ECONOMIC IMPACT OF CONTAINMENT IN GUADELOUPE: A NECESSARY BUT POTENTIALLY « RETE A KAZ A ZOT »

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EN BREF

- **The purpose.** Simulation of the effects of containment on the Guadeloupean economy.

- **Hypothesis.** The MEGATOM model (see website atom-eco.fr) and a microsimulation module for Guadeloupe based on INSEE data. A set of hypothesis is postulated around supply and demand shocks representing one month of containment.

- **The results.** Overall, the economy would experience both a negative supply shock and a negative demand shock. One month of containment would cause a decrease in regional GDP of -6,9%. The situation of households would deteriorate, with the monetary poverty rate falling from 18,2% to 24,1%.

H1N1, Ebola, Cholera, Spanish flu... the epidemics that have spread on a large scale have brought with them significant economic impacts. However, unlike what has been analysed in these past pandemics, today’s pandemic will hit economies with much greater force since the authorities have imposed severe constraints on the mobility of people in order to slow the spread of the virus. The halt or slowdown in production in several sectors will have an immediate impact on the economy as a whole. Globalized containment meets health objectives that are not without consequences in terms of economic impact. In fact, one could say: "It looks like a crisis, with the consequences of a crisis, but it is not a crisis". The economy is dormant, or more exactly on a pause.

In Guadeloupe, the anxiety climate of these days should not make us forget that the territory is broken to the exercise of confinement. Indeed, the hurricane period precipitates the households in the shops before the confinement, the economic activity stops nearly completely, everyone keeps informed of the evolution, and this until the red alert is lifted. But the comparison is imperfect because one of the major differences here is the duration of the health risk and its impacts, as well as the confinement of the population.

More unemployed or more deaths: it is to this kind of appalling arbitration that the State is subject. And in this schizophrenic situation, whether people are unable to work or confined to their homes, the effect is the same from an economic point of view: a production reduction.

In this note, we estimate the impacts of confinement on the Guadeloupean economy using a macroeconomic simulation tool. Such a quantitative assessment remains difficult as the current context is changing every day. Therefore, our assessment will certainly be subject to revision to take into account not only the changing international context (impact on partner economies and vice versa) but also the decisions that will be taken by the authorities at the end of the containment (support for businesses, pace of "de-containment", etc.). However, if we want to try to measure the impact of this containment on the economy, we must first postulate certain hypotheses in the light of changes in the behaviour of households, sectors of activity and the government. Then, to understand our results, we will have to conduct our analysis by making a clear distinction between two mechanisms of transmission of the shock, since it has a dual nature. On the one hand, it passes through the demand channel (since consumers in particular change their behaviour), and on the other hand through the supply channel (due to a strongly disrupted production of goods and services).

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A MULTI-DIMENSIONAL DEMAND SHOCK

In economic jargon, it is said that demand plays a"multiplier" role on level of production. It amplifies the level of activity when the shock is positive and acts in the opposite direction when there is a downturn. Three components of demand will play an important role.

A CHANGE IN HOUSEHOLD BEHAVIOUR

The first is final household consumption, which represents 59% of Guadeloupe’s GDP in 2017 according to INSEE. In this period of confinement and health crisis, consumer behaviour is ambiguous.

On the one hand, for fear of shortage, there is a"cold" panic movement that push consumers in shops leading to an over-consumption of so-called"priority" goods (food, pharmaceuticals, toilet paper ...). This sudden increase in demand can create a scarcity of products if stocks are insufficient, or even rationing of customers (such as gas in some service stations).

We postulate that the rush on basic needs is equivalent to one month of additional consumption (thus on average +8.5%) to cover food consumption during the confinement period.

On the other hand, consumers become scarcer in the markets during the period of confinement and look for less fresh produce (fruits and vegetables, fish shops). This is reflected in lower demand for these products. This reduction could lead to a situation of excess supply and the organisation of special operations in shops or parallel markets to sell off stocks) generating a fall in the prices of agricultural products. A reduction in the consumption of so-called"non-essential" goods and services (transport, clothing) is also to be expected. Expenditure on consumption of durable goods (household appliances, renovation) will be postponed, as will consumption of non-essential services (restaurants, leisure, tourist travel, etc.).

For the purposes of our simulation, we assume that, with a constant budget, the consumption of these goods is reduced proportionally to cover food needs during the month of confinement. Finally, some consumption of goods and services (rent, financial activities) remains unchanged. For the simulation exercise we assume that the demand behavior for these so-called "indispensable" goods and services do not change during the period of confinement.

A DROP OF INVESTMENT

The second important component of demand is investment, which, according to INSEE, represents 18% of regional GDP in 2017. In addition to the multiplier effect, investment spending exerts volatility on the economy due to its "accelerator" effect: a change in the economic climate affects the demand for investment goods. For example, the prospect of additional market opportunities encourages firms to invest more in order to be ready to meet excess demand. And in the case of containment, a decline in final demand mechanically leads to a very large decline in investment.

Investment consists mainly of demand for construction capital goods (65% of total investment demand) and manufactured goods (24% of total investment demand). As the saying goes, "when construction is running, everything is running". However, this popular vision is not true any more. The construction sector will be severely impacted with the cessation or suspension of activities on several construction sites. This sudden reduction in the level of activities (which is assumed to last one month) will therefore have an impact on other economic sectors, such as the industrial sector, which supplies it with intermediate inputs. In the case of Guadeloupe, a drop of 1000 Euros, for example, in the output of the Construction branch reduces demand for intermediate inputs by 670 Euros.

For the purpose of our simulation we will assume all the investment are stopped during one month.

DESERTIFICATION OF TOURISTS

The onset of the pandemic quickly led to a major restriction in passenger mobility. For Guadeloupe and according to INSEE, tourist spending represents between 4 and 5% of GDP. Containment measures brought the holidays to a standstill and the repatriation of travellers was quickly implemented.

We will postulate that tourist spending on Guadeloupean soil is zero during the entire containment period (one month). Thus, the drop in tourist attendance leads to a drop in activity in the hotel and restaurant sectors. Travellers devote almost half of their budget (45%) to these type of services.

A SHAKEN SUPPLY OF GOODS AND
SERVICES

Through the analysis of demand effects, a typology of sectors of activity that are more or less affected by containment measures is presented. This is the second channel of shock transmission.

Firstly, some sectors are authorised to remain open, such as the agri-food industries, transport, energy …, are relatively less affected by the containment measures. These sectors deemed "priority" continue to operate even though they are suffer from the reduction in the demand for their products. This transmission mechanism reveals the interconnection and the interdependencies of the economic system. Thus, as a ripple effect, containment measures, will indirectly affect other activities such as transportation, fuel sales as well as ocean freight (with a time lag due to orders placed prior to containment).

Secondly, the sectors covered by Article 1 of the decree of 14 March 2020 (cafés, restaurants, shows, events, etc.), but also tourism, hotel accommodation, passenger transport, construction and commercial services are heavily penalised. These sectors account for 37% of economic activity.

Thirdly, the sectors directly related to public spending are partially protected by the containment measures. Thus, the sectors of Education, Health, Public Administration and other Non-Market Services remain in operation and the employment as well as the workers' salaries continues to be assumed by the State and the local authorities. Households that obtain their remuneration from the public branches are well protected from the economic impacts of the pandemic. One could even expect an increase in public spending in these sectors of activity because the State has to face a multitude of new needs (overtime, wage bonuses for health workers, public police services, fire brigades, etc.).

A LOSS OF PRODUCTIVITY IN PRIORITY SECTORS

Containment measures have direct impacts on worker productivity through a variety of channels.

First, school closures and containment require parents to keep their children at home and care for them. As a result, work/family balance is more difficult to achieve and could lead to increased absenteeism leading to a reduction in labour force productivity. On the other hand, while the increase in telework allows part of the workforce to remain operational and avoid a complete stop of activities, it probably involves some loss of efficiency in the co-ordination process of production.

Similarly, distancing measures, while possible in some industries, may be very difficult to implement in others and may eventually lead to a complete cessation of activities, with workers exercising their right to withdraw or contractors simply deciding to close down. Similarly, health institutions and professionals in times of health crisis may lack resources, while some doctors and nurses may be infected. This consequently affects their labour productivity.

For the purpose of our simulation, we will assume a 5% drop in productivity in the sectors that remain active.

MACROECONOMIC UNDERPERFORMANCE REMINISCENT OF 2009

We simulated the containment scenario around the different hypotheses presented with the MEGATOM simulation model applied to Guadeloupe. Our results show, as expected, a significant loss of economic activity. This is due firstly to the fall in household demand, secondly to the closure of non-essential sectors and finally to the loss of productivity in priority sectors.

The over-consumption of agri-food products by households, will lead to an increase in the price these products (+0.92%).

Similarly the negative shocks of demand and supply, lead to a decline in real GDP of -6.9%, i.e. a significantly greater drop than the results obtained at the national level (-3% according to INSEE and -2.6% according to OFCE).

The bad economic result will generate a deterioration in the household’s welfare with an increase in the monetary poverty rate from 18.2% to 24.1%.

We have to go back to the social crisis of 2009 to observe such macroeconomic phenomena. At that time, in a context marked by the international financial crisis, it was mainly investment (-12.2%) that marked the economic slowdown. Public works had experienced a major air gap due to the significant reduction in public procurement, and the
delay or cancellation of projects. The tourism sector, for its part, came to a halt. Household consumption (-3.3%) also contributed to the 6.3% decline in Guadeloupe’s GDP, while French GDP growth fell by -2.6%. After the 44-day strike, several companies had ceased their activities. This is a reminder that the production capacity could be affected beyond the crisis period.

THE GOVERNMENT PREPARES THE “POST-WAR” ECONOMY

It is to avoid the social consequences of the economic slump that is likely to result that the government proposes to put in place three major measures, mainly to support the supply but also the demand.

First, a solidarity compensation fund will be introduce. It consists, at the central government counter, of a monthly aid of 1500 euros if 70% of turnover is lost in March as a result of the pandemic. Additional aid of up to 2,000 euros is also available at the local authority counter (possibly co-financed by the state).

The government then plans to cover the short-term cash-flow needs of businesses. This involves contributing to the payment of current bills (rent, energy), guaranteeing bank loans, and deferring wage and tax charges.

The last measure concerns short-time working. Companies will be able to pay their employees placed on short time working an indemnity equivalent to 84% of their net salary if it is higher than the SMIC and 100% if the salary is lower than the SMIC. The firms will then receive an allowance to compensate for the wage charges. The purpose of this mechanism is to protect workers from their loss of income by enabling them to maintain their level of consumption. Here, the short-time working allowance will also make it possible to maintain the employment link between the worker and his employer in order to facilitate the resumption of activities at the end of the confinement. However, this presupposes that the firms have the liquidity to cover this wage bill. This is not sure in a context where, on one hand, 90% of the companies have less than 10 employees (among which are mainly very small companies with less than one employee) and where, on the other hand, the payment periods are long, which reduces the immediate cash flow of the companies.

With these three measures, the government wishes to set up a substantially safety net for individuals and companies. In doing so, the welfare state wants to prevent companies from collapsing and being unable to resume normal activities after the pandemic. Moreover, from the point of view of workers who are technically unemployed, maintaining the employment link will in due course enable them to resume activities quickly. However, the almost immediate closure of stores on 16 March, without being able to prepare for it, could lead to the disappearance of many small businesses with little cash flow.

A CONSTRAINED "POST-CRISIS" ECONOMY

The purpose of this note is not to predict the state of the economy at the end of the containment, it is limited to measuring the short-term effects of a reduction of activity. All our calculations are based on one month of containment. If the containment were to last several months, we would certainly have to revise our assumptions because the cumulative effects could be significant. However, it is clear that in the face of a pandemic, recovery will depend on the extent of the economic slowdown, its duration and the solvency of the government, which will be obliged to borrow and invest massively to stabilise the economy. It seems obvious, however, that if the crisis is short and partly control, the rebound could be very strong.

Phase II of the public response to the Corona virus pandemic is not know yet, but it appears that most of the world’s major developed countries are preparing for major stimulus measures. For the time being (phase I), the government seems to be simultaneously trying to cushion the negative shock of the economic downturn and prepare the post-war economy with costly short-term measures. Like most European countries, it has taken the gamble that social measures must be taken to maintain a certain level of income for the vast majority. This strategy aims to put a kind of pause in activity while making recovery possible by keeping companies and the economic structure operational.

In any case, stopping activity for one month will automatically lead to a reduction in the turnover of businesses. While the government could guarantee bank loans, companies would still have to be up to date with their contributions in an economy where the colossal amount of social debt is partly the result
of long payment periods. The European Central Bank will probably have little alternative but printing money in order to finance the tens of billions of dollars borrowed by France and other European countries, at the risk of creating inflation. Even though the government has promised that it could modify its support programmes if the duration of the containment period were to be extended, the extension will have even more serious structural and lasting consequences that will lead to a huge increase in the government’s debt. In the “post-war economy”, however, there will be debt repayment, which in the medium term will probably involve cuts in public spending, tax increases and austerity policies.

Moreover, it could be that, like echoes of the health crisis, the impacts will last beyond containment, with ratchet effects in certain sectors such as tourism, restaurants, or cinemas where the neologism “deconfinement” measures could be progressive to limit the effects of crowding.

Furthermore, for the crisis to end, we will need to be able to count on an intact industrial and commercial structure to allow a resumption of economic activity (and therefore for the various interdependent businesses to survive so as not to block the system) and trade with our trading partners (from Guadeloupe, but also from France).

What about the morale of the companies? At the end of the social crisis of 2009, the business climate indicator for companies had reached its lowest level (a loss of more than 40 points), mainly due to difficulties related to payment delays and cash flow. Therefore, companies could adopt a wait-and-see attitude before relaunching their investments, especially if the system is tightened.

BUT A REBOUND EFFECT IS LIKELY

However, some companies may be able to reduce bleeding. This is the case for those that have adopted strategies such as contributing to the “war” effort and providing them with a boom in activity. For example, local rum distilleries have begun mass production of hydro alcoholic gel, which offers the cane-sugar-rum sector a new diversity of activity in a sector where sugar and rum quotas have been suspended.

In addition, the economy is benefiting from a drop in global demand for fuel precipitated by the coronavirus epidemic and containment, which is reflected in a drop in the price per barrel. Companies could thus enjoy lower production costs as long as producing countries do not reduce their production. Similarly, a reduction in the regional tax on fuels could lower business costs.

On the other hand, and even if consumer confidence cannot be predicted, there could be a positive demand effect. Indeed, reduced consumption in times of confinement implies higher household savings rates and probably, thanks to what is known as a “wealth effect”, deferrals of consumption of goods and services that were considered non-priority (manufactured goods, construction, etc.). In economics, intertemporal choice theory teaches that agents can reduce their consumption today, save more to consume more tomorrow. If so, the rebound could be quite strong after the health crisis... provided that households are not "Ricardian" type, i.e. they do not anticipate an increase in taxes to finance the public debt.

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