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VAKHTANG CHARAIA

# 136

EXPERT OPINION





საქართველოს სტრატეგიისა და საერთაშორისო ურთიერთობათა კვლევის ფონდი  
GEORGIAN FOUNDATION FOR STRATEGIC AND INTERNATIONAL STUDIES

## **EXPERT OPINION**

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The contemporary world is facing the dangers posed by the global spread of the new COVID-19 which has created a qualitatively new set of problems for the economy. The global crisis has caused many difficulties for Georgia and its economy which require a proper understanding and appropriate targeted actions.

Although the outbreak of the severe acute respiratory syndrome (SARS) in 2003 was more life-threatening, the new strain of the coronavirus proved to be a much more contagious disease. As a result, the head of the World Health Organization described the spread of COVID-19 as a pandemic.<sup>1</sup>

The problem was exacerbated by the fact that the governments of all countries where the coronavirus is widespread did not fully understand the complexity of the task at hand. Nor is it inconceivable that the governments of these countries deliberately concealed the existing situation until such time as it was impossible to cover up the situation; that is, until the scale of the outbreak of the coronavirus became very large. China<sup>2</sup> and Iran<sup>3</sup> were particularly prominent in this regard.

Unfortunately, the position of the United States Secretary of Health and Human Services, which believes that the creation and dissemination of the coronavirus vaccine should be the prerogative of the private sector and not the government,<sup>4</sup> has to be considered as erroneous. Such an approach is fundamentally false, given the fact that we are dealing with a pandemic which is impossible to tackle without active government action.<sup>5</sup>

Although the coronavirus is primarily a medical problem, at this point it already has a markedly negative impact on the economy of more than 190 countries around the world. Therefore, it is evident that the world is in danger of a new economic crisis.<sup>6</sup>

Up until now, economists have typically studied the impact of the economic crises on the general healthcare system,<sup>7</sup> the mental health<sup>8</sup> of the population and communicable disease transmission.<sup>9</sup>

The current situation in the world has inverted the perspective, showing us that the coronavirus and its global spread are already causing a widespread economic crisis<sup>10</sup> and that the coronavirus will virtually be transformed into an “economic pandemic.”<sup>11</sup>

The creation of a new term, “Coronomics,” by Prof. Ajith de Alwis, is commendable in order to focus on the problem of the impact of the

spread of the coronavirus on the economy. The term is a combination of two words, “corona” and “economics,” and the subject of its study is the negative economic effects of the coronavirus.<sup>12</sup> Later, another similar term appeared – “Corononomics.”<sup>13</sup>

The relevance of Coronomics is not only conditioned by the fact that the coronavirus pandemic has already been declared but also that such global threats are likely not an impossibility in the future as well and the world must learn to live and engage in economic activities under such conditions.<sup>14</sup>

It is necessary to realize that the world is not facing a classical type but, rather, a qualitatively new global economic crisis. Its causes are not endogenous but instead exogenous; that is, these causes are not generated within the economy but are provoked by the rapid spread of a source outside of the economy – the coronavirus. Given this factor, in contrast to the classical economic crisis, both separate countries and the whole world are at risk of, according to the new term, a “Coronomic crisis.”

The fact is that until now neither the future of overcoming the coronavirus nor the effectiveness of the efforts to limit its spread are clear; thus, at this stage, making more or less clear economic predictions about the possible behavior of economic agents is very difficult.<sup>15</sup>

For economists to recognize an economic crisis, an economic recession must take place at least for the duration of two quarters. Whether or not an economic crisis develops in the context of Coronomics depends on how long the pandemic lasts; that is, how long it will take for medics, biologists and pharmacists to overcome the disease. In other words, today the economy is a hostage to medicine.

The economic hardship has already had a negative impact on China and some European countries.<sup>16</sup> In times when a number of companies in the world’s second-largest economy, China, were shut down and when countries of the European (EU) Union with developed economies faced similar difficulties, it is safe to say that the world is actually facing threat of a “Coronomic crisis.”<sup>17</sup>

It is noteworthy that the instruments economists discuss most widely to use are mainly related to the experience of the global financial and economic crisis of 2008-2009.<sup>18</sup> However, it is important to remember that the source of that global crisis was directly within the economy while the

Coronomic crisis is directly linked to the success of medicine in defeating the coronavirus. Notably, the search for similarities between these two crises should be considered as a mistake.<sup>19</sup>

One of the first things that the coronavirus has damaged in the economy is the tourism sector. Passenger air carriers were also hurt. The decline in stock markets has had a direct impact on the real sector of the economy. Based on the experience of the 2008-2009 global financial and economic crisis, economists are in possession of various tools, such as tax exemptions or the reduction of the payroll and value-added tax rates, and also the reduction of interest rates by central banks (fresh rate cuts) and liquidity provisions alongside the government's strengthening of social protection for the poorest part of the population. Of course, in addition to these measures, increasing government funding for healthcare is clearly a priority. The extent to which these measures will be successful in the times of the Coronomic crisis will largely depend on the time it takes for medicine to develop, manufacture and disseminate a coronavirus treatment drug as well as an appropriate vaccine.

It is noteworthy that the measures listed will ultimately lead to an increase in the budget deficit and this, most likely, will be a major post-crisis problem for all of the countries affected by the pandemic. Therefore, it is important to distinguish between the types of measures to be taken during the Coronomic crisis and the post-crisis period.

The fact that the economy almost stopped in China and in many European countries has had a direct impact not only on the decline in demand but also, primarily, on the decline in supply.<sup>20</sup>

A greater decline in supply as compared to that of demand will directly result in the increase of inflation. The only way to restrain it through the instruments available to central banks is to raise interest rates. Again, this, in turn, will have a negative impact on supply and economic growth.

For those central banks which are in the inflation targeting regime, restraining the inflation caused by the declining supply, as is well known, is impossible without stalling economic growth.<sup>21</sup> The Coronomic crisis, in our opinion, will give economists another reason to argue why the inflation targeting regime is not working particularly in import-dependent countries.<sup>22</sup>

The spread of the coronavirus has given rise to ideas that oppose free trade although it is clear that precisely in times of pandemics those countries that oppose globalization will suffer more.<sup>23</sup> Given the fact that the pandemic is a global phenomenon and the Coronomic crisis is a threat to the whole world, isolationism and de-globalization are obviously a disastrous way for the world economy. On the contrary, in the post-crisis period it is necessary to diversify value chains and supply chains which should reduce potential risks.<sup>24</sup>

Therefore, special attention should be given to the de-concentration of the large companies based in China which will help to reduce the risks associated with global threats in the future.

In times of the Coronomic crisis, it has become clear that large companies may find it particularly attractive to move their factories from China to those countries which already have free trade with China.

In this regard, in term of the EU, countries which have free trade both with the EU and China are noteworthy (e.g., Iceland, Georgia, Switzerland, etc.). However, Georgia, which is geographically between the EU and China and is located in the transport corridor connecting Europe and Asia, deserves special attention. The US interest in having a free trade agreement with Georgia should also be taken into consideration.<sup>25</sup> Using Georgia as a regional economic hub can be considered as one of the strategic directions of the post-crisis development.

The challenges of the Coronomic crisis have penetrated both locally and internationally and transcended the boundaries of economic pragmatism. More and more countries are introducing a state of emergency and the nationalization of some companies (railways, hospitals, etc.) is being considered.<sup>26</sup> Most likely, there will not be the necessity to use such a mechanism in Georgia; however, in an emergency situation, the government is allowed to use certain facilities for the purpose of realizing the objectives arising from the fight against the epidemic.

One of the pragmatic solutions during a standard crisis with underlying economic foundations is to stimulate the economy which is often realized through the financing of infrastructure projects. However, it is unclear whether this approach will work in the time of the Coronomic crisis. In particular, in the standard case, infrastructure funding, in turn, creates additional jobs. Extra jobs generate new revenues for specific families.

Extra income is a source of bearing additional costs and with more income, cost structure is more diverse; mainly, this begins with the realization of basic needs and gradually moves into the entertainment and leisure industry, transport, communications, technology acquisition, better living conditions or lifestyle in general, and so on.

It is noteworthy that in the light of the Coronomic crisis laden with uncertainty, it is difficult to argue that government economic stimulation may lead to economic recovery. With the high probability, in the current situation, people will still be focused on hoarding essential supplies, food and medicine which for its part in Georgia's case is characterized by high levels of imports, leaving the country in the same vicious circle. At best, this measure can be used in the post-crisis period.

In the current situation, the support of the local production looks quite promising and especially appealing is the manufacturing of those products which substitute import even if it is in the context of producing medical antiseptics, masks or essential foodstuffs. Unfortunately, it should be noted that this is not as simple as it may seem at first glance and, above all, it depends on the duration of the crisis.

The fight against the virus may come to an end in the next one, two or even three months but setting up an enterprise and receiving the first products within this timeframe is, in the most cases, not likely possible. Afterwards, the stability of the market is important. It may be possible to produce additional products at current prices in response to the increased demand but after overcoming the crisis, it is doubtful if the local market will need this product and also whether it will be able to compete with the imported product. A separate issue is whether the country will need this manufacturing in the post-crisis period after the world returns to its usual, or close to it, rhythm of life.

This does not mean that local manufacturing has no future. It is just about showing moderation and pragmatism, maximizing the diversification of the sectors and trying to properly comprehend the problems. For example, at this stage it would be advisable to organize and conduct the spring agricultural work in a high-quality fashion. For that purpose, first of all, it is necessary to provide villages with seed materials. In this area, the country will have positive results shortly while in the areas of a relatively long-term impact, it is necessary to consider the relevant risk contingencies.

The temporary “suspension” of the Chinese economy and the cessation of flights by passenger airlines have reduced the demand for oil which has led to a decline in world oil prices. By contrast, individual oil-producing countries are trying to utilize the uncertainties caused by the Coronomic crisis and rearrange the world market. The fact is that the aggregate demand for this product has decreased and the supply is increasing which, according to market principles, is reducing its price. By the second half of March 2020, the world price for Brent crude oil fell more than twice in comparison with early March and amounted to USD 27 which for many oil-producing countries is less than the cost of production and, more importantly, poses a problem to a fiscal and balance of payments structure.<sup>27</sup> Meanwhile, Saudi Arabia plans to increase production gradually, first to ten million barrels and then 13 million barrels by the beginning of April.<sup>28</sup>

According to one notable study, today’s supply may exceed the daily global market demand (approximately 100 million barrels) by 20 million barrels.<sup>29</sup> Goldman Sachs is relatively mild in its forecast but also follows the same train of thought which estimates excess to reach around 3.9-5.7 million barrels per day.<sup>30</sup> Bearing in mind the world-wide oil savings deposits which amount to approximately 1 billion barrels, their replenishment in the case of the first scenario will take about three months while for the second scenario – 6 months.

After a drop in oil prices, it did not take too long for the US’s decision to replenish its stockpiles<sup>31</sup> which would probably not take more than ten weeks.<sup>32</sup> According to these scenarios, oil prices may go below zero after the expiration date; in other words, oil exporters will have to pay extra to importers in order to remove the produced oil reserves from their oil-wells.<sup>33</sup> As surprising as it may be, similar cases have already been reported in the energy sector of various countries.<sup>34</sup>

It is difficult to predict how long the “oil price war” of 2020 will last and, hence, whether or not it will reach a negative benchmark as it may transcend the point of directly being an oil trade issue and become a precondition for geopolitical and even military actions among different countries. However, Saudi Arabia does not fear the unfolding events. The state-owned oil company, Saudi Aramco, had already received a directive to extract an additional 300,000 barrels from reserves and 250,000 barrels from the local market and export it to the world market with an additional USD 10.25 discount (less than USD 20 of the overall price). Saudi Arabia itself will compensate the local market with natural gas.

Falling world oil prices will have an ambiguous impact on oil-importing countries, including Georgia. Due to its close trade and economic relations with Azerbaijan and Russia, the currencies of these countries are expected to depreciate which will directly affect GEL as well. Moreover, as a result of the fall in international prices for oil products, in the context of the current Coronomic crisis, the remittances from these countries to Georgia will be reduced.

Remittances will also be reduced from other countries as well since our countrymen will have less money to send to their families and relatives in the events of a “paused” economy.

In a time of the Coronomic crisis, virtually every country will lose the purchasing power of its population which will negatively impact the export of Georgian products. For the same reason, foreign direct investment will decline which will hinder the country’s economic growth.

All of this will lead to a further devaluation of GEL. In this regard, it is important to prevent the drastic surge in the depreciation of GEL. For this purpose, the National Bank of Georgia will need to use all of the instruments at its disposal, including the use of foreign exchange reserves to ensure a gradual depreciation of GEL without radical leaps.

It is noteworthy that the decrease in oil prices, *ceteris paribus*, will reduce the revenues received in the national budget from the value added tax and excise tax levied from oil products. The expectation of a decline in the price level for oil products may not be realized at all as oil importers and/or distribution/retail companies might not refuse to accept increased profit margins, especially at the initial stage.

It is important for the Government of Georgia to bear in mind that the key task during the Coronomic crisis is to overcome the epidemic while minimizing the damage to the national economy. As for the post-crisis period, it requires a special program to stimulate economic revival which will have to be done separately.

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