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WHAT IF THE COVID-19 OUTBREAK LASTS MORE THAN ONE QUARTER?

POLICY NOTE

Introduction

The only measure we currently have to control coronavirus (COVID-19) global pandemic spread as well as not to become an even more severe public health crisis is social distancing. All over the world, including Turkey, we are transitioning from a voluntary social distancing measure to a compulsory one. So far, Turkey has imposed a curfew for those who are under 20 and over the age of 65, restricted intercity travel, and initiated distance education, including universities, for all academic institutions. Turkey is taking measures alongside everyone else.

Due to the social distancing measures, we have temporarily changed our way of life and habits. Accordingly, from services sector to manufacturing industry, economic activities in a plethora of sectors are shrinking rapidly at the onset of falling supply and demand. To give an example, on arrivals from abroad, truck drivers mostly transporting goods have a mandatory fourteen-day quarantine. Under these circumstances, supply chains are no longer function like before. We will have to get accustomed to seeing familiar challenges even in intercity trade unless there are positive developments in the health side of things sometime soon.

To this day, we published two policy notes measuring the negative economic effects of COVID-19 and started discussions on what could be done to limit its impact. The objective of our first policy note was to emphasize that the current negative economic downturn is of a size never encountered before and that unprecedented circumstance requires extraordinary measures. As such, for the first time, a mechanism is required to function as the "buyer of last

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resort" similar to central banks' "lender of last resort" function for the real economy. Additionally, we emphasized the increasing importance of income support for those who just lost their jobs and are currently unemployed. The first policy note further argued that the Central Bank could be financed via purchasing Treasury Bills (T-Bills) or government bonds to be issued by the Treasury during this period.

In the second policy note, in order to tackle a public health crisis of such a dimension, we underlined utilizing future projections of the disease and, as a result, planning of production activities with double-digit contractions in mind. We put forth initial discussion ideas and rough estimates for (i) what should be done for the production of goods and services to meet urgent needs of the health care system, (ii) how to support the transformation of companies to fulfill these new needs, (iii) and what is required to make sure that the remaining companies are able to reach the next production period without losing their working capital. By calculating the cost of a fair income support program, we noted that there would be no difficulty for the government to provide this support.

However, in both of these policy notes, we projected a "sudden stop" in economic activity for only a few months and not more than one quarter. Since this was the case, we assumed that for the COVID-19 mitigation process, the help of swap agreements among central banks could be carried out in a series of extraordinary national measures without experiencing major problems with our relations with the outside world. After all, the problem is not only in Turkey but also everywhere else.

Yet, what needs to be done if there is a "sudden stop" in the real economy, not for one quarter, but several quarters and consequently a deeper recession? It is crystal clear that the global financial system does not have an emergency response mechanism to deal with sudden pauses in the real economy- especially if the emergency situation in the real economy simultaneously occurs everywhere. During the last global crisis between 2007 and 2008, when the current system was last fortified, it only took into account a "sudden stop" in only a handful of financial markets in some countries. Today, the need for global cooperation must be correctly addressed. We have to clearly understand where the difficulties lie.

This policy note will shed light on the extent of COVID-19's toll on the real economy and the economic contractions to be expected in 2020, considering that the period lasts a few quarters but one quarter. Taking into account the "sudden stop" dimension on the real economy, the indispensability of global cooperation with a "transparent and reliable program framework" will be underlined, proposing a G-20 based cooperation mechanism. As a result, we underline that large fiscal expansion packages required by each country to alleviate their economic woes is unlikely without global cooperation. Moreover, the outside world, not discussed much in previous policy notes, will be analyzed considering the external ldebt payments of the government and our companies.

I. GROWTH IMPACT

To what extent would the COVID-19 pandemic have impact on Turkey's 2020 growth rate? Under such circumstances of great uncertainty, only very 'rough' evaluations can be made. Nevertheless, rough estimations are required to give us an idea of the seriousness of the current event, and shed light on how extraordinary of an economic policy is necessary.

There are numerous health measures in place to combat COVID-19 that are affecting the economy. Civilian aviation has come to an almost complete standstill. International travel has become almost impossible. Travels between and within cities have significantly declined. Entertainment venues, restaurants, and shopping malls are closed. These are the sub-items of private consumption expenditures and some of them are crucial for the economy. For example, the share of transportation expenditures in overall private consumption expenditures is 16 percent while the share of entertainment and culture as well as restaurant and hotel expenditures are 7.9 percent and 5.6 percent, respectively.Moreover, approximately 11 percent of exports of goods and services consist of income from tourism. Tourism income has almost evaporated. Each social distancing decision taken has impacted an integral pillar of the economy and has become an indicator of components in the Gross Domestic Product (GDP).

Determining early repercussions of these decisions in some concrete leading indicators is possible. For example, the real sector confidence index fell sharply in March. Likewise, in the last week of March, the value of shopping with credits cards decreased by 31 percent compared to the week before. The *TEPAV Retail Confidence Index*, the data of which was collected in late March and early April, also fell sharply. In the first seven days of April, electricity consumption witnessed a 13 percent year-over-year drop.

Based on the aforementioned set of information and the expenditures side of the GDP into account, making an assessment on growth is possible. First and foremost, a number of assumptions should be made regarding the possible effects of the decisions taken on the sub-components of expenditures. In particular, we are searching for the answer to the question, “if the value of the related expenditure item before the crisis was 100, what would it be now due to the crisis?” Then, the expected value for each expenditure item will be multiplied by the percentage of share that expenditure item has in the GDP (average for the 2012-2019 period). Consequently, we can calculate the possible decrease in the GDP under current circumstances, which would possess the value of 100 under normal conditions.

Accordingly, we may calculate how much the GDP would fall, due to COVID-19 measures in place, if it were to last for a one-year period. If the conditions and decisions in question would take six months, it should be necessary to divide the overall calculated rate of decline for one year by two. We should divide this one-year figure by three, four, or however long we would expect the measures to last. Calculated in this manner, under the assumptions listed in the table, the annual GDP loss would be about 40 percent when compared to the situation without a crisis (Table 1). In other words, if the impact of the crisis would last for six months, the GDP loss would be around 20 percent.

Table 1 - WHAT WOULD BE THE LOSS OF GDP DUE TO THE OUTBREAK LASTING A YEAR?

WHAT IS THE LOSS OF GDP DUE TO THE OUTBREAK LASTING A YEAR?	Affect of crisis (before crisis= 100)		% in GDP (2012-2019 average)
		Within the household expenditure (%, 2012-2019 average)	
1. Weighted effect on private consumption expenditures	65		59.6
1.a Food, non-alcoholic beverages	95	21.3	
1.b Alcoholic beverages, tobacco	85	3.2	
1.c Clothing and shoes	60	7.4	
1.d Residential, water, electicity, gas and other fuels	100	15.7	
1.e Furniture, home equipement, home maintenance and repair	50	8.1	
1.f Health	100	2.1	
1.g Transportation	35	16	
1.h Communication	100	3.4	
1.i Entertainment and culture	10	5.6	
1.j Education	90	1.5	
1.k Restaurants and hotels	10	7.9	
1.e Various good and servies	50	7.7	
2. Government's consumption expenditures	120		14.4
3. Investment expenditures	30		29.3
		Approximate share of exports of goods and services (%, 2012-19 average)	
4. Weighted effect on exported goods and services expenditures	58		24.7
4.a Revenue from exported goods except for tourism	65	88.5	
4.b Revenue from tourism	0	11.5	
		Approximate share of imports of goods and services (%, 2012-19 average)	
5. Weighted effect on imported goods and services expenditures	61		-28.1
5.a Imports of non-energy good and non-tourism services	65	79	
5.b Energy imports	50	19	
5.c Tourism expenses	0	2	
Gross Domestic Product	62		
Growth Rate	-38		

The point we want to draw your attention once more to is that this is a rather rough calculation under heavy uncertainty. We may quickly evaluate how realistic the assumption is by looking at sub-component values designated for expenditures. For example, the assumption is that there would be no tourism income or expense (see second column in Table 1 with the value of '0').Likewise, it is assumed that the consumption expenditures for restaurants and hotels would decrease from 100 to 10 which are plausible values. Additionally, for example, the statements made by the Minister of the Interior regarding decreasing intercity and municipality traffic, the '35' value of the transportation expenditures may have remained higher than the current reality. On the other hand, the '30' value in the case of investment expenditures may also be low since more investment expenditures can be made. The important takeaway: The calculations can be utilized as a composition for evaluating the potential longer-term impacts of COVID-19 on the economy. If the current measures and conditions would last a year, the contraction in the economy would not be 5 or 15 percent as expected earlier. It is now more accurate to think of the calculated value as a range, for example, expecting contractions between 30 and 50 percent. The width of the range reflects great uncertainty. However, note that the OECD (2020) announced 23 percent contraction in the Turkish economy (for the measures and outbreak lasting a year). The report was published in the second half of March. We now further understand the course of the infectious disease.

These values are not exact answers to the question of how much our economy would shrink in 2020 because we have actually grown at a high rate in the first two to two and a half months of the year. Moreover, even if the outbreak and the measures taken last six months, the economic activity volume may recover during the remainder of the fiscal calendar. Although these issues are taken into account, the main determining factors for the 2020 growth rate are the duration of the pandemic and taken measures. In the numerous circumstances we encounter daunting shrinkage figures; unfortunately, this is the inescapable reality. The important thing is to consider what can be done in the face of this situation.

It is noteworthy that the Turkish economy contracted by 14.4 percent in the worst period of the global financial crisis in the first quarter of 2009. If the worst days of the crisis would spread across the entirety of 2009, the contraction rate for 2009 would be at least 14.4 percent. The economic problem we are currently facing obviously runs deeper than at that time.

II. WHAT KIND OF COST IS REVEALED IF THE RECOMMENDED MEASURES ARE IMPLEMENTED?

First, we focus on what would have happened if the measures suggested in the first policy note (Özatay and Sak, 2020a) considering the pandemic would last for few months were also implemented supposing if the outbreak would last for six or nine months.

The proposal then was to create a “buyer of last resort” mechanism for the real economy, like the function of central banks being the “lenders of last resort.” In tandem, income support for those who had lost their jobs was offered. Calculating the cost of this proposal is extensively difficult without the expertise and knowledge of organizations such as the abolished State Planning Organization; it is also not possible within the limitations of this policy note. Instead, a rough estimation can be made from the ‘rough’ growth impact estimations of the second section.

Let us assume that 80 percent of the loss in income (GDP) will be undertaken by the government within the framework function of being a buyer of last resort. In this situation, for a six-month period, 19 percent of GDP is required in support packages. If the outbreak lasts for nine months, this value becomes 27 percent of GDP.

These are high values- very high indeed. However, there is another point to be considered here. Being a buyer of last resort, especially in terms of storable goods, is a more ‘comfortable’ function that can be fulfilled. As the economy initiates its normalization process and demand starts to increase, payments will be made to the government as sales from stocks are made. Therefore, some of the ‘burdensome’ costs will be temporarily valid; these costs will then eventually decrease for the government.

In the second policy note (Özatay and Sak 2020b), what could be done if the social distancing measures became compulsory was discussed. We emphasized that in order to cope with a public health crisis of this dimension, projections need to be jotted for the future course of the infectious disease, not its past, and planning production activities with considerations made with these projections.

Income support per household calculated from two different forms of calculations; by considering that 80 percent of the current workforce would not work and by taking the rate of unemployed before the pandemic into account. The calculations revealed that providing a

2000 lira per month aid package for three months would equal to 3.3 percent of 2019's GDP. As a result, a six-month program would mean 6.6 percent of the GDP, and a nine-month program would require 10 percent of the GDP.

To the calculation, it is necessary to add the burden of delayed payments of electricity, water, natural gas, and taxes, as well as the support to be given to alleviate the reduction in working capital of companies, and the purchasing of new products and services required to increase the health services' capacity. Calculating the aforementioned items also exceeds the limits of this note; however, it can be done. Nevertheless, the burden will significantly increase. It should also be considered that economic activity will drop much more in the event of compulsory social distancing.

III. FEASIBILITY ISSUE

In both of the previously published policy notes, it was underlined that the government support would have to be met by monetary expansion. The Ministry of Treasury and Finance would issue T-Bills and these government securities would be transferred to the Central Bank's portfolio in one way or another. As a result, the monetary base would increase.

A significant and common point of criticism to our writings was the risk perceptions of Turkey would increase due to the policy of monetary expansion. This was the main reason we had dedicated the following assessment in the concluding remarks of our first policy note:

"… Of course, we are aware that this threatens to increase the perception of risk related to our economy, yet we are living in an unprecedented era where it is time to take unprecedented measures. Our monetary expansion policy should be explained as an unprecedented move and it should be stated that after a while this will be revoked with a plan.

The point that we must not forget is that shortly after the 2001 financial crisis, the T-Bills or government bonds issued by the Treasury were converted into money by the Central Bank to support mostly state banks- resulting in a significant monetary expansion in the system. At the time, because monetary expansion emerged as a part of the reliable economic program, no confidence issues arose. The lesson from that experience is that an economic program as a response to the extraordinary cases can also be designed and implemented in a way that does not create a problem of trust."

Certainly, the increased perception of risk stemming from the government providing several months of support can be mitigated for Turkey. As an extension of the two studies previously mentioned, one of the authors who wrote these works also made suggestions reflecting our common interest (Özatay, 2020): First, the target and what to do to achieve should be identified in a transparent manner. Second, various scenario forecasts should be made on when this outbreak will reach its peak and how soon it will decrease to an insignificant level. Third, the monetary provisions of support must be calculated. Fourth, to what extent the required resources should be financed by monetary expansion should be explained in advance. Fifth, based on the various scenarios for the duration of the outbreak, when and how quickly monetary expansion will be withdrawn should be explained. Sixth, offerings in the government budget have to only be used to minimize the damage caused by the outbreak. In this context, it would be of utmost interest to postpone mega projects, reduce the income guarantees from the budget and review the existing contracts within this framework. Seventh, a persuasive mechanism has to be designed to fulfill external obligations as much as possible. Precisely, global cooperation opportunities should be sought within a "transparent and reliable program framework."

If the pandemic and measures taken would last longer than a few months, given the shrinkage scenario we mentioned in the previous section, the government support discussed in the previous policy notes will need to be done in a much larger scale. While all liabilities in the local economy are postponed or undertaken by the government, it is an unrealistic assumption to expect foreign liabilities to continue without disruption. At this point, a crucial problem arises: How will the perception of risk be reduced given that the support that the government should be providing in the case of a longer pandemic? How will the support package prevent further deterioration on the balance sheets, causing a huge jump in interest rates and exchange rates and thus the further contraction of the economy and the need for financing to increase?

Developed countries are under the threat of similar economic contractions and significant increase in unemployment. Numerous published reports have emerged trying to roughly measure the extent of the threat (e.g. OECD, 2020). Developed countries have an upper hand in terms of reacting with economic policies against unprecedented economic contraction. They can take on debt with relatively low real borrowing costs. Furthermore, they can have a large amount of monetary expansion without increasing the risk factor. Of course, what kind of economic policy reactions is expected and the risks that alternative policies may have are discussed in those countries. Nonetheless, in the overall analysis, it is possible for these countries to carry out much larger support packages and programs with much less risk increases than in countries like ours (for these discussions, see Baldwin and di Mario, 2020, and *et al*). The situation in developing countries is dissimilar to developed countries.

Without a doubt, if we were in a less fragile economic structure, we would be able to react harsher against the COVID-19 outbreak and be less at risk. There are a lot of lessons to be learned in the aftermath; however, there is no use in discussing it at this stage. The important question is: What kind of international order/cooperation mechanism should there be so that we can support our economy without fear? If such cooperation cannot be established, what can we do alone in this war?

IV. HOW TO VIEW GLOBAL COOPERATION?

When talking about global cooperation in the COVID-19 outbreak era, we know that it is essential to look at the issue from a much wider perspective. Nevertheless, with the boundaries of the policy note in mind, we considered it to be more appropriate to limit ourselves to external financial obligations in order to make the most functional policy suggestions possible. An important portion of the criticisms received before was related to external financial obligations.

Suggestions for combating the global pandemic made by economists from developed countries may not be directly implemented to developingcountries. In the fight against COVID-19, time-saving measures introduced until a vaccine is developed affect developing countries more directly. Why? Leaving the institutional capacity problems aside and focusing directly on the financial issue, there are three main reasons that can be counted.

First, the rapid decline in global demand due to the quarantine measures of voluntary or compulsory social distancing is stopping world trade and virtually eliminating the ability of developing countries to earn much-needed foreign currency. Second, the financial repayment capacities of these countries are completely eliminated, as developing countries cannot borrow with their own money- mainly because they borrow with the US dollar and, during periods of increasing uncertainties, international funds are for home asset preference instead. Third, only the US government can print the US dollar. The conundrum is not primarily about the system, rather the current design of it.

While a series of fiscal and monetary policy measures are domestically taken for employees, business owners, and businesses, fulfilling external financial obligations should not be expected from the country at this time. On the contrary, a global cooperation mechanism is required to control the negative effects of the same directional fiscal policy measures to be implemented by each country on their balance payments.

Due to every country being caught unprepared and combating the contagious disease, everyone is rightfully worried about putting out the fire in their own homes. However, it is beneficial not to forget the 'next day' coming. If a functioning global mechanism for foreign obligations of countries cannot be built today, recovery will become more difficult due to uncontrolled bankruptcies and spread in systemic risk. The rebound will become harder and spread over a longer period of time.

If COVID-19would, last for a few more quarters, not as previously expected, the impact of the economic shock is exponentially growing- as depicted in the third section. In this case, what a country such as Turkey with short-term external debt payments (for the forthcoming year) worth of 172 billion dollars can do is clear.

Let us begin with the 'local' framework. First, there is a need for swap deals that will provide US dollars for fulfilling maturing payments. However, the U.S. Central Bank (Fed) is strict about this type of collateral while the IMF's mechanism discussed in the mid-2017 is yet to be implemented and even if it were enacted, it would need to be further strengthened- therefore, these options remain to be limited.

In this case, considering the fact that both swap capabilities may be limited and the need for foreign currency high as the pandemic lasts longer, flexibility is thus eliminated. All debts are already recorded in the external debt registry within the Central Bank of the Republic of Turkey (CBRT). Accepting that the crisis will last for few quarters, there is no local remedy other than for the CBRT or the Treasury to undertake all foreign debt payments of the country, start negotiations with all creditors from a single source, and begin reconstructing these payments moving forward. This is not a question of a good or bad step, it is of utmost necessity.

On the other hand, it can be considered that the CBRT/Treasury acquires preferred stocks or switchable bonds from the companies in question alongside their foreign liabilities. These stocks and bonds would then later be offered to the public by converting them into shares when the appropriate time arrives. How to design such a mechanism or why it should be designed exceeds the scope of this policy note. What is important here is floating the companies in Turkey that have borrowed from foreign markets protects both employment and production capacities of those companies.

Of course, the current reserve level of the CBRT or its potential reserve level in the near future will not be sufficient for such an operation. Or, as aforementioned, only local efforts are insufficient without changing the existing swap conditions with the Fed or providing swaps with a yet to be implemented and debated mechanism similar to that of the IMF.

For this reason, it is also significant to seek global cooperation and support the current search process. Moreover, many developing countries face this dilemma one way or another. A new global cooperation mechanism is essential to overcome this period without causing a major break in the functioning of international payments.

V. SUDDEN GLOBAL STOP IN THE REAL ECONOMY AND THE G20

After the 1996 South East Asia financial crisis, the G20 was initiated as an informal coordination mechanism that brought together treasury ministers and central bank governors of respective countries. With the 2007 global financial crisis that started in American financial institutions, the G20 became a more formal entity with summits attended by heads of state and other high-ranking government officials. The 1996 and 2007 ‘sudden stops’ caused by the directional change of international cash flows due to increase risk perceptions of financial markets allowed the G20 to emerge. Now, however, both developed and developing nations, almost the entire world, are faced with sudden stops in the real economy directly driven by an infectious disease outbreak. The current dynamics are very different compared to previous cases. For timely economic policy coordination within the G20, it is useful to reconsider the MAP (Mutual Assessment Process) created by the IMF to provide a successful coordination in order to cope with sudden stops in the real economy. In this process, it is useful to establish a mechanism for opening swap or credit channels between G20 central banks, providing grants and interest-free credit support for employees in developing countries, SME support programs, and also delaying foreign payment obligations of developing countries.

Along the lines of G20 MAP, the IMF when necessary should be enabled to make swap agreements between central banks of G20 nations. Flexible intervention mechanisms against external shocks, including SLS, previously brought to the agenda of the IMF (2017), are needed today. Beneficial to reinitiate this regulatory agenda today as it was not accepted by the American administration when it was first introduced. Furthermore, through the MAP, mechanisms such as grants and interest-free support loans, which as discussed are to be provided to the SMEs at the local level, should be directed towards developing countries. Therefore, for supporting segments lacking income streams, to restart international trade, and float SMEs, national support programs can be designed and facilitated via national employment agencies, domestic eximbanks, and development banks. Encapsulating developing nations, Turkey, South African and emerging markets in the G20, including other emerging candidates in sub-Saharan Africa, must be noted.

Coordination should be facilitated so that the existing external obligations of the countries may be further postponed. The health of the global banking system is vital in this process. The goal of all these support mechanisms should be to ensure the functioning of international trade corridors that supply chains are unbroken, and social cohesion is not further deteriorated. Everyone can do their part in the fight against COVID-19 and the global economy as a whole may be re-operated when desired- no country shall be left enclosed.

Along with the battle against the COVID-19 outbreak, the focus should be on the augmentation of the MAP process within the G20 with new tools to overcome the sudden stop in the real economy. MAP can also directly contribute to global cooperation between central banks and treasuries.

The ‘new’ ideas coming to life in such multilateral mechanisms require time. Instead of constantly developing newfound ideas, the already debated ‘new’ ideas discussed in the past are more useful. Let us not forget that emergency credit mechanisms and swap lines could not be realized against external shocks from the new ideas brought up during the 2007-2008 crisis. The solutions to be taken are already here.

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