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Globalisation in the Time of Coronavirus or One Hundred Years of Solitude for New Zealand?¹

Abstract

This article considers the effects that the Covid-19 pandemic may have on those aspects of international commerce and trade that are most relevant to New Zealand's economic future. It covers changes to international political economy and the likely impacts of the huge international policy response. Businesses are starting to trade differently, people no longer cross borders so freely, there is changed use of technology, there are challenges for the financial sector, and governments are taking on new roles and issuing huge amounts of debt. Bilateral trade tensions are becoming more acute. People are going to have to live through disruption and pay for this pandemic.

Keywords Covid-19, economic, trade, supply chain, policy, debt

Health protection vs economic openness

This article analyses impacts on commerce and trade that may result from the Covid-19 pandemic, lockdown and recovery. It focuses on the international economic environment and its implications for New Zealand. It is inevitably speculative, being

written at a time when the health outcomes are unclear, let alone economic ones.

The world has been hit by many shocks over the last century, including pandemics (SARS), supply shocks (the OPEC crisis), demand shocks (9/11) and financial shocks (the global financial crisis). The Covid-19

pandemic is particularly complex, with the potential to combine all these aspects. In addition, its impact has been heightened because it has been unexpected, sudden, massive and globally synchronised.

The initial economic damage has been unprecedented – government-imposed restrictions on the movement of people, resulting in production close-down and demand contraction. In this early stage the economies of many countries have been partially frozen to reduce disease transmission, putting the economy on an 'economic ventilator'. The second phase is the opening of businesses and households, accompanied by huge government stimulation. The third phase still lies ahead of us: economic stabilisation, which will be necessary to restore productivity and return towards trend growth. In the meantime, there is economic disruption and turbulence, much of it with long-term consequences.

A country can reduce its health damage by controlling its borders, but New Zealand's economy is built on openness. This article analyses the global shock, tracing likely Covid impacts on cross-border flows of people, goods and capital,

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and asks what this may mean for New Zealand economic recovery.

International political economy

The rise of Covid-19 in China, its rapid spread through the world, and its particular impact in OECD countries has increased global tensions, fanned the flames of de-globalisation, and pointed to a mounting vacuum in world leadership.

The US federal system of government has struggled to present a coherent national policy, let alone display international leadership. Its medical capacity, its pharmaceutical firms and its digital capabilities have the ability to show world leadership. But its struggle to contain infections, the intense politicisation of the pandemic, the divisions caused in society, and the bickering fight to secure personal protective equipment supplies have damaged its international reputation for crisis management and recovery.

The US has found itself surprisingly dependent on Chinese production of medical clothing, ventilators and pharmaceutical precursors. The administration has used the crisis to reinforce its message of economic nationalism, urging US firms to lessen dependence on Chinese suppliers, to onshore key production capability, and to use American supply chains. Some administration announcements appear to breach World Trade Organization (WTO) undertakings, probably with impunity. This has reinforced the 'Make America Great Again' message, and extended US policy of technological decoupling to essential medical supplies.

China also damaged its international reputation with its early mishandling of the virus, but has subsequently tried to take advantage of the leadership vacuum. Tight lockdown measures emphasised the advantages of an efficient authoritarian administration, while its production capacity allowed fast gearing-up of pharmaceuticals and medical equipment. It has supplied medical equipment and assistance to affected countries, what has been termed the Health Belt and Road. The Chinese response has reinforced its belief in the importance of domestic production capacity, as outlined in its predominant vision for industry policy, 'Made in China, 2025'.

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China's competence in Covid-19 containment and assistance has impressed other countries in the region. In addition, early Chinese industrial recovery may drive international recovery next year. But many countries have tempered their admiration, with concerns about their own over-reliance on Chinese supplies and about the over-extension of Chinese soft power.

In addition, third countries are worried about how medical rivalry is exacerbating the trans-Pacific tensions in trade, technology and finance that are already evident between China and the US. The tentative steps towards containment in 2019, such as the US-China phase one trade agreement, have now broken down.

This increase in economic tensions comes at a crucial time. It has been very difficult to forecast economic impacts, due to our lack of understanding of Covid-19 health outcomes, the sensitivity of economic activity to epidemiological assumptions, and the lack of historical

precedent. The most authoritative international forecast to date is the April 2020 IMF *World Economic Outlook* (IMF, 2020). It projects world growth contracting by 3% in 2020, a global contraction not seen since the 1930s. With China slowing to 1% growth and the US projected at negative 6%, this contraction is very widespread. Most other countries in the region are expected to take comparable hits to their economic growth, and for those reliant on trading hubs such as Singapore, the impact is major. The contraction is made worse by the concurrent collapse of world energy markets, decimating US shale production. These projected slowdowns will cause social and political problems for their countries, and are likely to exacerbate regional economic tensions.

Early real-time data and surveys of job loss and business disruption to date support these projections, pointing to an initial contraction of a magnitude last seen in the Great Depression. However, the IMF's and other forecasts are based on a 'V-shaped' bounce-back in 2021, and if there is a longer ('U-shaped') downturn or a second Covid wave, then outcomes could be considerably worse.

There have been many calls for international leadership and coordination through the G7, the G20 and APEC, but, like the medical responses, the economic policy responses have so far been almost entirely national in delivery. There have been some efforts by multilateral organisations to increase stimulus, such as the IMF's increased emergency intervention facility, and the G20's talk of debt relief for less-developed countries. The WTO reports a wave of notifications of trade breaches based on Covid-19 disruption. With the absence of strong WTO enforcement and waning belief in the benefits of globalisation, there is now a significant risk of a severe increase in trade protection, which could prolong economic depression. Surveys in the US show markedly increased support for trade protection. The WTO itself forecasts a decline in world trade of 13–32% in 2020.

Asia-Pacific regional bodies such as APEC or ASEAN have had a limited role in health standard setting and emergency production. However, both bodies could focus on updating cross-border trade flows

in the post-Covid environment. Under upcoming New Zealand leadership, APEC could consider extending its business travel cards (which offer visa-free travel) to certify Covid-safe travel status, and could use its working groups to set health standards and guides to best practice, and counter unnecessary agricultural protection, working through remote meetings where possible. However, there is a risk that the Covid-19 experience might dial back attempts by these regional organisations to liberalise cross-border movements.

National policy responses

So far, national policy responses have been quite different from the laissez-faire policies of the 1930s Depression: initially many countries instituted emergency job protection and business support programmes to counter the effects of the lockdown. This has seen governments take on a new economic and political role as 'employer of last resort'. To deal with post-lockdown problems they have committed to major fiscal stimulus programmes, providing public funds as high as 10% or more of GDP; this looks to be several times larger than the total global financial crisis-era stimulus. The US congressional approvals of over \$3 trillion must be the largest ever in history.

These huge programmes need to be funded. This will be reasonably straightforward for countries like China with low national debt and high savings. The US has the advantage of borrowing in the world's reserve currency, but its demands will be huge, with public debt forecast to rise as high as 120% of GDP by 2025 (Committee for a Responsible Federal Budget, 2020). This could stress sovereign funding markets and crowd out other borrowers. The medium-term impact on interest rates is quite unclear.

These policies will eventually result in governments taking corporate and household liabilities onto public balance sheets. So far sovereign debt markets have been orderly, assisted by low interest rates and the availability of global savings, but a sovereign debt mountain looms ahead. Credit rating agencies are struggling to assess Covid-19 risk on sovereigns and corporates, and there will be many

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downgrades ahead. Some countries are already pushing for non-conventional forms of 'modern monetary financing': for example, the Bank of England has been buying UK government debt directly. Markets will be scrutinising this aggressive, unconventional quantitative easing, with its adherents calling for a revolution in public financing.

The New Zealand government has announced a huge budgetary commitment to the Covid-19 response effort (Treasury, 2020). It has established a fund of \$50 billion, \$30 billion of which is already committed, with a likely fiscal impact of around 7% in 2020. Because the New Zealand public accounts have been in very good shape (net public debt starting at around 20% of GDP), the extra funding requirements so far look likely to be handled in a conventional way on sovereign markets.

Monetary policy actions have also been uncoordinated (the main international response being the US Federal Reserve's

extension of liquidity facilities to selected countries). With most countries' interest rates already ready so low, traditional monetary policy has limited stimulus capacity. Central banks have been more focused on ensuring financial market liquidity, yield curve pricing and bank balance sheet health. The Reserve Bank of New Zealand has promised up to \$60 billion of large-scale asset purchases (Reserve Bank of New Zealand, 2020). Exchange rate depreciation against the US dollar has been allowed or encouraged by many authorities.

Industry policy has been more ad hoc, with many governments focused on ensuring supply from essential industries, bolstering badly affected industries such as airlines, and stimulating sectors such as construction which promise a multiplier impact.

Overall, governments have significantly increased their role and size during the pandemic crisis functionally, technologically and legally, and this has longer-term implications. Emergency legislation has allowed for unparalleled closure of some (non-essential) economic activity and direction of some (essential) functions.

Beyond 2020 the IMF foresees some economic bounce-back, though that will depend on success in containing the virus and in rebuilding economic confidence. For much of the Asia-Pacific region it will mean a return to growth, though from a significantly lower production base, with high unemployment of labour and continued overcapacity in declining industries (though potentially higher productivity via digital expansion).

Renewed growth will bring its own policy challenges, possibly as early as 2021: how to stabilise economies with some strong growth sectors and pockets of recession, how to dial back on stimulus programmes, how to prevent resurgent inflation, how to reduce national debt, and how to share out the burden of paying for the crisis. This could involve unpopular political decisions, and test the governance of key economic institutions.

Business developments

The need to access urgent medical and other supplies during the lockdown

has exposed the complexity of modern containerisation, shipping, port-handling, warehousing and trucking arrangements. For the most part the freighting of essential supplies continued satisfactorily, both in New Zealand and in the region, despite reports of air cargo hold-ups, lack of containers, stocking problems and increased food wastage.

The crisis has exposed the network of complex, interlinked supply chain arrangements. Initially there were shortages stemming from the closure of production plants, especially in China. As a result, many companies have been re-mapping their input sourcing. They are reassessing their supply risks, rethinking their just-in-time stocking policies, building inventory, designing for resilience, simplifying supply chains, investing in remote tracking technologies, and in extreme cases onshoring production lines.

Certain countries are exerting political pressure to onshore, using the pandemic experience as an opportunity to reduce concentration on Chinese supply. Australia is reassessing whether it has become too dependent on Chinese export markets. Governments are considering local production of essential medical supplies and emergency medical stocks. Some East Asian countries are taking the opportunity to increase food stocks, to promote domestic food production, and to institute 'food sovereignty' policies with rice or wheat export bans. There is a risk that such policies will lead to a revival of agricultural protectionism in the region. In addition, Covid-19 has been used by the US as an excuse to prohibit export of certain technologies and supplies.

Particular economic sectors have been hit especially hard. Most at risk of disruption have been cross-border businesses involved in travel or hospitality, and, particularly, capital-intensive airlines, airports and aircraft production, where company valuations have been hugely hit. Other traditional public-facing services, many of them small to medium-sized enterprises, have been at risk during lockdown, and some will never recover, causing stress in the commercial property sector. Industries facing digital substitution (such as publishing and media) or distance substitution (education and travel) are also

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at imminent risk. It is not all bad news: some industries are growing strongly (digital communications, electronic commerce, tele-medicine). A consequence will be considerable sectoral churn, with job shortage and job vacancies occurring at the same time.

Some AI-enabled sophisticated factory production has continued without disruption through the lockdown and there have been advances in automated warehousing and inventory management. This experience will add pressure to continue to digitise much of the production and transport process (enhanced by the application of 5G and 6G technologies), potentially reducing industrial labour requirements. There may be a boost in the use of 3-D printing technologies to localise production.

New Zealand commodity production sits at the origin of export supply chains, and has felt less impact than some countries' exports. Food commodity prices have not been too badly affected so far. The swift suppression of domestic Covid-19 cases

could give New Zealand food exporters the advantage of advertising 'safe sourcing'. In small countries there is less scope to onshore production of essential supply; food production is ensured in New Zealand, but the government will likely increase emergency stocks of medical equipment.

People movements

The crux of the Covid-19 response has been quarantining and travel restrictions. Border control has become a front-line operation, with health officials in many countries becoming the first line of border defence (in contrast to the traditional primacy of immigration officials in Europe, security officials in the US and agricultural officials in Australasia). At-border freighting processes such as authorised economic operators and single window systems have had to adapt to this.

For travellers it is unclear how long the widespread disruption will continue, especially for international travel. It appears that Covid-19 will likely result in ongoing changes in business behaviour, fewer face-to-face transactions, less physical travel, a big increase in virtual meetings using Zoom and other technologies, and an increase in virtual conferences and trade shows. There has been a shift to digital marketing, digital ordering, digital payments, digital signatures and in some cases digital delivery.

The technologies used for isolation enforcement may increase state powers and reduce individual privacy rights, particularly following the success of some East Asian governments in controlling the pandemic. Chinese digital platforms already integrate communication, banking and digital purchase apps with location tracking and tracing, and Western systems may follow.

There will likely be a significant reduction in international tourist travel, with travel initially targeting safe, direct destinations within 'bubbles'. There will be a relative increase in domestic tourism in many countries, and perhaps development of sophisticated virtual reality travel options. The tourism sector may be burdened with stranded assets such as large tourist hotels and cruise ships, and encounter increased costs at airports.

Stressed health systems and infection fears mean that governments are becoming

less welcoming to foreign migrants. In New Zealand this has already had an impact on agricultural and seasonal labour supply. Conversely, small well-managed island countries like New Zealand may appear attractive boltholes for wealthy migrants.

It is more complex to predict the movement of New Zealanders. Some diaspora Kiwis working in professional services in host countries have returned. In the meantime, household composition has changed during the lockdown, house construction has slowed, and significant Airbnb space has become available on the rental market. Most forecasters see a reduction in house prices, which will affect household balance sheets and consumption.

There has been a huge increase in sophisticated digital distance teaching technologies at all levels in the education sector. As job prospects for the young dry up, there will likely be an increase in domestic tertiary enrolments. Conversely, there will likely be a reduction in international students (although there may be a 'safe country' substitution effect in New Zealand). If distance learning becomes the standard for international tertiary education, New Zealand universities may struggle to compete longer term with the superior branding of well-known international institutions.

Capital flows

There have been big swings in exchange rates and asset values during the crisis, but cross-border capital movements have continued unabated. The highly digitised finance sector, assisted by new fintech developments, has so far suffered little disruption from economy lockdowns.

The challenge ahead for the sector is to continue financing stressed businesses and

home mortgages, as non-performing loans increase and job loss widens. Following the global financial crisis, Western bank balance sheets have built resiliency with higher capital adequacy, tightened regulation and less risk from contagious financial instruments. A major industry failure (e.g. in the oil or airline industries) might be large enough to stress the financial system, but currently there is little sign of a GFC-type meltdown.

The insurance industry is suffering some stress from business disruption coverage, contract works insurance claims, travel insurance claims and other Covid-related risks. The reinsurance market appears closed to new pandemic insurance policies. The industry may not suffer major failures itself, but the inability to provide ongoing insurance coverage could stymie new business initiatives and construction developments. With its small market and seismic risks, New Zealand may struggle to attract competitive insurance quotes.

Overall impacts

Hidden beneath the stimulus programmes and funding mechanisms are some big socio-economic questions. The burden of the Covid-19 disruption, the economic costs of slow growth and the fiscal costs of government response programmes will fall unevenly. Young jobseekers, employees in affected sectors, shareholders, savers, homeowners, retirees and taxpayers are all affected in different ways. The length of lockdown restriction has become a political issue dividing the elderly, who face health risks, and the young who face job risks.

A major decision for governments will be how much of the cost should be borne by future taxpayers as they seek to reduce

long-term debt burdens. Countries are trying to avoid austerity approaches after the global financial crisis experience, but it is possible mounting public debt may leave them with little alternative. The New Zealand Budget envisages growth-led debt reduction, but this is unconvincing with public debt forecast to increase for eight years and then only slowly decline. Once the immediate health risks subside, Covid-19 could stress political systems and result in social dissension over who should pay. This comes at a time when intergenerational equity is already under severe pressure in the context of climate change.

Internationally, there are already arguments about Covid-19 cost burden-sharing among countries, so far led by US-China tensions. In time, arguments like this will likely raise developed country/developing country tensions (and in the case of New Zealand this may involve Pacific Islands relationships).

This has been a very unusual global crisis. We are still learning about its effects. But it is clear that some parts of economies have been heavily impacted, and many business, travel and governmental practices may change their modes of operation forever. Returning to the title of this article, Covid-19 does not spell the end of globalisation and neither does it portend a period of autarky, but it certainly challenges the way all our economies will interact in the future.

1 With apologies to Gabriel García Márquez.

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