Implications of the COVID-19 Pandemic on Development Priorities and MCC Analytics

Background

The COVID-19 pandemic is profoundly impacting well-being and economic activity across the globe. For MCC and other international aid institutions, urgent questions arise concerning organizational response to the crisis. MCC is addressing immediate pandemic-related fallout, such as delays in government responsiveness, inability of contractors to work, and the resultant problems in meeting the statutory 5-year time limit on compact funding. However, given MCC's mission to promote poverty reduction through economic growth, it is equally important to think through potential long term implications of the pandemic and what they imply for MCC's practice, including project design and analytical tools.

Alternate economic scenarios for the world economy, markets, and pathways to growth

Consider two contrasting cases of how the pandemic will unfold. Under a (relatively) benign, best-case scenario, the virus is brought under control quickly via mitigation and/or a vaccine, economies re-open, and the world returns to approximate business as usual by around early 2022. Repercussions, even in this most favorable case, could include costly disruptions to markets and supply chains that will take time to repair before growth can resume. Poorer households and vulnerable groups may suffer disproportionate health and economic losses, while safety nets get stretched. A debt crisis for many lower-income and lower- middle-income countries (LICs and LMICs), already looming before the pandemic, seems likely.

Under a far worse scenario, the virus may continue to wreak havoc on health and safety nets beyond the short-term, with widespread consequences for the global economy and no return to "business as usual," particularly if a vaccine is not developed and mass produced within the next 18 months. Governments in rich countries, responding to political pressures already developing before COVID-19, become less outward looking. Global value chains shorten, replaced by "on-shoring" or "near-shoring" of intermediate input production as firms seek to reduce risk. Opportunities for international migration and remittances diminish over time. In addition to facing a serious debt crisis, LMICs increasingly struggle to attract direct foreign investment. Within countries, economic activity revives only fitfully, given continued health concerns and weak demand. Human capital development slows due to reduced funding for education, lower school attendance, and fewer opportunities for on-the-job training. Past pandemics have worsened inequality (Ostry and Loungani, IMF), and COVID-19 may exacerbate matters by accelerating trends in automation and losses of unskilled jobs.

Of course the actual path may lie between these poles. For example, the virus threat may recede but still leave long term structural changes in the world and domestic economies. Depending on the scenario, any or all of the following may be significantly altered: labor market supply and demand; international and domestic migration and remittances; opportunities for growth through export in global value chains; capital markets supply and demand, particularly for developing countries; direct foreign investment flows; urbanization rates and economic agglomeration, food security, and more.

While the foregoing list suggests reductions or contractions, other aspects of the world or domestic LIC and LMIC economies could expand, or do so faster than previously. For example, the digitalization of work; trade in services using digital technology; and growth of regional or domestic markets in place of trade with developed countries. Ultimately, the pandemic may affect the possibilities for growth, the drivers of that growth, and the relationship of growth to poverty reduction, which will be affected by the likely increase in inequality.

Questions for the EAC

In light of the scenarios noted above, what reflections can the EAC offer on the following questions:[1]

1. MCC investment focus

- In view of potential de-globalization and increased trade friction, should MCC place greater emphasis on *regional development and integration* (by expanding activities under the new concurrent regional compact authorization) to enhance regional market integration, and support scale economies? Should more attention go to domestic markets as a driver of growth, at least in larger compact countries?
- To offset financial market disruption, should there be a greater emphasis now on blended finance approaches, with inducements to FDI and the private sector?
- Under the "worst case" scenario, should MCC focus resources on those projects with the largest payoff in terms of employment generation and short-term poverty reduction?
- Is the case for targeting specific economic sectors stronger? If so, which sectors emerge as potential drivers of growth in a COVID-shaped environment?

2. Analytical tools to meet emerging needs

- MCC's Constraints Analysis considers binding constraints to growth, emphasizing barriers to private investment. Do the potential COVID-19 scenarios outlined above alter how we should think about– and test for– constraints to growth? Put another way, are there likely to be different or exacerbated market failures that inhibit growth and poverty reduction?
- What, if any, additional diagnostic tools should be put in the MCC arsenal in light of these possible COVID futures? (For example, related to complexity analysis, trade, development finance, urbanization, technology, resilience to macro, sectoral or health shocks, food security).
- MCC's Cost-Benefit Analysis is essential for choosing among investments that address growth constraints. In light of the pandemic, are there outcomes that should be given weight besides incomes, e.g., income or consumption security, resilience? What are practical methods for incorporating them? Are there implications for the choice of discount rate?
- What implications are there for project design and implementation, if any?

[1] Given that potential impacts of the pandemic are strongly time-dependent, the specific timelines for MCC investments should be kept in mind. The diagnostics and project design phase leading up to Compact entry into force can take up to 2-3 years. Compacts themselves have a congressionally mandated 5-year durations. Therefore, for new compacts, investment outcomes will be felt only after several years at least. However, projects currently under development will be implemented sooner and can also be potentially adjusted.