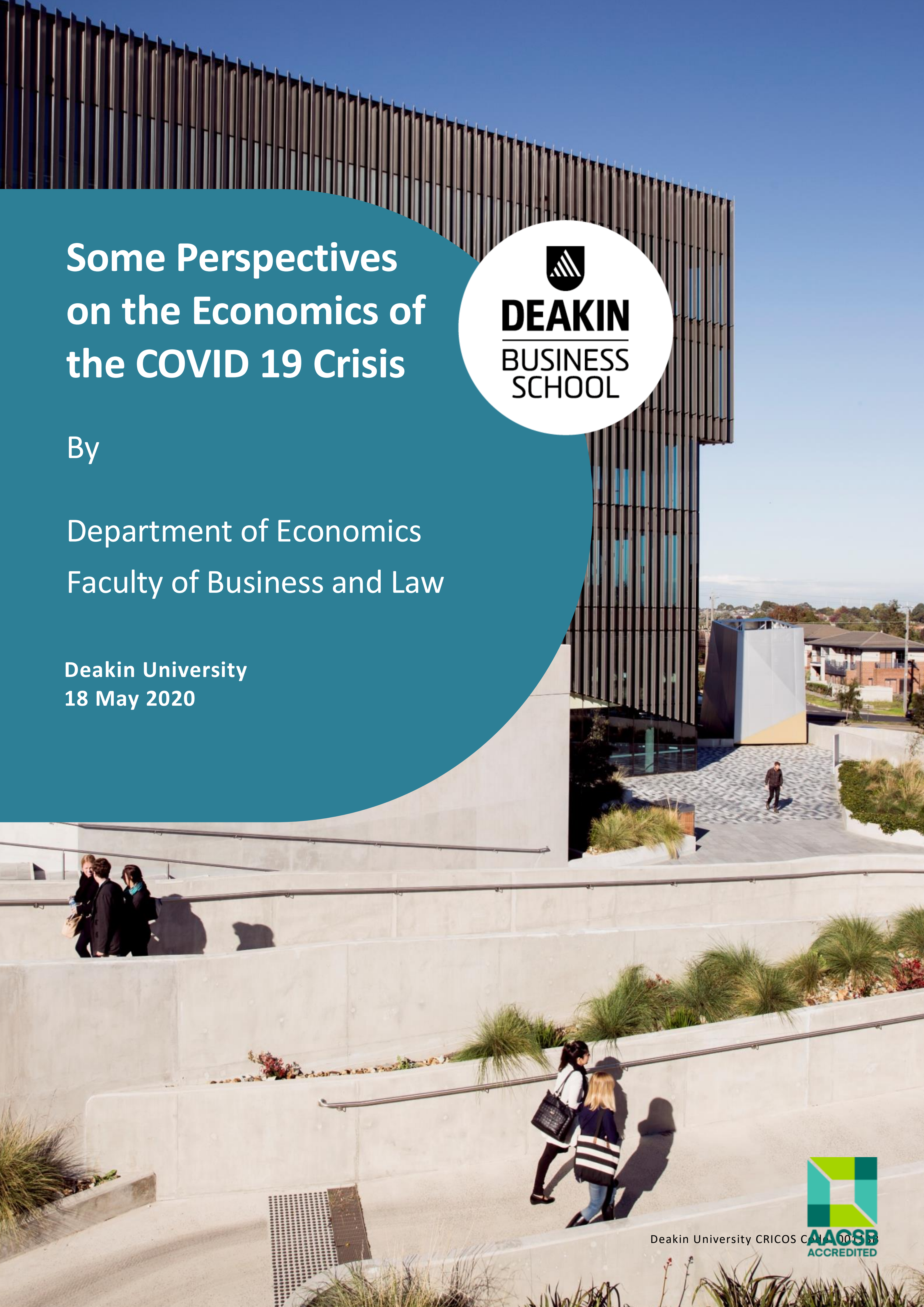

Some Perspectives on the Economics of the COVID 19 Crisis

By

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The following document brings together the expert views in several specific areas of economics collated from the academic staff of the Department of Economics at Deakin University in regards to the potential consequences of the COVID 19 crisis in their immediate areas of expertise. As the list of these expert views reflects, the interests of our Economics staff at Deakin cover a wide array of topics and we have the capacity and capability of training our current and future students up to the highest standards in all of these areas. Should you need additional information regarding the courses offered by our department or have some general inquiry about our department please do not hesitate to contact us as we provide contact details below:

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COVID-19, Government Interventions, and Income Inequality in Australia

Without any government intervention, COVID-19 would have drastically increased income inequality in Australia.

An ABS Business Survey suggests that during the period 16-23 March 2020, the top-five sectors that were adversely affected by COVID-19 were, accommodation and food services; arts and recreation; wholesale trade; retail trade; and health care and social assistance. More than 70% of the businesses in these sectors reported they have been adversely affected.

These top five badly-hit sectors comprise 42% of low-income earners in a representative sample in Australia. That is, at least 42% of the low-income earners would report even lower earnings due to COVID-19.

Only 19.5% of high-income earners are represented in the top-five badly hit sectors, while for middle income earners, this rate is 28.5%.

The ABS Business Survey also reports that the three sectors least affected were professional, science and technical services; electricity, gas and water supply; and mining (ranging 21% to 37% of the businesses).

In a representative sample, 15.6% of high-income earners work in these least-hit sectors, while this rate is 8.3% for middle-income and 4.8% for low-income earners.

All these suggest that the government interventions through the JobSeeker, JobKeeper, small business, and youth allowance schemes are likely to reduce the potential widening of incomes in Australia.

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Covid 19 Crisis and International Trade

Covid 19 is a world-wide contagious virus that all countries should be trying to eradicate to protect the health of their populations and reduce the loss of life. To ensure that future pandemics are not as severe, global cooperation in the areas of public health will be crucial. As economists, our concern should also be for the world-wide economic suffering caused by the virus.

According to the World Trade Organisation (WTO), world merchandise trade will fall between 13-32% in 2020 and a recovery is expected in 2021 depending on the duration of the covid-19 outburst, discovery of a vaccine or treatment and the effectiveness of the policy response from governments. The impact on world trade will be more severe than the GFC of 2008/09 due to the spread of the virus amongst the 10 largest economies in the world (including the G7, Canada, France, Germany, Italy, Japan, UK, USA, and China). Exports from North America and Asia will be the hardest hit while services trade like tourism and educational services will be more directly affected by transport and travel restrictions, especially international travel.

Australia is a small open economy where international trade has always been and will continue to be important to our standard of living, economic growth and welfare. We rely on overseas markets to purchase our products as well as supply us with both goods for consumption as well as inputs that we need for our own production processes. We also rely on overseas countries to provide us with a continuous supply of skilled and younger workers to counteract our aging population and low birth rate.

Currently Australia’s top 5 exports are iron ore, coal, natural gas, education related travel services and personal travel services. The top 5 countries that purchase these exports are China, Japan, South Korea, UK and USA. While our top 5 imports are machinery, mineral fuels, vehicles, electronic machinery and equipment and medical/technical equipment. The countries that supply these goods to Australia are China, USA, Japan, Germany and Thailand. Since the virus has caused both a supply shock (exports will fall) and a demand shock (imports will fall), there will inevitably be a reduction in trade flows between countries. So the severity of the virus and the recovery phase policy response in these countries is very important in determining the impact on the Australian trade performance. Just as important are the relationships and policy positions on trade between our trading partners. For example, a continuation of the trade war between China and the USA would be counterproductive for both world and Australia trade.

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Covid-19 Pandemic, Businesses and Workers

The COVID-19 pandemic has caused a tragic loss of life. Unfortunately, government responses have created enormous social and economic losses. Large portions of the national and international economy are closed. While many workers can work from home, millions have lost their jobs. Following years of stagnant wages, many workers now face the prospect of wage cuts and reduced hours of work. Careers have been permanently disrupted. Uncertainty over their incomes and careers weakens workers' bargaining power, thereby further widening income inequality.

In many jurisdictions the use of emergency powers has led to government overreach; this has increased uncertainty and raised the cost of doing business. The damage done to workers and businesses will take a long time to reverse. Moreover, government responses to the feared second wave and an even larger pandemic in the future cast a long shadow over the horizon.

Nevertheless, in disaster there is always opportunity. Some existing businesses will prosper and newer businesses will emerge. In business as in medicine, people are resilient, resourceful, and innovative. There is light at the end of this long dark tunnel.

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Covid 19 Crisis and Monetary/Fiscal Policy

In response to COVID-19, countries have imposed stay at home orders, social distancing and other measures aimed at preventing the spread of the virus. These actions had many businesses closing, increasing the number of unemployed. Unlike past downturns, this recession is the result of intentional health policy measures to respond to a pandemic. Given the scale and abruptness of these measures, the recession is likely to be very pronounced. As a result, treasuries around the world have introduced employment retention schemes, tax breaks and other subsidies to sustain companies through a collapse in demand for their products and services and to alleviate unemployment. At the same time, central banks have cut rates, purchased assets, created lending programs, and modified financial regulations to support financial markets and minimize long-run economic damage.

Within the Australian context, treasury has introduced various programs such as additional income support for individuals and households, temporary relief for financially distressed businesses and the “Jobkeeper” payment, to name a few. In conjunction, the Reserve Bank of Australia (RBA) has used a mix of tested and untested monetary policies. Among conventional actions, it has lowered the Cash Rate target to 0.25 per cent for the foreseeable future. The RBA has also implemented a new set of policies that other central banks enacted during the Global Financial Crisis. These various measures are intended to reduce uncertainty, and ensure that businesses and households can adapt to the abrupt and sharp decline in economic activity due to COVID-19.

This pandemic, once again, highlights the importance of coordinating monetary and fiscal policy responses to soften the impact of large-scale, negative shocks.

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Mental Health Impacts of the COVID-19 Pandemic

Many labelled the COVID-19 the most challenging crisis the world has faced since the World War II, as its multidimensional impacts have been at a global scale threatening people's lives in almost every country. As of 17 May 2020, the number of infections has now reached to 4.7 millions approximately with a death toll of over 300,000. Beyond the obvious health impacts of the COVID 19 crisis in terms of mortality figures, the virus has caused an enormous economic downturn globally due to the public health response measures taken by governments around the world. As a result, large parts of the national and international economy are closed with complete shut downs of domestic and international travels in most countries. While some workers (mainly "white collar") are able to continue to work from home during the self-isolation and quarantine measures introduced by governments in order to minimise the spread of the virus, many workers (mostly "blue collar" doing manual work) lost their jobs simply due to the fact that their workplaces were shut down such as restaurants, entertainment venues, and pubs and clubs. The number of people who lost their jobs, for example, amounted to millions in the context of the US and hundred thousand in Australia.

As all of these changes are taking place, one area we should pay particular attention is the undoubted consequences of these changes for mental health and psychological well-being in both the short and long run. Combined with the economic consequences such as unemployment, the virus itself due to its social implications such as self-isolation appears to cause substantial increases in anxiety and depression, substance use, loneliness, domestic violence, and an epidemic of child abuse. Hence, issues of service access and continuity for people with developing or existing mental health conditions are now a major concern along with the mental health and well-being of frontline workers even in the most developed countries facing the COVID 19 crisis due to the fact that mental health services lack enough resources.

The COVID 19 crisis on the positive side however provides a unique opportunity to identify our weaknesses in terms of provision and delivery of health care services regarding mental health and psychological well-being and being better prepared for similar future threats to our societies around the world. Hence, let's recognise the reality of global pandemics even in our era and be resilient to recover from their consequences by implementing the steps needed to mitigate them and by taking the necessary lessons for our future generations to come.

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Covid 19 Crisis in Developing Countries

Developing countries started lockdown almost at the same time as in developed countries but failed to implement adequately due to social norms, political reasons, and high population density. Therefore, economic activities in these countries have stalled but health risks remained high. Crippling healthcare service in developing countries cannot cope with the enormous health risks brought about by the pandemic. To stimulate economic activities in sectors that generate more employment and export revenue, developing countries might opt for reducing already low health expenditure during the crisis. Many basic healthcare services also depends on aid from donor countries. Unprecedented economic slowdown in developed countries that is also expected to persist for quite a long time would affect aid flows to developing countries in the short- and medium-run. These might exacerbate their already poor health conditions that have negative consequences for long-run economic growth. Economic impact of the Covid-19 shock might be more severe in developing than developed countries since the former lack sectoral diversification that acts as a shock-absorber during a crisis. For example, garment sector consists of more than 40% of total exports in Bangladesh, which is the second largest garment exporter in the world. Cancellation of contracts from developed countries including Australia have resulted in huge unemployment in this sector and the most affected cohort is the young female who are also the most socially vulnerable group. Thus, the Covid-19 shock may also have differential impacts across gender, religious minority and ethnic groups in developing countries. Developed countries are also heavily connected to developing countries through the global supply chain; therefore, they are not immune from the effects of disruption of economic activities in developing countries. Going back to the example of garment import from developing countries, there might be an inflationary pressure in developed countries due to supply chain disruptions of cheap imported consumption goods.

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COVID-19 and E-commerce

The COVID-19 pandemic brings a once-in-a-century disruption to the market with significant and long-lasting consequences. While the lockdown and social distancing rules imposed by the Australian Government in March 2020 have successfully flattened the curve to slow the transmission of COVID-19, the majority of routine daily economic activities have come to a halt. Most businesses feel the immediate financial pinch, and the business environment has been reshaped completely, and probably permanently. However, every cloud has a silver lining. While the pandemic brings serious destruction to the market, the exact same force of destruction could originate creative evolvement in some industries, and e-commerce is one such industry that thrives amidst the pandemic. Before the pandemic, Australian e-commerce accounts for about 10% of total retail sales with an annual growth rate of 17.2% (AusPost eCommerce update, Feb 2020). The largest category in e-commerce is Homewares and Appliances, which accounts for about 25% of online spending, and the smallest category is Takeaway Food, which accounts for about 4% of online spending (NAB Report, Feb 2020). It is expected that COVID-19 will bring the following fundamental changes to the e-commerce market:

- **Market participants, including consumers, merchants, and online platform providers, will all benefit from the increase in market size in e-commerce.** As COVID-19 compels consumers to shift their shopping habits online, the market size of e-commerce is projected to grow significantly. The increase in market size will lead to lower production costs and hence lower prices, thanks to economies of scale. The Takeaway Food sector, for example, has already seen some positive changes. Online food ordering platforms, such as Uber Eats, Menulog and Deliveroo, have long been criticized by restaurant owners for their high commission fees. The huge surge in takeaway demand and pressure from restaurant owners prompt those delivery companies to provide incentives and lower commission fees to attract merchants and consumers to use their platforms. Uber Eats just announced to reduce its commission fee from 35% to 30% permanently from mid-May 2020 (Business Insider, May 11 2020). This is a win-win outcome to all market participants: Consumers benefit from lower delivery fees and increasing takeaway options, and merchants benefit from paying lower commissions. For the online ordering platforms, while the profit margins shrink with lower commission fees, the sacrifice is compensated by greater sales volume. Economic theory tells us that price competition tends to intensify when products are homogeneous and buyers have low switching costs. If those delivery companies are not able to differentiate their platforms with distinctive, user-friendly features and build customer loyalty, price competition could intensify, and we may see a further decrease in delivery fees in the future.

- **The pandemic will lead to more efficient and innovative ways of doing business.** Some of the best- known companies started during great recessions, including recent examples of Airbnb (2008) and Uber (2009), echoing the creative destruction theory advanced by the famous economist Joseph Schumpeter stating that "the very logic of the capitalist system [is that] after some time of depression, new entrepreneurs would emerge. And then there would be a new 'swarm' of entrepreneurs. A wave of prosperity would start up and the whole cycle would roll on" (The Economist, May 16 2020). There will be no exception from this recession caused by COVID-19. Social distancing, remote working, and online learning-all of them will spur new ways of doing business and new business models will emerge in e-commerce. The latest examples include the strategic alliance between Airbnb and dating app Bumble for virtual dating (FB Newsroom, May 15 2020), and the merger between Facebook and the image-sharing platform Giphy for digital marketing (Yahoo! News, May 14 2020).
- **The continuously growing market of e-commerce will lead to more in-house production and vertical integration.** For business owners, a crucial decision to make is whether to perform a production activity in-house or outsource the activity to market firms. When a firm is small relative to the market, normally it is optimal to outsource non-core production activities to the market, as market firms can perform the same tasks with lower costs on account of learning by doing or being able to achieve the minimum efficient scale of production. As the business grows, it is sensible for a firm to take some production activities in house to ensure better quality control and avoid potential issues of coordination failure that may disrupt or delay production. For example, Amazon, the largest e-commerce company in the US, outsourced all of its deliveries to major shipping companies before 2013. As the sales continue to grow, Amazon gradually expands its air fleet to handle more of its own shipping. In 2018, 26% of Amazon's purchase deliveries were done in house (CNBC, Feb 15 2019). We expect to see the same business trend in Australia's e-commerce market as the market grows. In particular, major players in the market, such as Myer, David Jones, Coles and

Woolworths, will be doing more shipping in house and actively seeking potential acquisition opportunities.

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Covid-19 Pandemic, Market Structure and Competition

The COVID-19 outbreak will have long-lasting effects on market structure and competition across industries both in Australia and overseas. In the absence of government intervention, those businesses which were struggling before the crisis, but would have continued had the crisis not happened, will be forced to either shut-down or dramatically reduce their scale of production. This will lead to less competitive markets, with clear losses for consumers. In order to avoid the creation of concentrated markets, antitrust authorities around the world will have to act differently than in the past, for instance, by being more tolerant towards cooperation among firms and by imposing less restrictions on merger activities, while keeping a close eye on those firms which are in a position to take advantage of the crises, for instance, by unnecessarily increasing the price of certain goods that are in high demand and for which supply is scarce; governments will also need to step in to stimulate demand and provide financial aid to those businesses which would otherwise be forced to shut-down due to the crisis, paying attention not to “save” those which would have shut-down anyway.

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COVID-19 effects on agriculture

Though the spread of the COVID-19 pandemic has been slowing down in many countries, the risk of food insecurity persists. As of now, global food supply has been adequate and international prices of food commodities have been generally declining since the onset of the COVID-19 crisis. However, the pandemic effects on increased unemployment rates, slowing consumer demand, border closures, logistical disruptions, and shortage of agricultural inputs and services question whether it remains economically viable for agricultural producers to continue their operations and whether the most vulnerable segments of the population and food-import dependent countries could still access and afford food. For Australia, the COVID-19 pandemic presents both challenges and opportunities. With a capacity to export over two-thirds of its value of domestic production, Australia is one of the most food secure countries in the world, and, hence, in a strategic position to help address global food insecurity. However, this $60 billion industry's reliance on major export markets such as China, the United States, Japan, the European Union and Indonesia also means high exposure to their economic slowdown and trade dynamics. In the current pandemic, a growing number of countries have imposed export restrictions and accelerated domestic food industry development in order to reduce reliance on food imports. As a major global food exporter, it is vital for Australia to continue to have meaningful engagement with its trading partners while enhancing its resilience. Investment in sustainable innovations and the rural economy, market diversification, trade facilitation, research into potential markets and better understanding the changing landscape of Australia's existing markets as well as investment in agricultural youth are some of the strategies that Australia should prioritise to future-proof the agriculture sector. At Deakin, our project on advancing innovations and resilience in agriculture youth is therefore opportune to shed light on how Australia should move towards this direction leveraging on its international economic partnership.

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