The economic cost of the pandemic. How much so far and how much more?

By Vicky Pryce, Visiting Professor at Birmingham City University and board member of the Centre for Economics and Business Research and [David Bailey], senior fellow at The UK in a Changing Europe, Professor of Business Economics at Birmingham Business School, and Visiting Professor at the Centre for Brexit Studies.

There has been considerable analysis of the measures put in place to deal with the pandemic. The human and economic costs for most countries have hugely surpassed early forecasts. And even those countries that started lockdowns early have had to inject massive amounts of liquidity into the markets and borrow at levels not seen since the Second World War, backed by what was effectively the 'printing' of money by the central banks, otherwise known as Quantitative Easing (QE). The estimates are that by the end of 2020 the world had already spent some $11US trillion dealing with the impact of the pandemic.

According to a report by the World Economic Forum last autumn, if there had been proper investment to prepare for this pandemic (as indeed there must be from here on), then the overall cost could have been kept to just $39US billion.[i] That actual spend of course will increase further – according to the same report – by a further $10 UStr as a new wave of infections has hit the UK and many other parts of the world with greater intensity than before, necessitating new measures to constrain the spread of the disease.

Where has the money been spent?

A lot of this extra borrowing has been directed to health services – with some of the money allocated by national governments but also with additional support for individual countries from regional and multilateral organisations like the EU, the World Bank and the IMF. Developing countries in particular have been able to access emergency debt relief and loans, often without usual extra conditions being imposed.

But such extra spending has not only been spent on health. Considerable sums of money have been allocated to providing direct stimulus for the economies to ease the burden of lockdowns on businesses, workers and consumers which would otherwise have meant a catastrophic fall in incomes and wealth. Indeed the international institutions are encouraging countries to continue with stimulus measures and not withdraw them too soon.

Why it is so different this time?

Since the middle of the last century recessions had tended to be caused by credit crunches and sharp rises in interest rates following borrowing excesses in preceding years. Think of regulatory failures as in the financial crisis of 2008/9, or supply shocks as in the various oil crises of the 1970s. This time the economic fallout has been the direct result of measures taken by the authorities to pretty much 'slam the brakes on' and close down both supply and demand in their economies, at least for a while, to deal with a health crisis.[ii]

The impact has been as significant as it has been unpredictable. In many countries, like in the UK, while just half of the economy has continued to operate, there have been some parts of the economy that have in fact expanded – such as IT services which have been in great demand as people started working from home, health and of course the public sector which has had to expand to deal with the pressures of the pandemic.

There have been some real winners – think of digital platforms like *Amazon* and *ebay,* supermarket deliveries, distribution, FinTec and so on. Manufacturing and construction took an immediate hit but have been in positive territory since they were allowed to reopen in June. But there have also been some real losers – transport, retail generally (except online), hospitality, the creative sector and leisure and tourism amongst them.

The UK takes a big hit

The UK has been particularly badly hit in both health and economic terms.[iii] With services making up up some 80% of GDP and with many service sectors particularly badly affected as face to face contact had to be restricted, this has required a massive mobilisation of support on a scale. In year one of the pandemic has far exceeded the fiscal response to the financial crisis of 2008/9. The sharp fall in the economy in the second quarter of 2020, after a modest decline in the first, was thought at the time by the likes of the Bank of England to have been the nadir of what it was hoped would be a V-shaped recovery, with things returning to normal pretty quickly. This hasn't happened, as many of us warned. Yes there was a sharp rebound in the summer months with a 15.8% rise in Quarter 3 – in itself a record. But by September this recovery was already fizzling out and by November 2020 the economy was once again registering monthly falls due to new lockdowns which have been in place more or less continuously since.

This looks therefore more like the W-shaped recovery some of us warned about after all. Overall, GDP is likely to have fallen by some 11% in 2020 and the economy at end-year remained around 8-9% below pre-Covid levels. Although some recovery is expected after a likely further decline in GDP in the first quarter of this year, the prospect of continued restrictions of some sort despite widespread vaccination programmes suggests that growth may not be much more than 5-6% overall in 2021. This means that we won't get back to where we were at end of 2019 before, at best, the middle and more likely the end of 2022. There is a long road to recovery ahead.

The fiscal cost

On the fiscal side this has meant that government finances in the autumn were showing sharp deteriorations with deep cuts year-on-year in VAT receipts, partly reflecting a cut in the rate from 20% to 5% for the hospitality and tourism sectors, reduced receipts from corporation tax, income tax, fuel duty and airport tax, as well as lower stamp duty receipts as a result of the temporary abolition of stamp duty for houses costing below £500,000.

Higher welfare payments as output and jobs contracted also then resulted in spending being markedly higher. As a result of the sharp contraction in the economy , those 'automatic fiscal stabilisers' in the UK are likely to have accounted for nearly £100b of what may end up being total borrowing of just under £400b for the financial year as a whole, ending in early April according to the Office for Budget Responsibility (OBR) estimate in late November[iv].

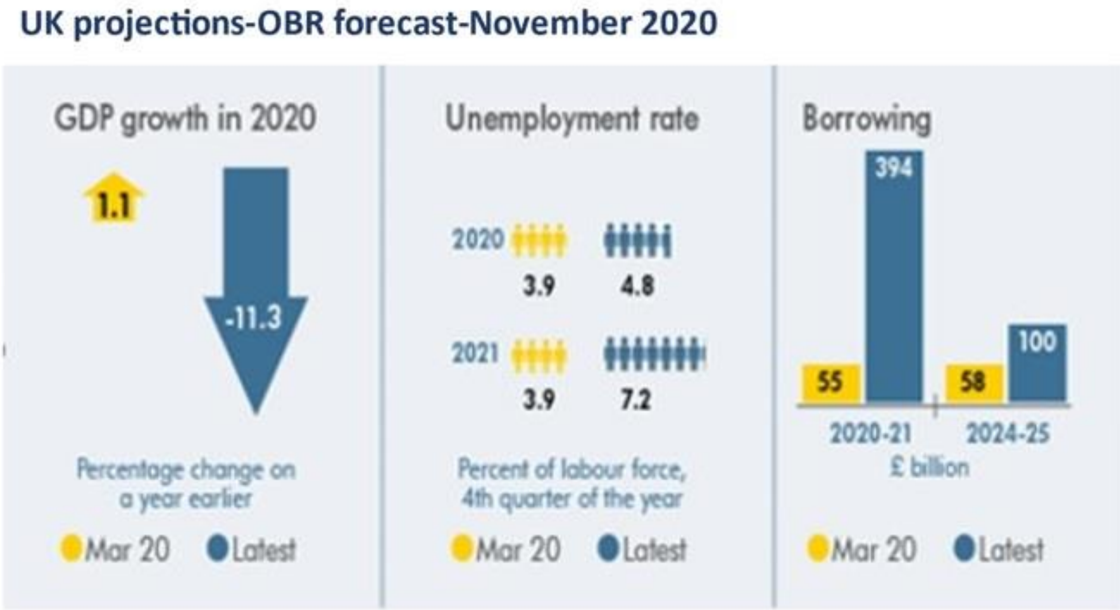
But there have also been direct stimulus measures such as tax breaks, business rate holidays, government backed Coronavirus Business Interruption Loans (CIBLs)[v]and Bounce Back loans (BBLs)[vi] for UK based SMEs with a turnover of up to £45m, as well as a loans scheme for larger enterprises. [vii] This has been alongside direct employment and income support as well as grants for small firms in retail that had to close. We have also seen extra targeted support to sectors that had have particularly suffered such as the creative industries, sport and charities which have been particularly badly hit, as well as a temporary increase in Universal Credit (this is due to end but at the time of writing there is mounting pressure to extend this support). Gaps remain, especially in terms of support actually managing to reach small firms that need it.[viii]

Furlough costs

More significantly in terms of the public purse is the cost of the furlough scheme introduced by the UK alongside many other countries in Europe and also Australia and New Zealand. This supports employers to keep workers on their books with the government paying at the start 80% of pay up to a limit of £2,500 if they didn’t work due to closures or lack of demand. Some 9.5m employees were supported in this way during the first lockdown and some 2.5m self-employed got extra help. Attempts to reduce the rate and make businesses pay more of a share were quickly abandoned in early autumn when the economic situation deteriorated again and the original terms were re-introduced in November and now extended to end April 2021 – and will likely be extended again. The cost this financial year is estimated at just under £90b.

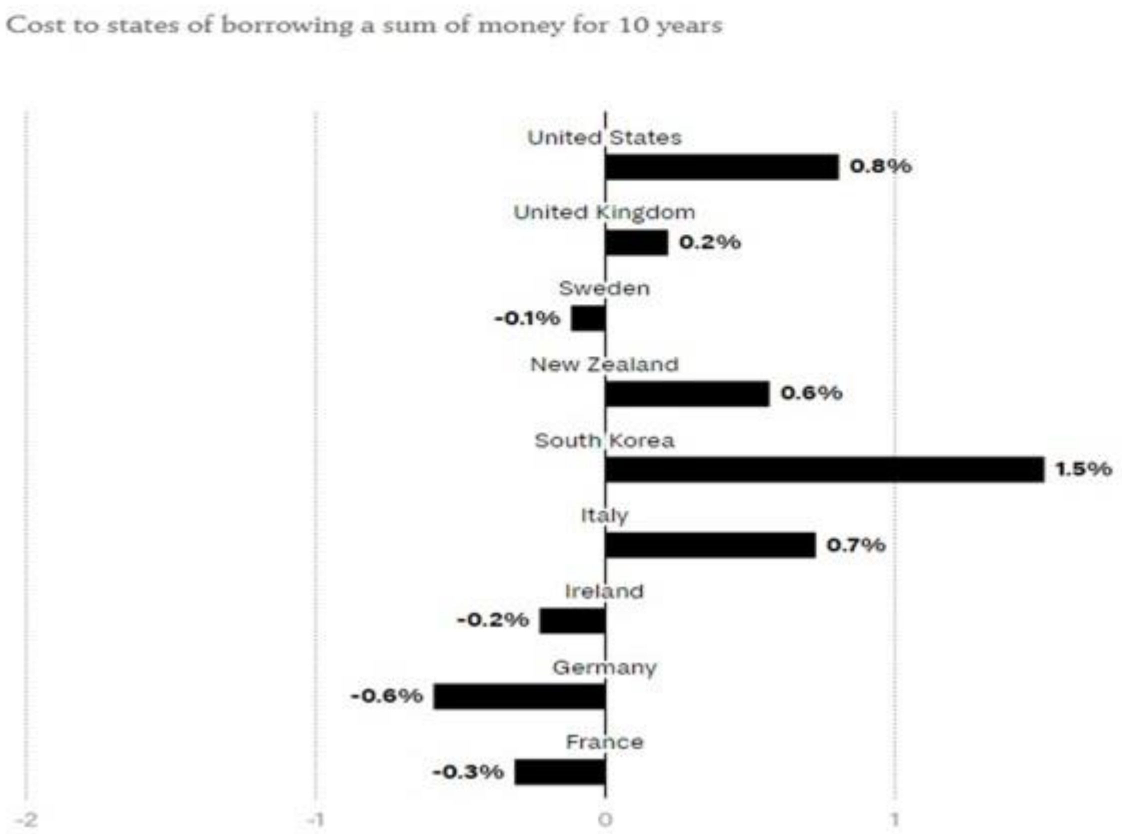
How much worse will it get?

There are undoubtedly clear gaps in the support offered so far with many disadvantaged groups complaining, in the main correctly, that they have been left out. The type of unusual recession we have been experiencing in the UK has left the young, the recent entrepreneurs, women and all whose work tasks cannot easily be done from work disproportionately shouldering job losses. Unemployment has risen from 3.9% to 5% but this is flattered by the still large number of people on furlough – probably around some 4m. The underlying rate is more like 6.5% and could rise further at the end of furlough. Government finances will not therefore improve in a hurry despite the supposed £100b saved by individuals during the pandemic which is waiting to be spent as the Chief Economist of the Bank of England, Andy Haldane has been arguing[ix]. With the economy therefore recovering but not exactly bouncing back, the deficit to GDP ratio won't fall as fast as hoped from the likely 20% it will reach this year. And there will need to be more borrowing every year until the end of the current parliament with the OBR estimating that we will still be borrowing some £100b to plug the gap between revenue and spending in 2024-25. And the debt to GDP ratio will rise further from just under 100% of GDP to a peak of 110%.



What next?

UK and others all able to borrow cheaply ***Source: Bloomberg, Tortoise***



The markets are happy to finance increasing debt levels at present, with interest rates across the world at record lows as the chart above indicates. At times countries, even heavily indebted ones, have been able to borrow at negative rates at year end 2020. The willingness of central banks to step in and support by buying government bonds in the secondary market has been particularly helpful. That may of course not last. The sums have been huge and at some point the markets may take fright. But we are not at that point now.

So far so good. But how the money has been spent and on whom has come under increasing scrutiny. Yes, some larger firms that did well, such as supermarkets that have seen sharp rises in turnover and profits so they have returned the business rates relief and repaid furlough money. But there have been concerns that some of the furlough money or borrowings through the guaranteed loan schemes may have been fraudulently claimed and /or misused. A report in December suggested that the taxpayer may be due to cover losses through fraudulent use of some £26b from the *Bounceback* loan scheme alone, in addition to the likely losses if some companies do not survive. [i]

A range of issues are making the news relating to £10b extra paid for PPE because of ill preparedness by the government according to the National Audit Office[ii], botched PPE purchases, some £150m wasted on out of date masks[iii], a track and trace app that was abandoned after costing £15b, and contracts of some £10b being awarded without proper competition to friends of politicians. In a crisis mistakes can and will be made, and can also most of the time be excused. But as the spending continues with the crisis being prolonged and restrictions still biting, worries about the lack of proper scrutiny during the early part of the crisis and since are now rising up the political and economic agenda.

A Race, but not between Health and Wealth

The government has said that we are now in a 'race' to vaccinate as quickly as possible against a virus that is mutating into more dangerous forms. How successful we are in this race will determine whether we will be able to soon live with Covid in society and reopen the economy and lead (fairly) normal lives, as against extended lock downs and a much greater economic hit to GDP and the government finances. There is not a simple health-economy trade-off as some suggest. Rather, getting the virus under control is key not only to public health but also to restoring economic growth and public finances.

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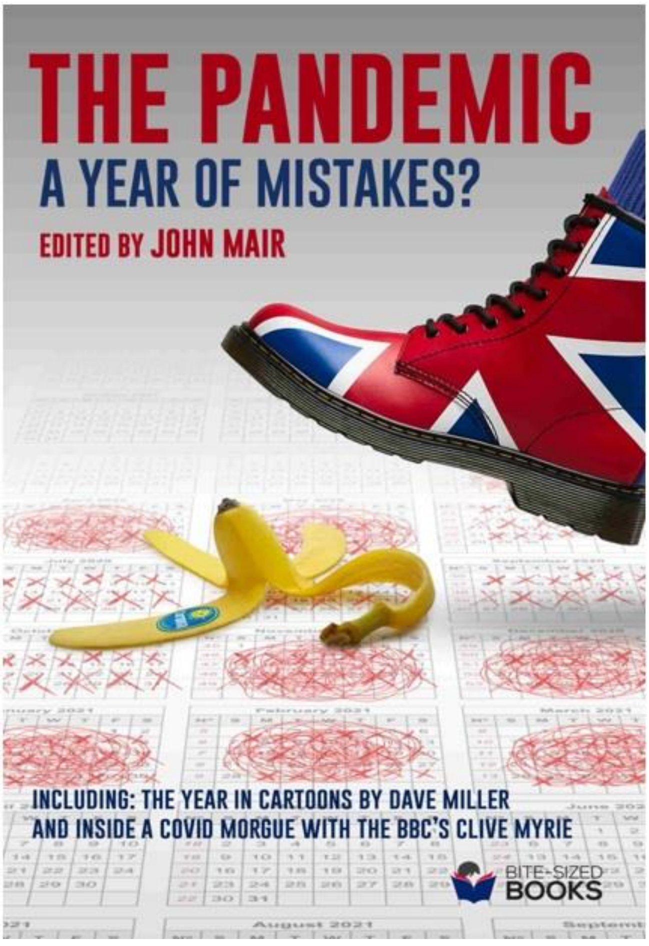
This Long Read draws on and develops a chapter by the authors in the new volume 'The Pandemic. A Year of Mistakes' edited by John Mair and available from Bite-Size Books.



Vicky Pryce is a leading economist & business consultant, a board member at the Centre for Economic and Business Research, and former Joint Head of the UK Government Economic Service. She is also a Visiting Professor at the Centre for Brexit Studies.

David Bailey works at the Birmingham Business School and is a Senior Fellow at the ESRC's UK in a Changing Europe programme. He is also a Visiting Professor at the Centre for Brexit Studies.