The 1st Winter School in Political Economy

The Corona Virus and the Resilience of the Economy

Ali Nassiri Aghdam
Assistant Prof. Allameh Tabataba'i University
Email: alin110@atu.ac.ir

Motivation

- Disasters such as Covide-19 Pandemic ends up with too much of costs:
- The loss of many lives: 58625 person till February 10, 2021
- Job loss: estimated to be 1210000 jobs
- Economic Growth: -6% (taking into account the effect of sanctions it was predicted that economic growth would have been positive)

Motivation

- Is it possible to reduce such costs in confrontation with such disasters?

Or equivalently,

How economy can be made more resilient in response to exogenous shocks, such as the Covide-19 Pandemic?

Outline

- What Does Economic Resilience Mean?
- Costs of Major Disasters as Exogenous Shocks
- Elements of Economic Resilience in Disasters
- Financial Resilience as a part of Country’s Macro-Fiscal Framework
- Good Practices for Disaster Risk Finance Policies
- Observations on Financial and Social Resilience in Iran

What does Economic Resilience Mean?

About Economic Resilience

- An Economic is Resilient if
  - ✓ Is able to recognize shocks on (or even in) time
  - ✓ Adjusts its mechanisms to respond properly
- In brief: responsiveness to the shocks
- A resilient economy designs and puts in effect buffers which absorb shocks and prevent shocks propagation.

Costs of Major Disasters as Exogenous Shocks

Disasters as Shocks

- Economies face with a variety of disasters over the time, including floods, droughts, earthquakes and disease (epidemic and pandemic)

Major Disasters' Costs

- Major disasters have caused severe economic disruptions or even economic contractions.
- The cost of some disaster events has amounted to
  - ✓ over 200 percent of gross domestic product (GDP) in small island states (IMF 2018a) and
  - ✓ over 25 percent of GDP in middle-income countries—e.g., losses from the 2008–2011 drought in Kenya (Government of Kenya 2012).
- Even in advanced economies major disasters have caused damages worth up to 20 percent of GDP, such as the earthquakes in Chile and New Zealand in 2010 (OECD 2014).

Major Disasters' Costs

- Damages to private assets such as buildings and factories directly impact households and businesses, interrupt economic activity, and ultimately reduce government revenue.
- Large multinational firms also suffer significant interruptions to production as just-in-time supply chains break down, causing potentially long-term economic impacts (Haraguchi and Lall 2015).
- These impacts affect the long-term growth and economic development of countries, and directly slow down efforts to reduce poverty and build shared prosperity.

Major Disasters’ Costs

- Governments face growing contingent liabilities from disasters, as they tend to shoulder a significant share of the costs for disaster response and recovery.

Major Disasters' Costs

- Sources of government liabilities in the aftermath of a disaster:
  - ✓ Fiscal transfer to subnational governments,
  - ✓ Rehabilitation of damaged assets,
  - ✓ Immediate relief and livelihood support,
  - ✓ Assistance to uninsured households,
  - ✓ Assistance to small enterprises, and
  - ✓ Stabilization of the private sector, as well as long-term stresses such as disruptions to agriculture value chains

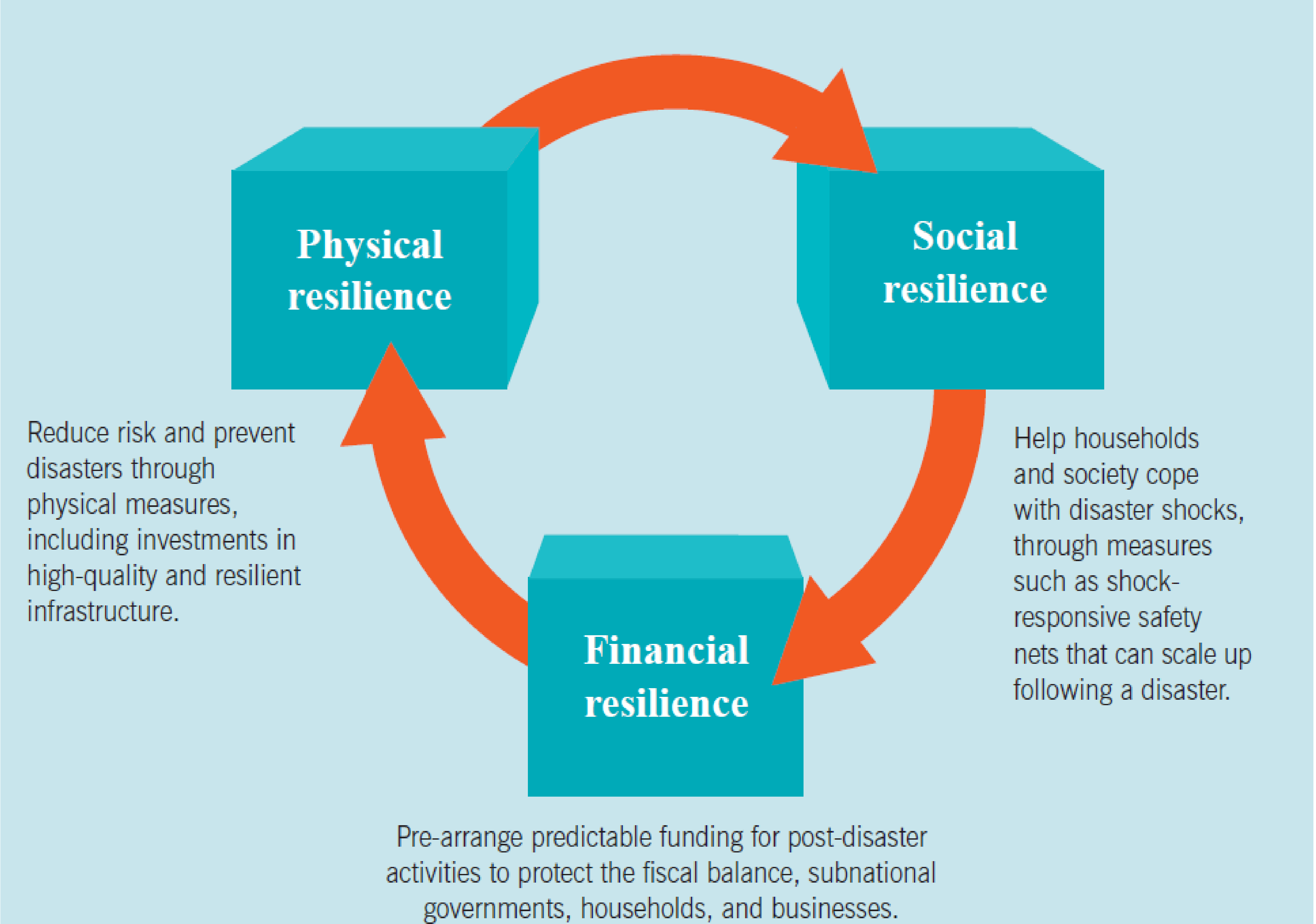
Major Disasters' Costs

- The question:

How governments and economies should cope with disasters (such as Covid-19 pandemic) to minimize the costs?

Elements of Economic Resilience in disasters

Three Elements of Disaster Resilience

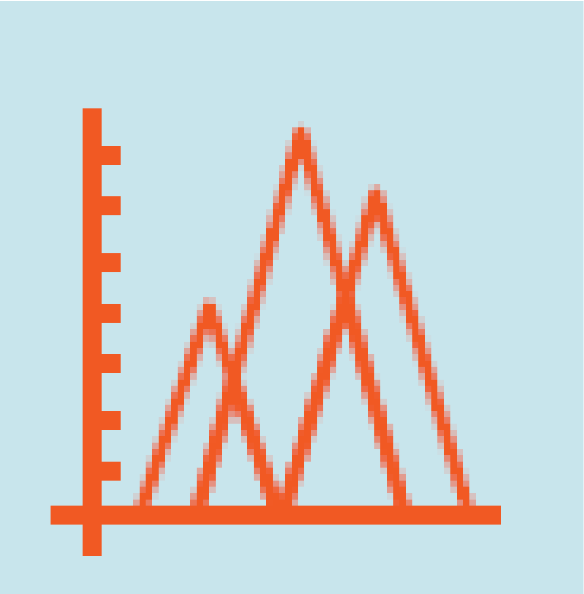


Financial Resilience as a part of Country’s Macro-Fiscal Framework

Financial Resilience

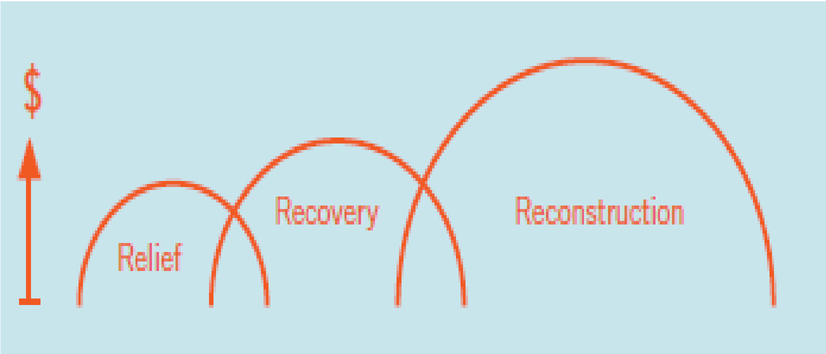
- Finance Ministries are in charge of raising relevant funds and disbursement of funds
- To perform in an effective way, they need to integrate disaster risks into their Macro-Fiscal Frameworks.
- Risk assessment as well as risk finance are necessary in doing so.
- The question: How they can perform in this way?

The Design Of Financial Protection Strategies Against Disasters



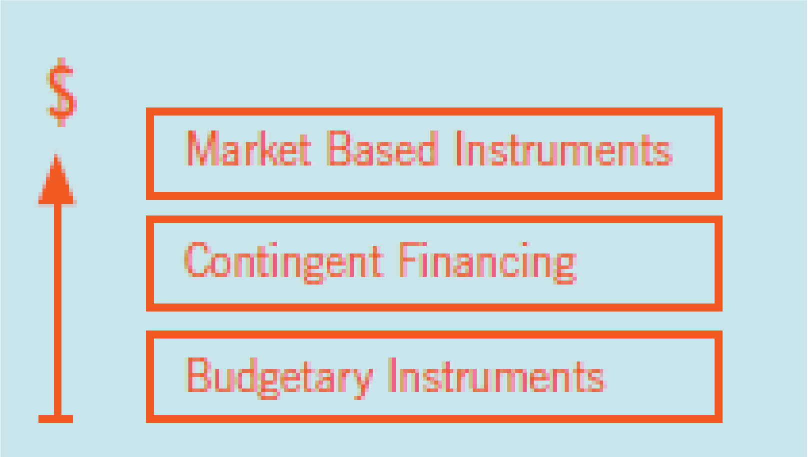
- **1. Data and analytics**
- *To make sound financial decisions, governments need the right information.*
- Appropriate risk information allows public and private decision makers to assess the costs of disasters and make informed investment decisions in allocating public resources.

The Design Of Financial Protection Strategies Against Disasters



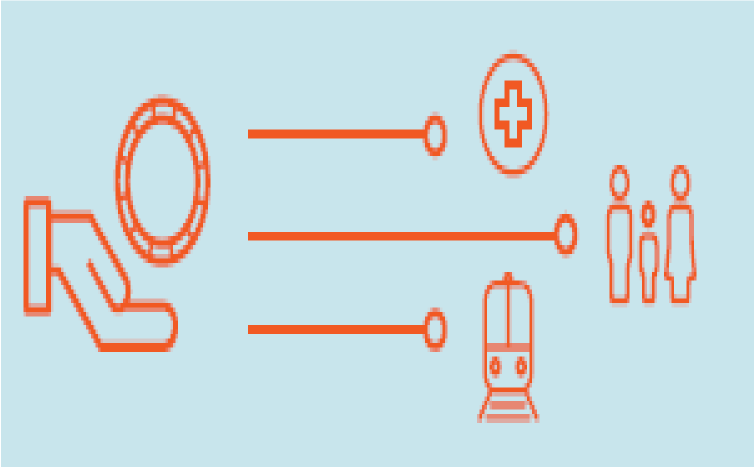
- **2. Timeliness of funding**
- *Speed matters, but not all resources are needed at once.*
- While rapid mobilization of funds is crucial to support relief efforts and early recovery, the government has more time to mobilize resources for reconstruction.

The Design Of Financial Protection Strategies Against Disasters



- **3. Risk layering**
- *No single financial instrument can meet funding needs for all risks.*
- The combination of financial instruments making up the government's financial protection strategy, should match the frequency and severity of expected disaster events along with associated funding needs.

The Design Of Financial Protection Strategies Against Disasters



- **4. Disbursement of funds**
- *How money reaches beneficiaries is as important as where it comes from.*
- Governments require dedicated mechanisms and expertise to effectively allocate, disburse, and monitor recovery and reconstruction funds.

Disaster Risk Financing Instruments

- Disaster shocks tend to increase government expenditure and hamper economic activities
- *There are multiple financing instruments that allow governments to finance the cost of disasters:*
  - ✓ *ex ante: those arranged before a disaster*
  - ✓ *ex post: those mobilized after a disaster*

Disaster Risk Financing Instruments

✓*ex ante: those arranged before a disaster*

- **1. Disaster reserve fund:** A dedicated disaster response fund, where undisbursed funds can be rolled over.
- **2. Contingency budget:** A separate budget line that is drawn down in the event of a disaster shock.

Disaster Risk Financing Instruments

✓*ex ante: those arranged before a disaster*

- **3. Contingent credit:** A loan arranged in advance that provides immediate liquidity once a predetermined trigger is met.
- **4. (Sovereign) risk transfer instruments:** Instruments such as insurance and catastrophe bonds that allow governments to transfer disaster risks to the markets and rapidly access payouts in the event of a major disaster.

Disaster Risk Financing Instruments

✓*ex post: those mobilized after a disaster*

- **5. Budget reallocation:** Redistribution of funds from other programs to cover emergency response and recovery needs.
- **6. Borrowing:** Raising of funds by issuing bonds or contracting loans for recovery and reconstruction.
- **7. Tax increase:** Temporary or permanent tax increase as a last resort to finance post-disaster activities.
- **8. International aid**: External development partners' assistance, which is often unpredictable.

The Importance of Governance Framework

- Governments also need to ensure that their regulatory and governance frameworks are appropriate to implement sustainable financial protection strategies.
- A sound legislative basis enables governments to develop and implement long-term disaster risk financing and insurance arrangements even through changing administrations.
- Institutional arrangements—including the establishment of dedicated fiscal risk management units or a cross-ministerial risk managing board—can also enhance comprehensive financial management against disaster risks in the long run.

Good Practices for Disaster Risk Finance Policies

UK: Contingent Liability Management Systems

- HM Treasury in the United Kingdom has introduced a contingent liability approval regime, where line ministries are required to go through an approval process with the Treasury to take on new contingent liabilities.
- Such a supervising system for contingent liabilities could enable ministries of finance to actively monitor, manage, and mitigate contingent liabilities across the government (HM Treasury 2017).

Mexico: Natural Disaster fund (FONDEN)

- Mexico’s Natural Disaster Fund (FONDEN) adopts a layered financial risk management strategy.
- It receives a mandatory annual budget allocation, which it complements with innovative financial instruments to smooth government expenditure on disasters.
- More specifically, FONDEN transfers disaster risk through indemnity-based reinsurance (to cover public buildings and infrastructure) and through catastrophe bonds;
- it has also purchased risk transfer instruments to cover exposure that exceeds the budget allocation by issuing catastrophe bonds through the Word Bank.
- FONDEN relies on a transparent damage reporting system and clear rules of disbursement.

Spain: Covering Extraordinary Risks

- Spain's Consorcio de Compensación de Seguros (CCS), a state-owned enterprise, provides additional coverage for "extraordinary risks" that are not covered by private insurance policies for individual and business properties (e.g., residential assets, personal properties, cars, railway vehicles) and personal injury.
- In Spain, it is mandatory to cover "extraordinary risks," including natural disasters (e.g., flood, earthquake, tsunami, volcanic eruption, and wind storm) and violent events (e.g., terrorism).
- The total amount of surcharge for the property insurance policies was US$690 millionb in 2015, and the aggregated insurance payout between 1971 and 2015 was US$10.4 billion.

Observations on Financial and Social Resilience in Iran

Labour Market in Iran

- Based on different estimations, in Iran:
- 7.64 million (about 30 percent) of labour force work in informal sector and do not have access to unemployment insurance as well as the health insurance.
- 78 percent of the poorest one-fifth are occupied in informal sector.
- 58 percent of the poorest one-fifth are under the coverage of charities and the other 42 percent remains without any social protection.

Affected Businesses

- Some businesses have been affected by Crona Virus (e.g. Wholesale and retail)
- In sum, in business sector, more than 7 million labour force have been affected by the lockdowns

Requirements of efficient intervention

- To contribute in economic recovery and social inclusion, the country needs to
  - ✓Raise relevant funds in a timeliness manner
  - ✓Recognize affected households and businesses

Features of Cash Transfer Program

- In the existing cash transfer system,

✓More than 24.2 million households (76.4 million individuals) receive subsidies in cash which amounts to more than 90 percent of total population

✓More than 7.6 million households receive monthly cash subsidies while they are among one-fifth of the richest families as well as the government officials (not affected by Covide- 19)

✓More than 3.7 million subsidy receiver families are uninsured with informal jobs which indicate they are more vulnerable than other receivers.

✓About 300000 of non-recipients are among the poorest families in Iran.

Financial and Social Resilience

- Financing is not tied in advance to efficient and transparent disbursement channels to ensure that resources reach the targeted beneficiaries at the right time.
- Furthermore, the capacity of people and businesses has not been developed to manage risk to reduce the need for public intervention.

Financial and Social Resilience

- Furthermore, pre-arranged disaster risk financing can also promote preparedness and recovery
- As you are told, in previous lectures, Iran’s budget deficit have been growing during last decade.
- Nowadays, not only ex ante instruments of financing disaster risk are poorly designed, but also government are struggling with difficulties in employing ex post instruments of financing disaster risks (selling assets, issuing bonds, raising taxes and rearranging subsidies)

Thank you for Listening