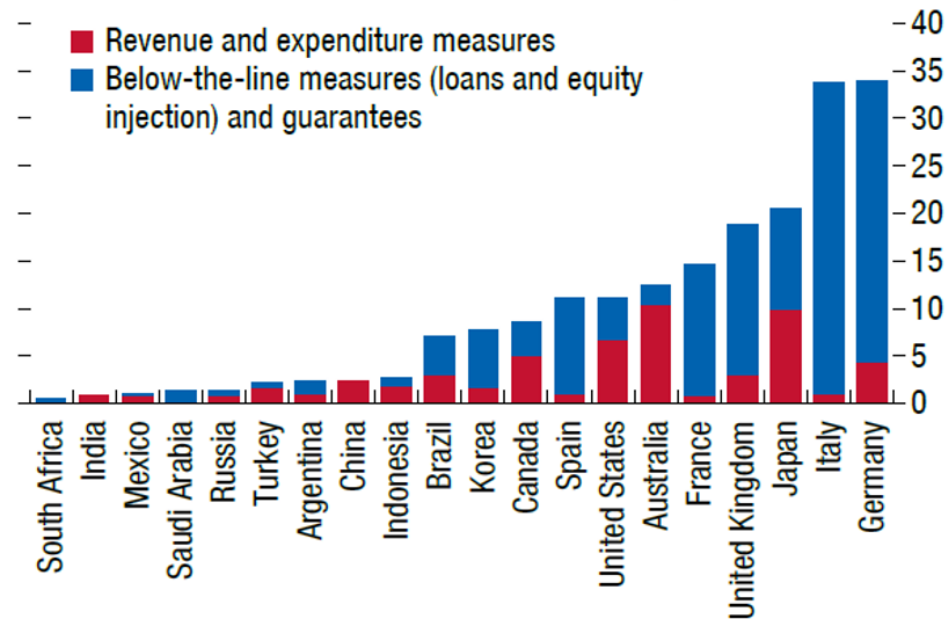
(Percent of G20 GDP, left panel; percent of national GDP, right panel)

Countries are providing sizable fiscal support in response to the COVID-19 pandemic.

### 1. Above-the-Line Measures



### 2. Above-the-Line and Below-the-Line Measures, and Guarantees



Sources: IMF 2009a; IMF 2009b; national authorities; and IMF staff estimates as of April 8, 2020.

Note: Panel 1 includes above-the-line spending and revenue measures only, weighted by GDP in PPP-adjusted current US dollars. Panel 2 adds below-the-line measures (loans, equity injections) and government guarantees to revenue and expenditure measures adopted in 2020. These are presented in the same panel for ease of reference but are not additive; see Box 1.1 and Special Feature Online Annex 1.1. The decomposition between loans and guarantees is based on available information as of April 8, 2020. G7 = Group of Seven; G20 = Group of Twenty; PPP = purchasing power parity.



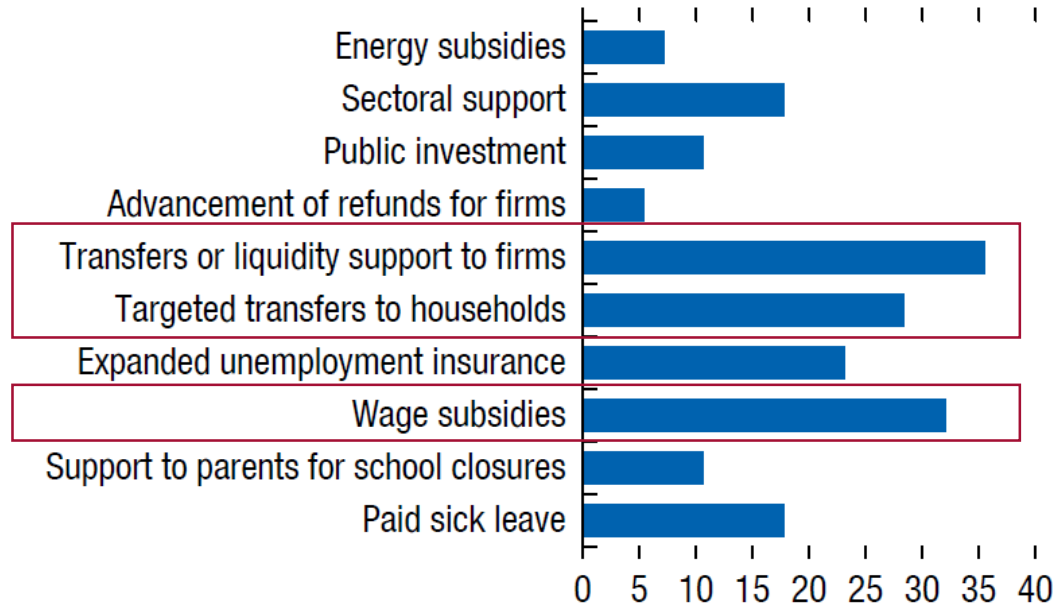
# Mostly Transfers and Subsidies

## Common Fiscal Support Measures for Non-Health Sectors in Response to COVID-19

*(Percent of countries with fiscal support)*

Countries are relying on a range of emergency lifelines to help hard-hit households and firms.

### 1. Spending Measure



Sources: Announcements by national authorities; IMF Policy Tracker; and IMF staff estimates.



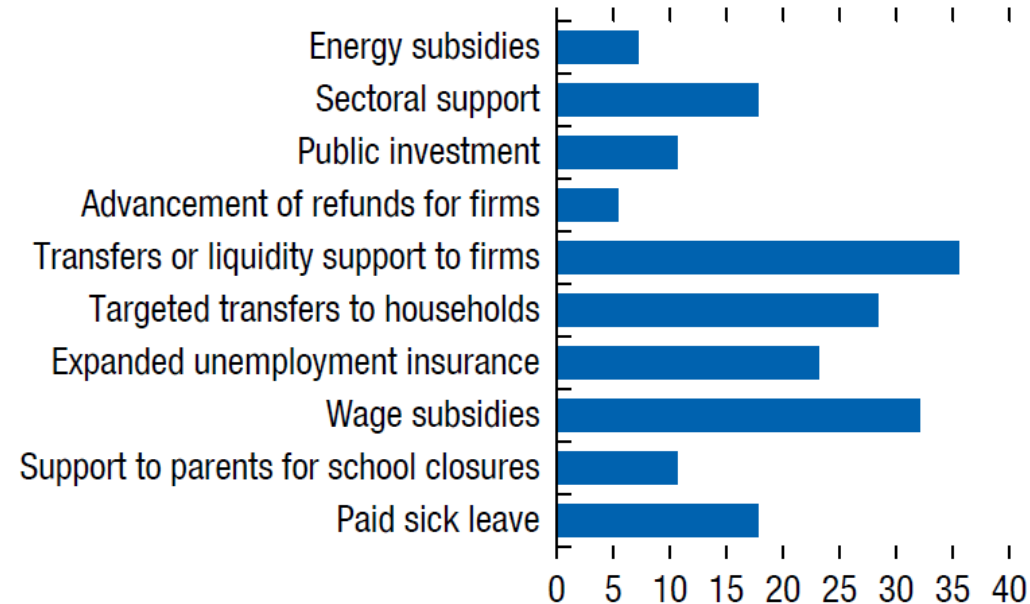
# Revenue and Tax Deferrals

## Common Fiscal Support Measures for Non-Health Sectors in Response to COVID-19

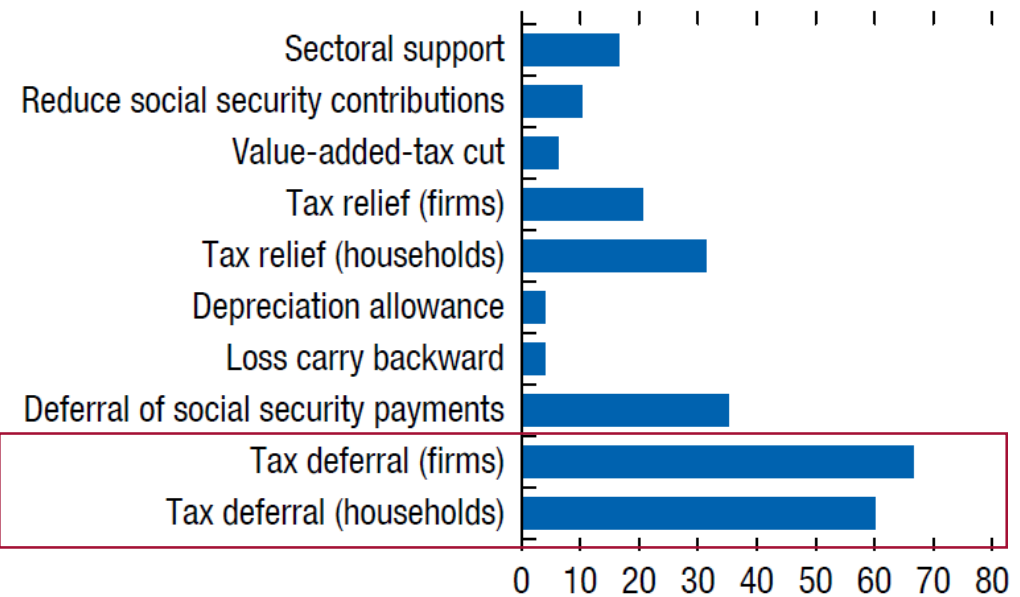
*(Percent of countries with fiscal support)*

Countries are relying on a range of emergency lifelines to help hard-hit households and firms.

### 1. Spending Measure



### 2. Revenue Measures



Sources: Announcements by national authorities; IMF Policy Tracker; and IMF staff estimates.

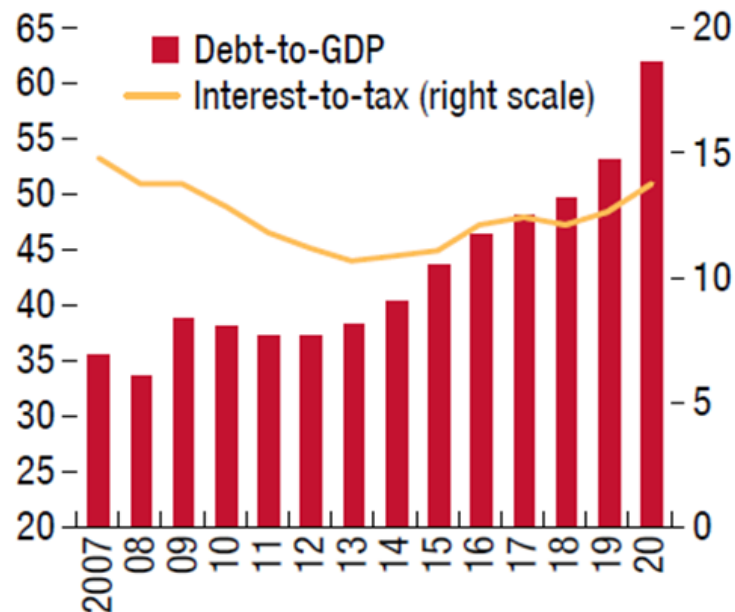
## Similar responses in Latin America

		ARG	BAH	BAR	BEL	BOL	BRA	CHI	COL	CRI	ECU	SLV	GUA	HAI	HON	JAM	MEX	PAN	PAR	PER	RDO	TTO	URU	Total
Health	Health emergency fund	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	22
	Emergency Procurement	x				x	x	x	x		x	x	x		x				x	x	x			12
	Tariff suspensions	x			x	x	x		x		x		x		x	x			x	x			x	12
Households	Temporary increase transfers	x	x	x		x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	21
	Payroll contribution deferrals	x								x	x		x		x				x	x			x	8
	Utility fee deferrals	x				x			x	x	x	x	x					x	x					9
	Tax deferrals	x			x	x					x	x	x		x	x		x	x	x		x		12
Firms	Tax deferrals	x				x	x	x		x	x	x	x		x			x	x	x	x	x	x	15
	Wage Subsidies	x	x		x		x	x	x			x	x		x	x			x	x	x			13
	Credit and Loan guarantees	x	x		x		x	x	x		x	x	x		x	x	x	x	x	x	x	x	x	18

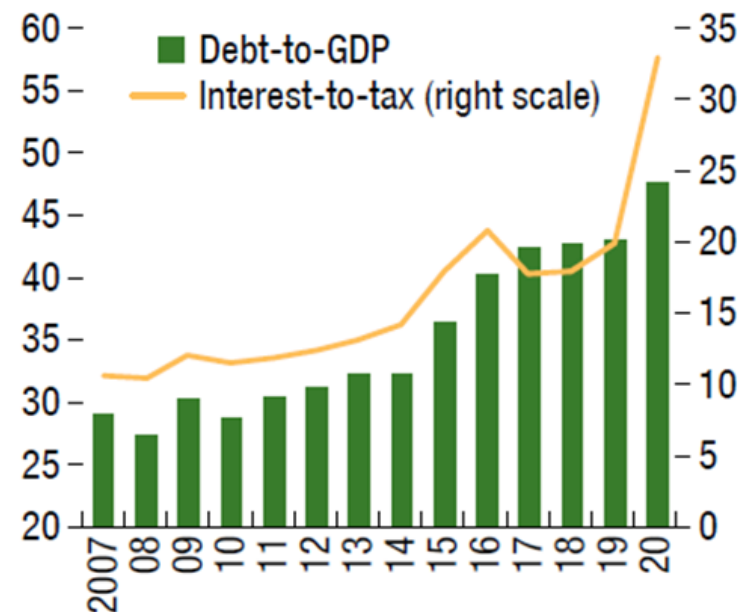
Pineda, Pessino, y Rastelleti (2020): **Política y gestión fiscal durante la pandemia y la post-pandemia en América Latina y el Caribe**

## Debt levels were already increasing before the Pandemic

### 2. Emerging Market and Middle-Income Economies



### 3. Low-Income Developing Countries



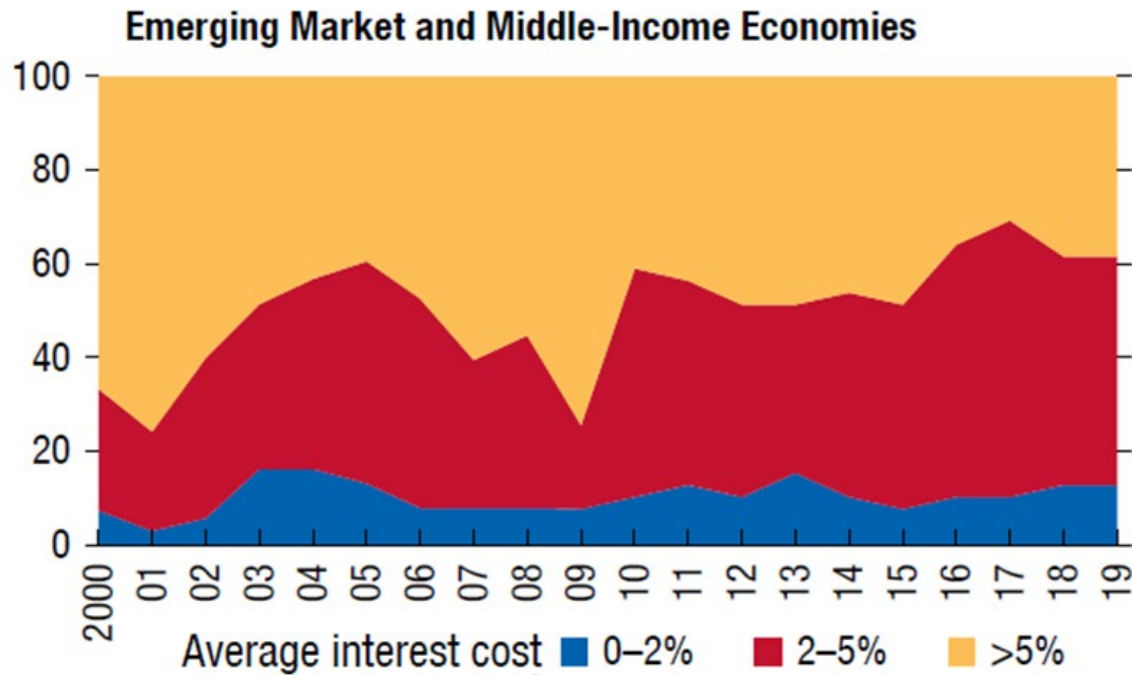
Source: IMF, World Economic Outlook database.



With low interest rate levels until 2019

## Distribution of Nominal Effective Interest Rates, 2000–19

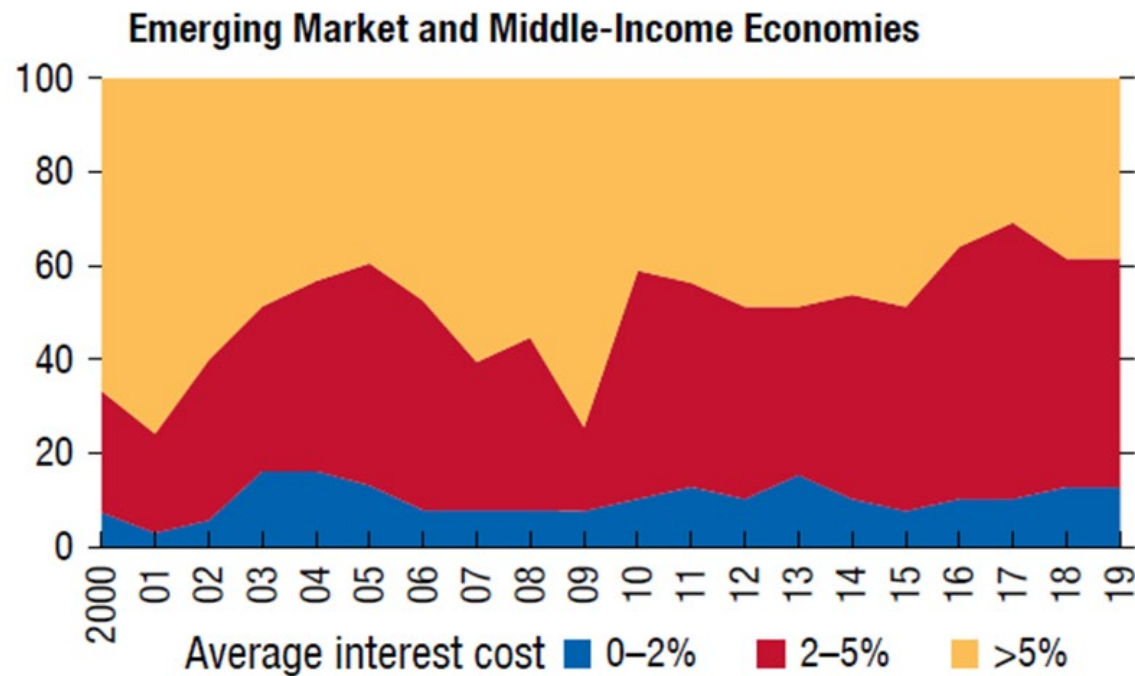
*(Percent of total countries for each group)*



But interest rates are now rising quickly for many developing countries

### Distribution of Nominal Effective Interest Rates, 2000–19

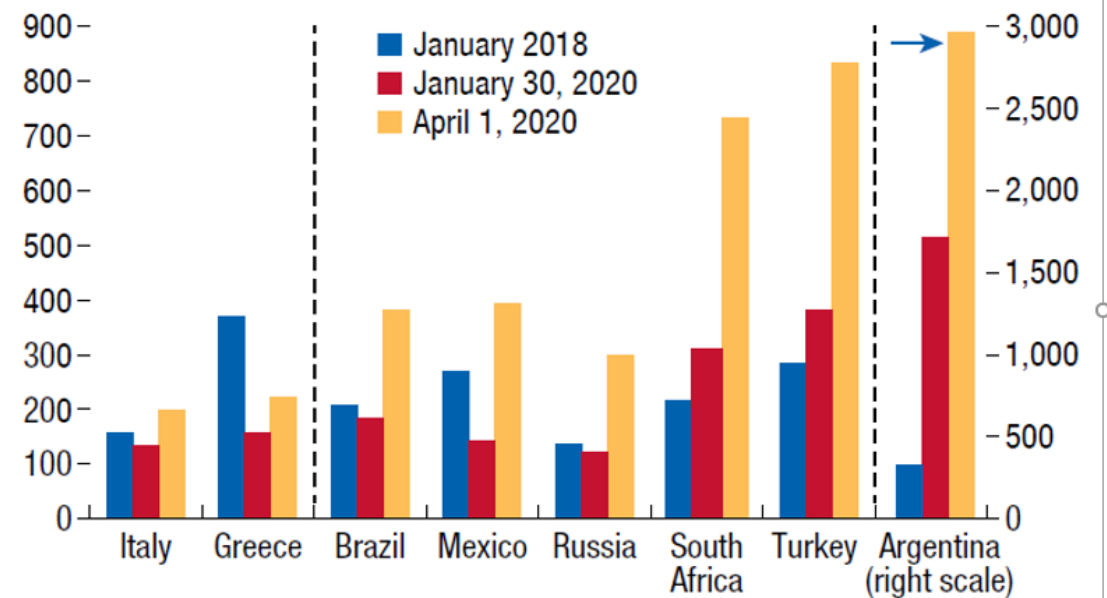
(Percent of total countries for each group)



### Figure 1.13. Sovereign Spreads

(Basis points)

Risks of a sharp rise in spreads remain in some advanced and emerging market economies.



Source: Bloomberg Finance L.P.

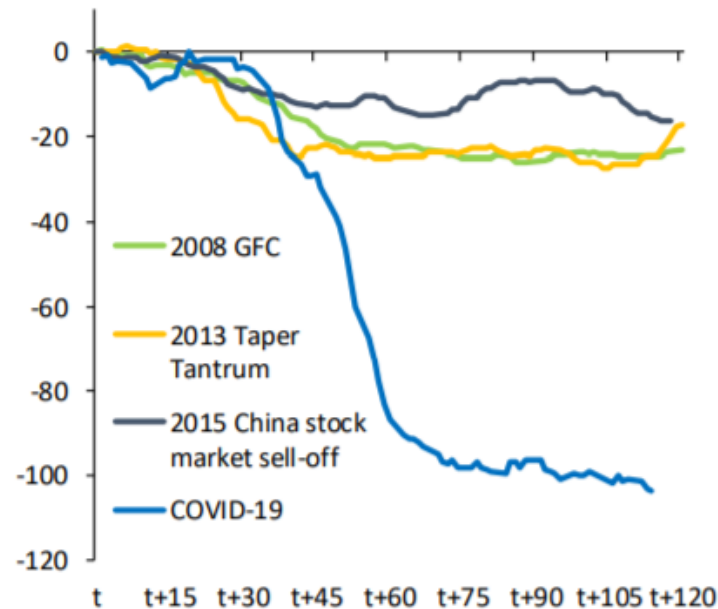
Note: Spreads for Italy and Greece refer to their sovereign yields over German bond yields, whereas the spreads for other countries are over the US Treasury bond yields. The World Health Organization declared COVID-19 a global health emergency on January 30, 2020, and a pandemic on March 11, 2020.





# Driven by Capital Outflows

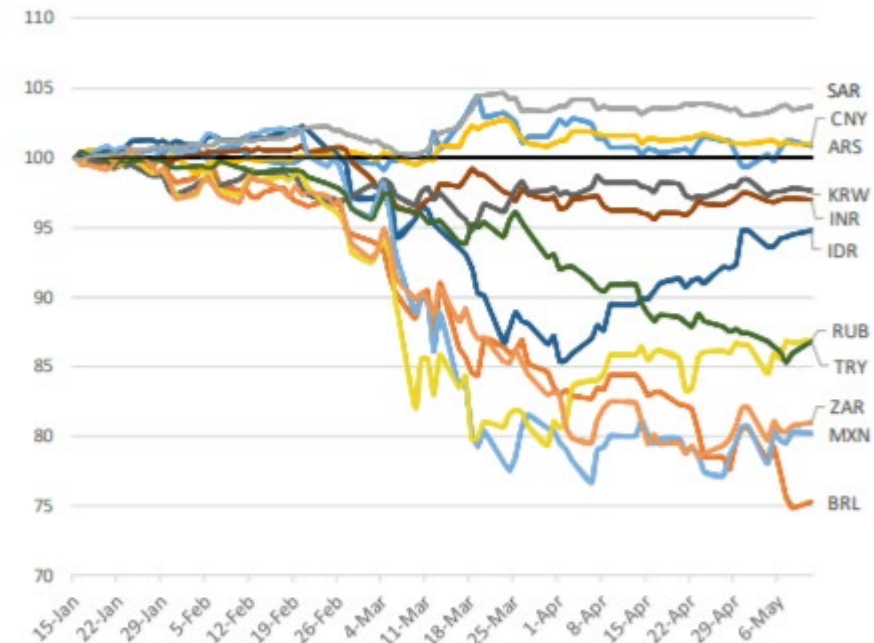
**Figure 3. Portfolio flows to EMEs today vs. past episodes (bln USD)**



Note: Cumulative non-resident portfolio flows to EMEs since event start date (t for GFC=9/8/2008; for TT=5/17/2013; for China sell-off=7/26/2015; for COVID=1/21/2020)

Source: Jonathan Fortun, Daily capital flows tracker. ©2020 Institute of International Finance, Inc. All rights reserved.

**Figure 1. Exchange rates – Selected emerging market economies, Jan-May 2020**



Note: Nominal effective exchange rate (broad index), rebased at 15 Jan 2020=100. An increase indicates an appreciation of the economy's currency against a broad basket of currencies.

Source: BIS, OECD calculations.

## Covid Impact on Public Finances

Pandemic Effects	Now	Later
More Spending	<ul style="list-style-type: none"><li>-Health spending</li><li>-Social spending</li><li>-Aid to businesses (grants, loan guarantees)</li></ul>	<ul style="list-style-type: none"><li>-Slow recovery → uncertainty</li><li>-Switch to fiscal stimulus</li></ul>
Less Revenue	<ul style="list-style-type: none"><li>-Lower output → lower tax collection (sales tax, service fees)</li><li>-Tax deferrals</li></ul>	<ul style="list-style-type: none"><li>-Less central government distributions (rules often based on previous year's numbers)</li></ul>
More Debt	<ul style="list-style-type: none"><li>-More debt at higher interest rates [harder for developing countries]</li></ul>	<ul style="list-style-type: none"><li>-Debt Defaults</li><li>-Central governments assume losses due to loan guarantees offered to firms</li></ul>



# 3 ways to finance spending

Tax

Debt

Print Money



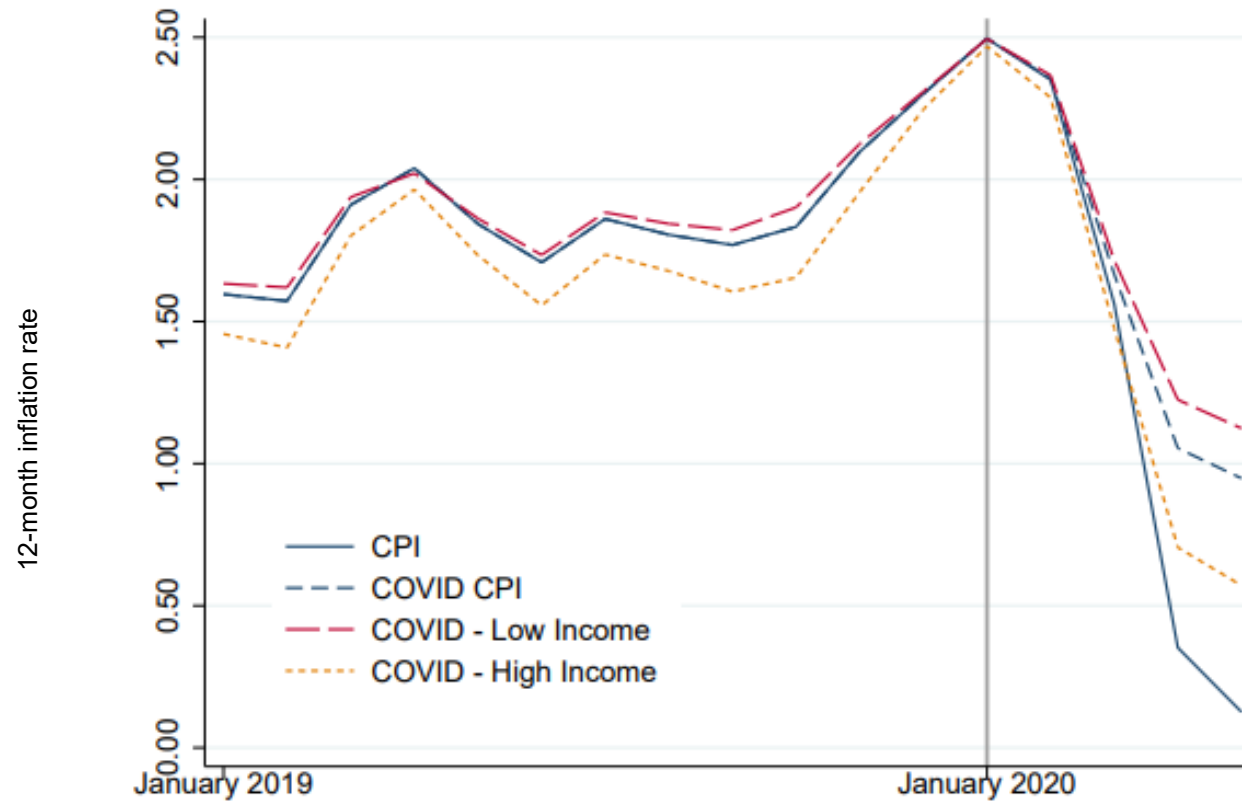


## Covid Impact on Public Finances

Pandemic Effects	Now	Later
More Spending	<ul style="list-style-type: none"><li>-Health spending</li><li>-Social spending</li><li>-Aid to businesses (grants, loan guarantees)</li></ul>	<ul style="list-style-type: none"><li>-Slow recovery → uncertainty</li><li>-Switch to fiscal stimulus</li></ul>
Less Revenue	<ul style="list-style-type: none"><li>-Lower output → lower tax collection (sales tax, service fees)</li><li>-Tax deferrals</li></ul>	<ul style="list-style-type: none"><li>-Less central government distributions (rules often based on previous year's numbers)</li></ul>
More Debt	<ul style="list-style-type: none"><li>-More debt at higher interest rates [harder for developing countries]</li></ul>	<ul style="list-style-type: none"><li>-Debt Defaults</li><li>-Central governments assume losses due to loan guarantees offered to firms</li></ul>
More Inflation	<ul style="list-style-type: none"><li>-Food price increases → + social spending</li></ul>	<ul style="list-style-type: none"><li>-Less real value of taxes with collection delays (property taxes)</li></ul>



## Food Inflation is already disproportionately affecting low-income households



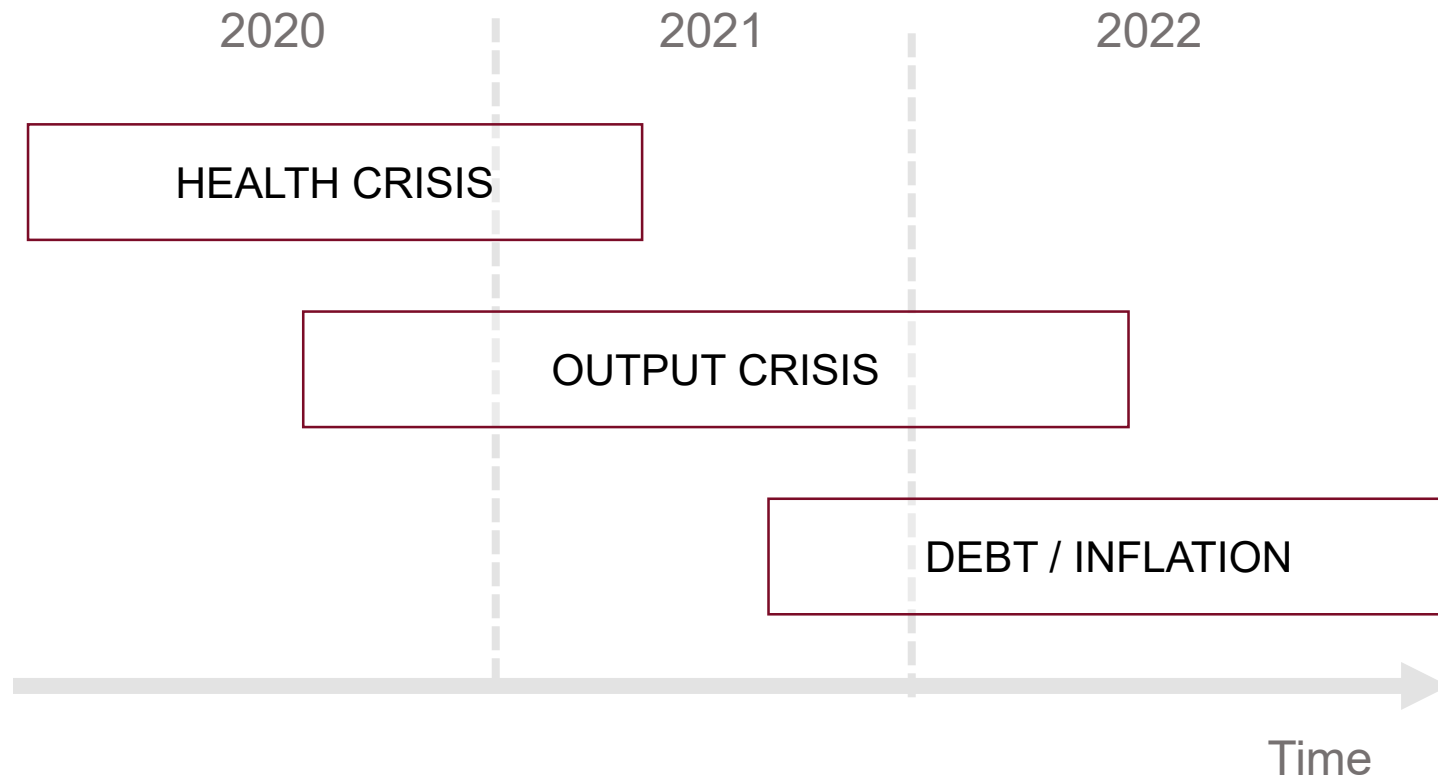
Low-income households are spending significantly more on food, which is having relatively more inflation during this crisis

Figure 2: US Annual Inflation with Covid Expenditure Baskets

Source: Cavallo (2020) : "[Inflation with Covid Consumption Baskets](#)" NBER Working Paper Series, No. 27352, June 2020.



# Overlapping Fiscal Challenges



# What can be done about it?



## Some ideas from fiscal research

- Fiscal response should follow the 4T rule → timely, targeted, transparent, and temporary
  - Timely + targeted: prioritize spending under different scenarios (what / when )
  - Transparency to avoid corruption: communicate and share information
  - Temporary spending/tax cuts, avoid permanent commitments that affect long-term sustainability
- Coordinate (vertical with state/central government, and horizontal with other cities)
  - In health but also other areas, such as procurement and financing negotiations (eg. request Central Bank program's like the Municipal Liquidity Facility in the US), to avoid fighting over the same resources and expand the available options.
- Anticipate and plan for future problems
  - Forecast and re-evaluate more frequently
  - Plan for multiple macroeconomic scenarios → uncertainty will remain high
- Crises can also be opportunities to push for reforms and innovate
  - Eg: digitalization of payments for taxes and fees.
    - Major Mayor Aki-Sawyer from Freetown - Sierra Leone is revamping property taxes to avoid cash payments.
  - Eg: re-negotiate tax pacts and push for autonomy
    - Major Trevino from San Pedro – Mexico asked the federal government to revise a four-decade old tax pact

What are you doing about it?



## Additional Resources

- Interamerican Development Bank (IDB) [COVID-19 city-finance](#) webinar (June 2020)
- IDB “[Red de ciudades](#)” website (additional city-level resources related to Covid-19)
- IMF “[World Economic Outlook](#)” and “[Fiscal Monitor](#)” reports
- “[Budgeting in a Crisis: Guidance for Preparing the 2021 Budget](#)” IMF Special Series on Covid-19
- “[Budget Execution Controls to Mitigate Corruption Risk in Pandemic Spending](#)” IMF Special Series on Covid-19







HARVARD | BUSINESS | SCHOOL

**Thank you**

---

**Alberto Cavallo**

[www.albertocavallo.com](http://www.albertocavallo.com)