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The World Needs to Prevent Post-Pandemic Economic Conflicts

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While the world is preoccupied coping with the human toll wrecked by the coronavirus pandemic, the stage is rapidly being set for profound global economic conflicts in the months ahead. Necessary immediate economic measures now underway, coupled with further inevitable recovery initiatives, are bound to aggravate long-festering policy differences between China, Europe, Japan, and the United States. High on the international agenda should be a concerted effort to defuse this threat.

Governments need to begin talking now about how to mitigate post-pandemic economic frictions. This should include looking for new understandings on permissible government aid and nationalization and how to unwind them, what to do about unprecedented levels of peacetime debt, the need for new sources of revenue, and how to safeguard national companies from predatory foreign investors.

The world is indisputably headed for a deep recession, if not a depression. Goldman Sachs already forecasts U.S. output contracting by 3.8 percent this year. German research institutes predict the country's economy is going to shrink by 4.2 percent. French GDP is expected to have shrunk by 6 percent in the first quarter of 2020, according to estimates by the country's central bank. The ultimate depth of the downturn is currently unknowable, but—chastened by their slow recovery from the 2008 financial crisis, which is attributed to inadequate initial spending—governments and central banks on both side of the Atlantic have brought out their financial bazookas.

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How this money is spent will sow the seeds for future conflict. The United States will be providing at least $500 billion in loans to U.S. companies, with more likely to come. The United Kingdom plans at least $400 billion in loan guarantees. Germany, which has promised to dip into its budget surplus, has already pledged $550 billion. And more is on the way.

Some of this money will likely give governments a stake in the companies they support. The International Air Transport Association estimates that the airline industry, for example, will need up to $200 billion of state support. Washington is considering taking an equity position in U.S. air carriers in return for such aid, as it did with the auto industry in the wake of the Great Recession. Italy is on the verge of nationalizing Alitalia. France may take a larger stake in Air France.

When and how to unwind these positions in this quintessentially global industry is a discussion that needs to begin now in order to protect consumers and to minimize the inevitable competitive distortions. U.S. and European air carriers and their unions have in the past demanded market-access limits on airlines from the Persian Gulf states—Emirates, Etihad, and Qatar Airways—alleging that undue state subsidies to them contravene current open-skies agreements. The looming threat to fair competitive practices is now far more widespread. Talks to minimize "beggar thy neighbor" practices under the cover of helping failing national airlines are urgently needed.

Higher Debt and New Revenues

In the wake of the coronavirus crisis, national debts are likely to reach levels not seen since the Second World War. The U.S. federal debt was already 91 percent of GDP before the new spending. Central government debt is 198 percent of GDP in Japan, 131 percent in Italy, 86 percent in the United Kingdom, and 81 percent in France. Short-term funding of these debts is not the issue: interest rates are at historic lows. But during the next recovery interest rates will begin to rise.

Predictably, in the United States Republicans are likely to again become deficit hawks if they are out of power. In Europe, Germany and The Netherlands are likely to reassert even more forcefully their long-standing moral objections to debt. A too rapid resurgence of spending probity could strangle economic recovery in its crib. Just as advanced economies have implicitly agreed to ramp up spending in recent months, they now need to explicitly agree on a timetable for reducing their debt during a recovery. Without such a roadmap in place, which should be a high priority for G20 finance ministers, the world risks a slow recovery or even a double dip recession. To manage their debt, governments will need new revenue sources. An economic revival alone cannot be expected to refill public coffers fast enough. But national systems of taxation are woefully out of sync with the realities of the modern global economy.

Financial transactions now account for a growing share of world GDP, but they remain largely untaxed. France, Italy, and the United Kingdom impose modest taxes on trades of stocks, bonds, and derivatives. But a proposal to levy a European Union-wide tax of just 0.1 percent has lain dormant for nearly a decade due to resistance from member states. In the United States, several proposals for such levies have gone nowhere on Capitol Hill, even though a 2016 Tax Policy Center study estimated that a financial transaction tax could raise $74 billion a year.

Similarly, in 2019 worldwide e-commerce retail sales amounted to $3.5 trillion. And could grow even larger as more home-bound consumers turn to on-line buying. Much of this activity is not taxed or the profits are sheltered in tax havens. The digital platforms that make much of this ecommerce possible—Amazon, Apple, Facebook, Google, and Microsoft—also pay little or no tax on their ad revenues as well as on the data they collect for advertising purposes and the provision of their platform.

The United Kingdom has implemented a 2 percent digital services tax, which it hopes will raise £500 million a year. France has a 3 percent tax in abeyance pending an international agreement on such levies, and it plans to proceed by the end of the year if there is no agreement.

The World Trade Organization (WTO) has been trying to negotiate an e-commerce accord for 14 months. The Organization for Economic Cooperation and Development (OECD) redoubled its efforts to craft a digital tax deal earlier this year. In the face of rising post-recession revenue needs, governments will be tempted to impose new, disparate levels of taxation that are bound to lead to international retaliation. Earlier this year, U.S. Treasury Secretary Steven Mnuchin warned that: "If people want to just arbitrarily put taxes on our digital companies, we will consider arbitrarily putting taxes on car companies." To avoid that, the WTO and the OECD need to swiftly conclude their negotiations and establish international rules on the nature and degree of taxation for e-commerce and digital platforms.

Fending Off Locust Investors

Finally, in the wake of the corporate destruction wrought by the coronavirus recession, the economic landscape will be littered with broken companies ripe for the plucking by what Germans call "locust" investors. Such opportunistic acquisitions by U.S hedge funds generated a great deal of anti-Americanism in the wake of the 2008 financial crisis. The coming backlash could initially be against China.

As Thilo Hanemann and Daniel Rosen of Rhodium Group ask: "After the 2008-09 crisis Chinese firms ventured out to acquire discounted assets around the globe…With China's economy having a head start coming out of the present crisis and its appetite for technology and other strategic assets as strong as ever, will history repeat itself?"

Australia, the target of much Chinese investment in recent years, plans to review all foreign investment to protect national interests. Such oversight will apply for at least six months, but there is every reason to believe these reviews will be in place for some time since the economic downturn is likely to extend far beyond that.

The EU, France, Italy, and Spain plan measures to defend strategic companies from foreign takeovers. European Commission President Ursula von der Leyen has pledged that the EU will remain open to foreign investment but will "balance this openness with the need to preserve our economic sovereignty."

In 2018, Congress gave the interagency Committee on Foreign Investment in the United States the power to review foreign investment in critical technologies, infrastructure, and sensitive personal data. For years there have been calls to expand such reviews to assess economic impact in general. In the wake of pandemic-induced corporate bankruptcies, pressure is likely to grow to curtail foreign investors' bottom-feeding off distressed U.S. companies.

The United States, Europe, and others need to come up with common guidelines on what foreign investors can and cannot purchase: what is strategic and what is not. If they fail to do so, those with deep pockets—be they Chinese companies or U.S. hedge funds—will play one country off against the other, feeding nationalist, populist backlashes.

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There is an immediate and obvious need for a massive economic response to the coronavirus pandemic and the deepening global recession. But the urgency of the immediate should not blind us to inevitable future problems that are within our power to defuse.