G20 INSIGHTS

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Coordinated and comprehensive fiscal and monetary stimulus for tackling the Covid-19 crisis

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The COVID-19 pandemic has had a severe negative impact on the global economy. Coordinated and synchronized global fiscal and monetary stimulus programs are, therefore, vital to address the challenges brought on by the pandemic, from both short- and long-term perspectives. To achieve this, the G20 must develop a coordinated framework, along with principles, to guide effective measures on a global scale. Such a framework and principles should aim to contain the spread of the virus and stabilize the economy in the short term, and adopt policies conducive to economic growth and development in the medium to long term.

Challenge

The COVID-19 pandemic requires a collaborative and coordinated response at a global scale. People and markets around the world need confidence, solutions, and strong leadership. The G20 leaders' pledge to inject over US$5 trillion into the global economy to limit job and income losses is welcomed. However, given the current scale of the pandemic and its severe negative impact on the global economy, coordinated and synchronized global fiscal and monetary stimulus programs are vital to address the challenges brought on by COVID-19 from both short- and long-term perspectives. To achieve this, the G20 must develop a coordinated framework, along with principles, to guide effective measures on a global scale. In summary, such a framework and principles should aim to contain the spread of the virus and stabilize the economy in the short term, and adopt policies conducive to economic growth and development in the medium to long term.

In the short term, fiscal measures must immediately prioritize spending on health and those in need, to stabilize the economy. A coordinated and synchronized global fiscal stimulus, with a long-term focus on building the global economy's resilience and vitality, must be developed around cohesive principles and frameworks.

Proposal

We propose a five-pronged approach:

(1) Globally coordinated fiscal stimulus for health measures
(2) Measures to promote infrastructure finance in developing nations
(3) Measures to address the widening income inequality gap
(4) Financial support for severely affected sectors such as small- and medium-sized businesses (SMEs)
(5) Monetary policy response to support expansionary fiscal policy and maintain financial stability

(1) Globally coordinated fiscal stimulus for health measures

Coordinated and synchronized global fiscal stimulus must prioritize spending.

In responding to the COVID-19 pandemic, countries have implemented strict measures such as quarantine, isolation, and social distancing. However, scientific models suggest that "transmission will quickly rebound if interventions are relaxed" (Ferguson et al. 2020, 2). A vaccine will prevent the global economy from losing US$375 billion every month (The Vaccine Alliance 2020). Therefore, governments, particularly of developed countries, must increase and prioritize their spending on a diverse range of innovative vaccine technologies and platforms to fast-track the vaccine development process. No country can be entirely free of COVID-19 if the virus continues to spread around the world. Therefore, in addition to a successful vaccine, governments also need to ensure equitable and affordable access to the vaccine.

We recommend that the G20 facilitate high-level intergovernmental cooperation to increase vaccine development and manufacturing funding, as well as secure political commitment toward equitable and affordable access, globally. In particular, the G20 countries should actively contribute to narrowing the COVID-19 vaccine funding gap of US$27.9 billion (of which US$13.7 billion is urgently needed)—as identified by the Access to COVID-19 Tools Accelerator[1] (WHO 2020a). In addition, the COVAX Facility, co-led by the World Health Organization, is designed to guarantee rapid, fair, and equitable access to COVID-19 vaccines for every country in the world (WHO 2020b). As of July 15, 2020, more than half of the G20 countries have expressed interest in supporting this initiative (WHO 2020b). The G20 should aim for full support from its member countries for this initiative.

The COVID-19 pandemic should be a wake-up call for the world to strengthen its healthcare and emergency response capabilities (Guterres 2020). Governments must prioritize spending on major medical facilities for pandemic prevention and treatment, as well as improving healthcare and emergency response capabilities. No country can be entirely free from the COVID-19 pandemic in an integrated global economy; the least developed countries (LDCs), particularly, face more difficulties in rebounding. McKibbin and Fernando (2020) indicate that economic costs can be avoided through global cooperative investment in public health in all countries. The G20 needs to broaden its scope beyond its member countries by supplying critical medical facilities (in the short term) and developing health systems (in the long term) in LDCs.

We recommend that a G20-coordinated fiscal stimulus program should not only focus on the short-term guarantee of critical medical facilities but also on the proactive development of prevention and control capabilities to resolutely prevent the pandemic from rebounding. In particular, such a coordinated fiscal stimulus program must include the specific scope of supporting investment in, and development of, the public health systems in LDCs. Direct investment, foreign aid, and loans from multilateral development banks should be applied to strengthen the in-country capacity building of LDCs in the areas of scientific infrastructure, health education, doctor training, and access to health technology (Bruckner and Mollerus 2020).

(2) Measures to promote infrastructure finance in developing nations

Increased infrastructure investment can support economic growth and stimulate demand, leading to increased tax revenue. For example, improved digital and transport infrastructure can develop nationwide connectivity, which will encourage the advertising of products through the Internet, attracting customers from all over the country. Furthermore, new residential areas can be constructed, which will use the Internet and new transportation infrastructure. This will result in increased corporate and income tax revenues; if part of these increased revenues were returned to infrastructure companies, they could further expand information and transport networks nationwide. In addition, advances in information technology will allow children to learn remotely using Internet services, while human capital development, in turn, will raise the country's productivity, which will contribute to economic growth and income equality. However, many governments face severe limitations in their ability to prudently finance such projects. Therefore, it is desirable to encourage private investment in infrastructure as well.

We recommend that the G20 countries increase the attractiveness of infrastructure investment to private investors by: (i) increasing the rate of return and reducing overall risk; they can do this by introducing ways to return tax revenue spillover effects, created by infrastructure investment, to investors and (ii) reducing risks associated with land acquisition by using land trusts.

Due to significant budget deficits caused by COVID-19, many governments will reduce spending on infrastructure investment drastically. Finance from the private sector has to be increased to satisfy infrastructure investment demand. Spillover tax revenues, created by infrastructure investment, will increase the rate of return on such projects, which will attract more private investors to infrastructure investment. Furthermore, the spillover tax return can help secure the maintenance and repair costs of existing infrastructure, which will enable reductions in existing infrastructure user charges.

The land acquisition process, a key stage of infrastructure investment, often takes time, due to negotiations with land owners. Additionally, corruption related to land acquisition is observed in many developing countries. Technology development of land trusts can create a platform to ensure transparency in land prices and enable land trusts to transfer usage rights to infrastructure companies without transferring ownership (Yoshino, Abidhadjaev, and Hendriyetty 2019). The use of land trusts will smooth the process of land development and reduce risks associated with land acquisition.

(3) Measures to address the widening income inequality gap

The COVID-19 pandemic has revealed the vulnerability and inequalities inherent in current development models and the global economy (Bruckner and Mollerus 2020). International Monetary Fund (IMF) research shows that the COVID-19 pandemic will widen the income inequality gap between the rich and poor (Furceri, Loungani, and Ostry 2020). Increased levels of inequality worsen social cohesion and public trust and deepen political polarization, which all harm a government's ability to respond to the pandemic (Sachs 2020). While targeted monetary support may help relieve the social and economic burden on the poor in the short term, countries need to prioritize productivity-enhancing structural reforms to address this problem in the long term (World Bank 2020).

We recommend that the G20 Saudi Presidency lead a high-level intergovernmental discussion to formulate a framework to assess the common interests and challenges of economic structural reforms post-COVID-19. The G20 leaders should agree on the joint and individual responsibilities of member countries, to address the pandemic's long-term impact on income inequality. Although structural reform policies are a matter of domestic agendas, they can also benefit from a common international approach through best practice sharing and spillover effects (Gurría 2009). Successful past experiences can be found in the Framework for Strong, Sustainable, and Balanced Growth introduced by the G20 in 2009. The framework can also act as an effective tool for delivering on an agreed promise (Schwanen 2010).

The first step in developing the framework is to agree on common international targets for addressing the widening income inequality gap bought on by COVID-19, while providing countries with the flexibility to decide on specific policies according to their level of development and circumstances (Gurría 2009). Priority considerations should include fiscal stimulus to boost investment in human and physical capital that could enhance innovation, the upskilling of the labor force, and the upgrading of supply chains (Liu 2020). The framework should also prioritize improving the macroeconomic and institutional environments through better governance, policy frameworks, market flexibility, and strengthened legal systems to foster effective competition (World Bank 2020)

(4) Financial support for severely affected sectors such as SMEs

Worldwide, SMEs have been among the most affected by COVID-19. For example, many small restaurants cannot remain shut for long periods and need liquidity to finance their immediate costs, such as rental and overhead costs.

We recommend that the G20 countries consider the following three policies for supporting SME finance.

Improve credit guarantees for SME lending by introducing differentiated fees to avoid moral-hazard problems

SMEs need loans to survive under the current difficult circumstances; liquidity in their balance sheets will help them cope with the economic slowdown. Credit guarantees can be effective tools to support private-bank loans to SMEs. However, such guarantees involve a moral-hazard problem—private banks tend to issue risky loans when supported by credit guarantees. To address this, the credit guarantee ratio can be differentiated based on the proportion of default losses brought by banks to credit guarantee corporations. Another way to avoid the moral hazard is to charge higher credit guarantee fees to those banks whose default losses are high (Yoshino and Taghizadeh-Hesary 2019).

Government banks can provide immediate loans to SMEs temporarily suffering the effects of the COVID-19 pandemic but not SMEs facing structural problems Some SMEs are temporarily affected by COVID-19. These SMEs will recover when business returns to normal. However, SMEs facing structural problems may not be able to recover, even after the pandemic subsides. The former group of SMEs should be rescued, and the latter should be given loans to restructure their businesses, rather than temporary assistance loans. Governments have to avoid crowding out private bank loans after COVID-19. When business normalizes (post COVID-19), government emergency bank loans should be shifted to private bank loans to avoid crowding out. Private banks can restart their ordinary loan supply after the economy goes back to normal.

Promote the use of hometown crowd funding or hometown investment trust (HIT) funds to provide loans to SMEs and startup businesses

COVID-19 will result in increased business failures, especially among startups and SMEs; this will make banks reluctant to lend money to them. In this situation, hometown crowd funding could offer an alternative source of financing for startups and SMEs. HIT funds collect money from individuals in a region to help local startups and SMEs. Community-based hometown crowd funding has been offered in Peru, Cambodia, Viet Nam, Japan, and many other Asian countries. Companies that offer hometown crowd funding can help startups and SMEs sell their products by creating platforms for sales expansion.

(5) The monetary policy response to support expansionary fiscal policy and maintain financial stability

In response to COVID-19, monetary policy has four main tasks: (i) providing short-term support for the economy through monetary easing and related stimulus measures; (ii) preserving financial stability through taking appropriate microprudential and macroprudential policy measures, including capital control measures; (iii) providing support for the currency, if needed; and (iv) providing support to capital markets, especially bond markets, in the case of large fiscal stimulus measures taken by the government. Central banks also need to be mindful of the need for regional financial stability, including monitoring capital flows, coordinating monetary and macroprudential policy measures to avoid unforeseen side effects of policies, and ensuring an adequate provision of international liquidity. Needless to say, these tasks may sometimes be in conflict, posing potential dilemmas for central banks and financial regulators.

The G20 has already made broad commitments in the area of supportive monetary policy:

"We pledge to continue to put in place a comprehensive package of monetary and regulatory policy measures to support economic and financial stability, and together with fiscal response, ensure an appropriate overall degree of macroeconomic policy support. Central banks stand ready to do whatever it takes to support economies across the full range of instruments consistent with their mandates. Coordinated actions taken by G20 member central banks should continue to help facilitate liquidity flows between economies." (Japan MoF 2020)

Our main recommendations on monetary policy and macroprudential policy are as follows:

Central banks should support fiscal policy measures and maintain capital market stability

The heavy demands currently placed on fiscal stimulus, together with decreased revenues resulting from falling demand, imply that many countries are likely to witness significant increases in government debt, which will burden their debt issuance capacities, both domestically and internationally. In many cases, local currency bond markets are still under-developed, and foreign appetite for government bonds may be limited.

We recommend that the central banks of G20 countries, where possible, act as buyers of last resort for government bonds, especially local-currency bonds, in order to ease pressure on government bond markets. Such purchases will also result in the expansion of the monetary base, which should contribute to monetary easing. Of course, these purchases must be made within prudent limits to avoid concerns about debt monetization and inflation.

International organizations should expand support for emerging markets

Central banks in many developing and emerging economies will have limited ability to purchase government bonds due to concerns about the reaction of foreign investors to risks of inflation and disruptions of foreign currency markets. In such cases, the G20 has already recommended that the IMF and multi-lateral banks extend financing (Japan MoF 2020) and that central banks of advanced economies extend swap lines to bolster foreign exchange reserves.

We recommend that the G20 countries support the expansion of such credit lines to the extent that is consistent with the longer-term fiscal sustainability of the borrowing countries.

Need to promote regional policy coordination

As noted above, monetary policy and macroprudential policy measures may have unintended side effects on capital flows, which can disrupt regional stability. One such example is the uncoordinated imposition of expanded deposit insurance systems in Southeast Asia during the global financial crisis in 2007–2008, which led to volatile capital movements as investors moved funds to safer havens.

We recommend that the G20 countries support the efforts of regional organs of macroeconomic and financial stability, such as the ASEAN+3 Macroeconomic Research Office in Southeast Asia and East Asia, to intensify efforts to coordinate such policies among their member countries to avoid volatile capital flows and the resulting instabilities.

Disclaimer

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Appendix

[1] . The Access to COVID-19 Tools Accelerator is a new, ground-breaking global collaboration to accelerate the development and production of, and equitable access to, COVID-19 diagnostics, therapeutics, and vaccines. It was set up in response to a call from G20 leaders in March 2020 and launched by the World Health Organization, European Commission, France, and the Bill & Melinda Gates Foundation in April 2020. The consolidated investment case calls for US$31.3 billion over the next 12 months. US$3.4 billion has been contributed to date (June 2020), resulting in a funding gap of US$27.9 billion, of which US$13.7 billion is urgently needed.

Existing Initiatives & Analysis