Occasional
Analytical Note

July 2020

The Fiscal Implications of COVID-19 for Lesotho: Lessons from Past Crises

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Outline

1. Introduction and Background

Covid-19 has spread very quickly across and within countries, causing turmoil. Consequently, the World Health Organization (WHO) declared a global state of emergency and individual governments followed. The pandemic is having enormous pressure on governments around the world as health policy responses are being strengthened and measures including travel restrictions, border closures, manufacturing plants shutdowns, school closures, lockdown of countries and other social distancing measures to limit human contact, are being undertaken to contain the spread of Covid-19 and the related potential overwhelming demand on health care systems. In Lesotho, a state of emergency was declared on the 10th March 2020 followed by a national lockdown from 29th March to 21st April, putting the economy to a standstill. The national lockdown was extended from 21st April to 5th May 2020. These policy responses are manifesting in disruptions to demand and supply, hence negative pressure on economic performances with dire consequences for public revenues (OBR, 2020).

The role of governments during this pandemic extends beyond treating the sick and containing the spread of the virus, but also includes mitigating its economic impact on people, businesses, and the economy as a whole and therefore exerts unprecedented pressure on government expenditures (Hughes, 2020). Lesotho had recorded 35 cases of Covid-19 with 2 recoveries and 23 active cases as at the 30th June 2020. This number is expected to rise over time. The treatment of the sick due to Covid-19 will exert upward pressure on government expenditure. In addition, laboratory analysis of specimen from suspected patients, and measures for containing the spread, such as the set-up and operation of the National Emergency Command Centre also present budgetary implications. The Lesotho Prime Minister has announced a number of socio-economic interventions aimed at easing the impact of Covid-19 and the lockdown on specified groups of people and businesses. These are mainly in the form of cash payments to identified groups of society as well as tax and license fees holidays for businesses and will add more negative pressure on Lesotho's fiscus. Safe to mention that Lesotho is not yet in a crisis situation as the number of infections are still low.

The pandemic and the associated economic disruption has the potential to substantially reduce tax revenue. The policy response could also have substantial direct budgetary costs. This paper analyses the fiscal impact of the current global pandemic on Lesotho. It is safe to acknowledge that predictions may be difficult because of the many unknowns surrounding this pandemic, including how extensively is it going to spread, how long is it going to last and future policy responses. However, lessons from the 20th Century global pandemic, the 1918-19 Spanish flu and the area/location specific outbreak of the 21st Century, the West Africa Ebola pandemic as well as the global financial crisis could provide useful insights for policy formulation and timely response. This paper draws lessons from these past crises to make inferences about the potential impact of Covid-19 on Lesotho's fiscal revenue and expenditure.

2. The 1918-1920 Spanish Flu and the 2014-2016 West Africa Ebola Pandemics

This Section reviews the impact of past health crises on government finances on affected economies to inform an assessment of the fiscal impact of Covid-19 in Lesotho. The closest parallel to COVID-19 is the 1918 influenza pandemic, popularly known as the Spanish flu. The 1918 flu was the last truly global pandemic. According to World Bank (2016), Spanish flu affected 187 countries. Lesotho was not spared and it was popularly known as Mokakallane. Basotho children born in 1918, "ba hlahile ka Mokakallane". However, there is no data on its impact on Lesotho. Some lessons could also be taken from the 2014 to 2016 West Africa Ebola pandemic, though it was more localized. The World Bank (2016) shows that it affected 3 countries in West Africa.

Hughes (2020) contends that the bulk (80.0 to 90.0 per cent) of the economic impact of pandemics results from the disruption to economic activity associated with the public health restrictions and social distancing rather than from people falling ill. Restrictions that have been imposed to contain the spread of Covid-19 are similar to those that were used during the Spanish-flu and the West Africa Ebola pandemics. However, spread containment measures implemented in 1918 were not as extensive in terms of closing non-essential businesses. Rather than closing businesses altogether, staggered business hours were introduced to avoid crowding in public transport (Garreth, 2008). Fiscal policies implemented to minimize the socio-economic impact of the Spanish flu have some resemblance to what governments are doing with COVID-19. However, there are differences as well. For example, while some tax relief is being provided for businesses during the current pandemic, taxes were actually increased during the Spanish flu to pay for the First World War (OBR, 2020). Socio-economic interventions by governments during the Ebola pandemic included subsidies and transfers to affected households, and bail outs of state-owned enterprises.

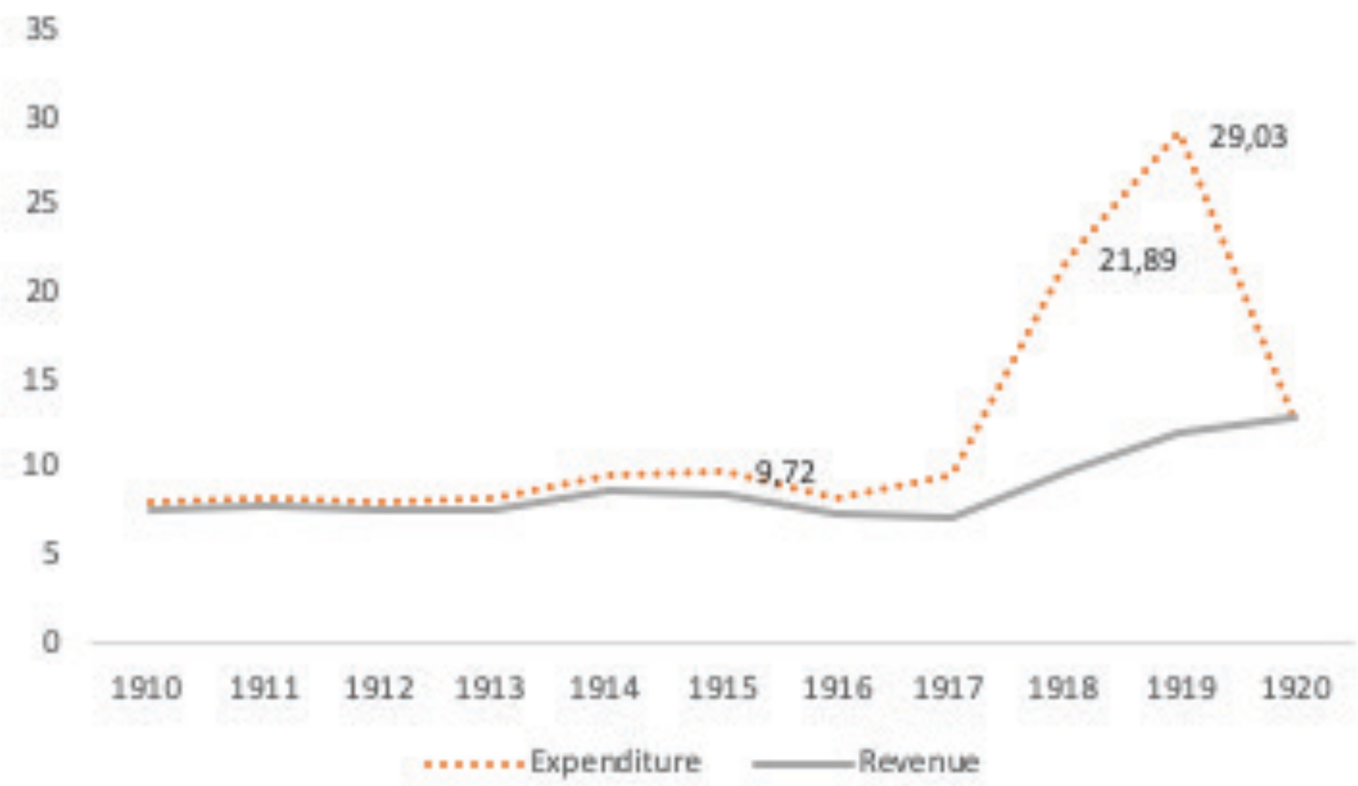
1. Table 1: Measures Undertaken to Contain the Spread of Disease and Minimise their Socio-Economic Effects

	No. of Countries	Containment Measures – Revenue Reducing Factors	Fiscal Measures – Expenditure Increasing Factors
Fiscal Measures – Expenditure Increasing Factors	187	Staggered business hours were introduced for non-essential businesses to avoid crowding in public transport, schools closed, sporting events cancelled and private gatherings banned, social distancing encouraged, self-isolation and quarantine practiced.	• Increased use of social security systems. • Recruitment of additional doctors and nurses. • Purchasing equipment and furniture for and running of quarantine facilities.
Ebola (2014 - 16)2	3	lockdowns and quarantines of cities, towns, and villages in which infection was discovered and border closures.	• Subsidies and transfers to affected vulnerable households. • Bailout of state-owned enterprises.
Covid – 19 (2019 -)	213 (Worldometers. info as at July 1st 2020)	Cities temporarily shut down, businesses and schools closed, sporting events cancelled and private gatherings banned, social distancing encouraged, self-isolation and quarantine practices, border closures.	• Tax relief for businesses. • Salary support. • Increased transfers to the vulnerable. • Recruitment of additional health personnel. • Testing and screening. • Use of antiviral drugs and antibiotics. • Purchasing equipment and furniture for and running of quarantine facilities.

Sources: 1 Public Health Report (2007), 2 Hughes (2020) and World Bank (2016).

The Spanish flu lasted for 24 months, from 1918 to 1919. It occurred during the First World War, which lasted from 28 July 1914 to 11 November 1918. Consequently, its fiscal impact is not easy to disentangle from the cost of the First World War. However, using the United States of America (US) as our reference because of ease of access to data, we observe that much more dramatic increases in government expenditure were observed in 1918 and peaked in 1919. As shown in Figure 1 below, in the US, government expenditure rose from less than 10.0 per cent of GDP before the Spanish flu to more 20.0 per cent of GDP in 2018 and reached a peak of close to 30.0 per cent of GDP in 1919, before falling towards pre Spanish flu levels in the following year.

Figure 1: US Government Expenditure and Revenue



Source: www.usgovernmentrevenue.com and www.usgovernmentspending.com

Government liquidity crunches were not experienced in many advanced economies, including the US, during the Spanish flu pandemic. This is because taxes had already been significantly increased to pay for the First World War, including the first US federal income tax.

The Ebola pandemic had adverse fiscal effects on Liberia, Guinea and Sierra Leone. Table 2 below shows that the primary fiscal balances jumped by 5.1 to 12.0 per cent of GDP among these countries between 2013 and 2014 and remained high in the subsequent two years. This reflected significant declines of 2 to 6 per cent of GDP in these countries' revenues in 2014 while government expenditure rose by 3.0 to more than 8.0 per cent of GDP in all countries except Guinea in 2014.

Table 2: Main Fiscal Indicators (per cent of GDP)

	2012	2013	2014	2015	2016
Guinea					
Revenue	20.2	19.3	12.5	13.8	12.2
Expenditure	26.1	25.1	24.7	23.4	20.9
Balance1	-5.9	-5.8	-12.2	-9.6	-8.7
Grants	2.7	1.5	9.5	6.6	4.0
Balance2	-3.2	-4.3	-2.7	-3.0	-4.7
Liberia					
Revenue	26.4	27.7	22.4	22.4	21.8
Expenditure	31.4	31.7	40.4	42.2	35.6
Balance1	-5.0	-4.0	-18.0	-19.8	-13.8
Grants	1.7	2.4	10.0	9.6	9.6
Balance2	-3.3	-1.6	-8.0	-10.2	-4.2
Sierra Leone					
Revenue	12.2	12.6	10.8	12.2	13.2
Expenditur	21.9	17.5	20.8	23.4	22.0
Balance1	-9.7	-4.9	-10.0	-11.2	-8.8
Grants	4.1	3.0	4.7	3.1	2.8
Balance2	-5.6	-1.9	-5.3	-8.1	-6.0

Source: World Bank (2016), 1 and 2 represent fiscal balance before grants and after grants, respectively.

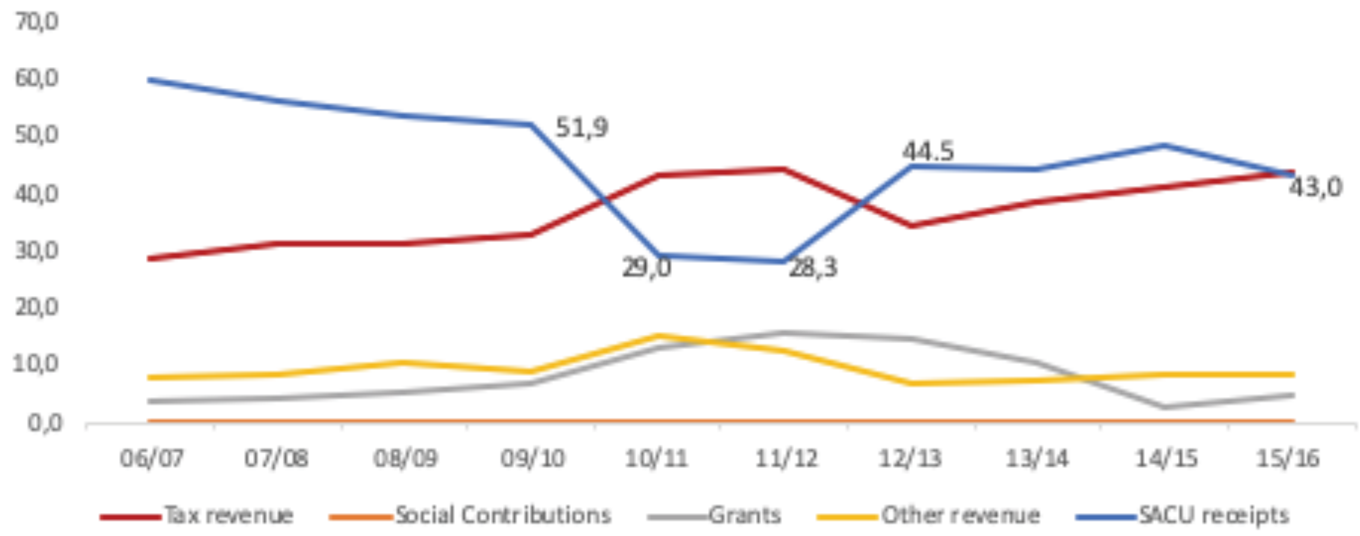
3. The 2007/08 Global Financial Crisis and Economic Recession

There is no data on Lesotho on past health crises to harness lessons from. Nonetheless, past non-health crises, particularly the global financial crisis and the resultant economic recession presents some important insights in relation to the impact on the fiscus. While there are distinct differences between the global financial crisis and Covid-19 in terms of the types of shocks through which they impact the economy, they also share some similarities in terms of the transmission of the shocks through the different macroeconomic variables.

With regard to the differences, the global recession impacted the real economy primarily via a demand shock while policy responses to Covid-19 are being transmitted to the real economy through both demand and supply shocks. The credit crunch that ensued during the global financial crisis affected the real economy primarily through a demand shock by causing a slump in household spending and, in turn, aggregate demand, which led to increases in unemployment. The economic effects of the Covid-19 outbreak and mitigation measures combine aspects of supply and demand shocks. The supply shock emanates from the complete and partial shutdown of economic activity, which have reduced the ability of economies to produce goods and services. The demand shock originates from reduced consumption of goods and services as people practice social and physical distancing by staying at home and the cautious spending by households because of the uncertainty surrounding the pandemic. It is exacerbated by the loss of jobs and income by some workers as a result of the halt in production by some workers. These differences notwithstanding, Covid-19 related demand and supply shocks are likely to have a similar impact on SA's production and imports and, in turn, SACU revenue.

The financial crisis induced slump in global demand and international trade affected economies differently in line with their diverse structures. In SA, the demand for exports of goods, amongst other things, plummeted. Consequently, firms had to reduce production, thus resulting in a decline in imports of inputs into the production process. The fall in imports had a negative effect on customs revenues, hence the Southern African Customs Union (SACU) revenue pool. SA is the largest contributor to the SACU revenue pool at more than 90.0 per cent. Consequently, revenue shares to SACU member states declined. As depicted in Graph 1 below, SACU revenue, hence total revenue for Lesotho plummeted during the fiscal years 2010/11 and 2011/12 following the 2007/08 global financial crisis and recession. The significant decline in government revenue heightened the risk of a balance of payments crisis. Consequently, authorities called for IMF financial assistance under the Extended Credit Facility.

Figure 2: Government Revenue by its Components



Source: Ministry of Finance

In the same way as other countries around the world, SA has implemented movement restriction measures, including border closures and a national lockdown, in an effort to contain the spread of Covid-19. This plug on economic activity and production is, in turn, a reduction in SA's imports of goods. In addition, the Covid-19 related decline in global demand and trade will reduce SA's production and its demand for inputs into the production process, hence its imports of goods. Consequently, SA's contribution to the SACU revenue pool hence the size of the pool will plunge. In turn, members' shares from the revenue pool for the 2021/22 financial year are going to decline just as it happened in the aftermath of the 2007/08 global financial crisis. The magnitude of the impact will depend on how long the crisis lasts, the extent of infections and how much policy space is available to address the after effects of the crisis, amongst other things.

4. The Lessons

The following lessons can be drawn from this analysis;

I. Expenditure rises substantially during health crises episodes because of expenses related to diagnosis, treatment and providing care for the sick as well as social safety nets to protect the poor and vulnerable from the socio economic effects of the crises.

II. Measures aimed at containing the spread of the health pandemic that involve complete or partial shutdown of economic activities, hence a cripple on economic activity, result in declines in government revenues. The increase in taxes prior to the Spanish flu minimized the impact on revenue while humanitarian aid provided some relief during the Ebola pandemic.

III. The policy response measures that are being implemented during Covid-19 are more extensive that it was the case with Spanish flu and Ebola. During the Spanish flu, staggered business hours were introduced instead of complete or partial shutdown of non-essential services in the case of Covid-19. Covid-19 policy responses cover measures that were not available during the Spanish flu such as tax relief, screening and testing as well as treatment with pharmaceutical drugs, which imply more pressure on government spending. In the case of Ebola social security support was extended to vulnerable households residing in affected locations only and not throughout the country as in the case of Covid-19.

These show that economies are going to experience increases in fiscal spending while revenue is going to fall as a result of Covid-19. The impact could be of a much higher magnitude than was the case with Spanish flu and Ebola because of the more extensive and broad nature of Covid-19 policy responses. The impact on revenue will be further exacerbated by exposure to a weak external environment over and above the domestic policy responses because Covid-19 is global and is taking place at a time when the world is more globalized than it was, at least during the Spanish flu crisis.

This paper draws the following conclusions from the aforementioned lessons;

- Government revenue in Lesotho will plummet as a result of economic restrictions that have been imposed to minimize infection and combat the spread of Covid-19.
- Fiscal revenue in Lesotho is going to suffer a double blow as SACU revenue for the 2021/2022 fiscal year will decline, mainly as a result of the plunge in SA's production and imports due to low global and domestic economic activity and demand resulting from movement restrictions as well as social and physical distancing.
- While it is unquestionable that Lesotho will see a fall in revenue, the magnitude of the decline is not easy to estimate. This is because many of the factors around Covid-19, such as how long it is going to last, remain unknown. However, the evidence that Covid-19 restrictions are more extensive compared to those imposed during the past two pandemics implies that the impact could be more severe.
- Treatment of the sick due to Covid-19 will exert upward pressure on government expenditure. In addition, Government is incurring costs related to testing and other measures that are being undertaken to prevent infection and the spread. The socio-economic interventions aimed at easing the impact of the lockdown on vulnerable groups in society and businesses will also have unprecedented budgetary implications.
- The impact of Covid-19 on both revenue and expenditure could be of a much higher magnitude than was the case with Spanish flu and Ebola because of the more extensive Covid-19 policy responses and the fact that it is global in nature. The magnitude of the impact will also depend on the extent of the spread of the virus. Lesotho is not yet in a crisis because of the delayed infections, the number of which is still small and manageable.

5. Recommendations

The Covid-19 related negative fiscal consequences are occurring at a time when government revenue in Lesotho is already under pressure as a result of the decline in SACU revenue in recent years. While policies that are being implemented due to COVID-19 are necessary, caution has to be exercised to minimize the pressure on the fiscal finances. It is in this regard that the following policy recommendations are made.

- Government needs to minimize the increase in expenditure by re-prioritizing spending from non-urgent items to activities aimed at preventing and/or containing the spread of Covid-19. Resort to domestic and foreign debt financing will have to be considered carefully to protect fiscal sustainability.

- The Covid-19 pandemic is putting Lesotho's vulnerabilities arising from high reliance on SACU revenue on the spot light. It thus highlights the significance of expansion and diversification of the formal private sector hence of the domestic tax net through domestic and foreign direct investment. This should feature prominently in the development and ultimate implementation of strategies to rebuild the economy post Covid-19.

- One of the measures that could be considered for minimizing the stress on government revenue from future similar crises is establishment of an unemployment insurance fund to provide short-term unemployment insurance for workers. This, coupled with creation of more formal employment will reduce the number of people in need of government support during times of crises.

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