

A Deeper Look into COVID-19's Implications for Formal Employment and Economic Growth

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Just a few hours after COVID-19 was declared a pandemic, many of the world's Heads of State, including Mexico's, imposed lockdowns on their country's population. This decision, although necessary for safeguarding the most precious good in life, life itself, implied serious consequences in terms of economic welfare.

At first, the Mexican government decided to stop every "non-essential" activity¹ from operating. However, after a few months, the government has started to gradually reactivate the economic activity in an attempt to dampen the effect of the pandemic in welfare. Now, what can we expect economically speaking from this unexpected virus outbreak?

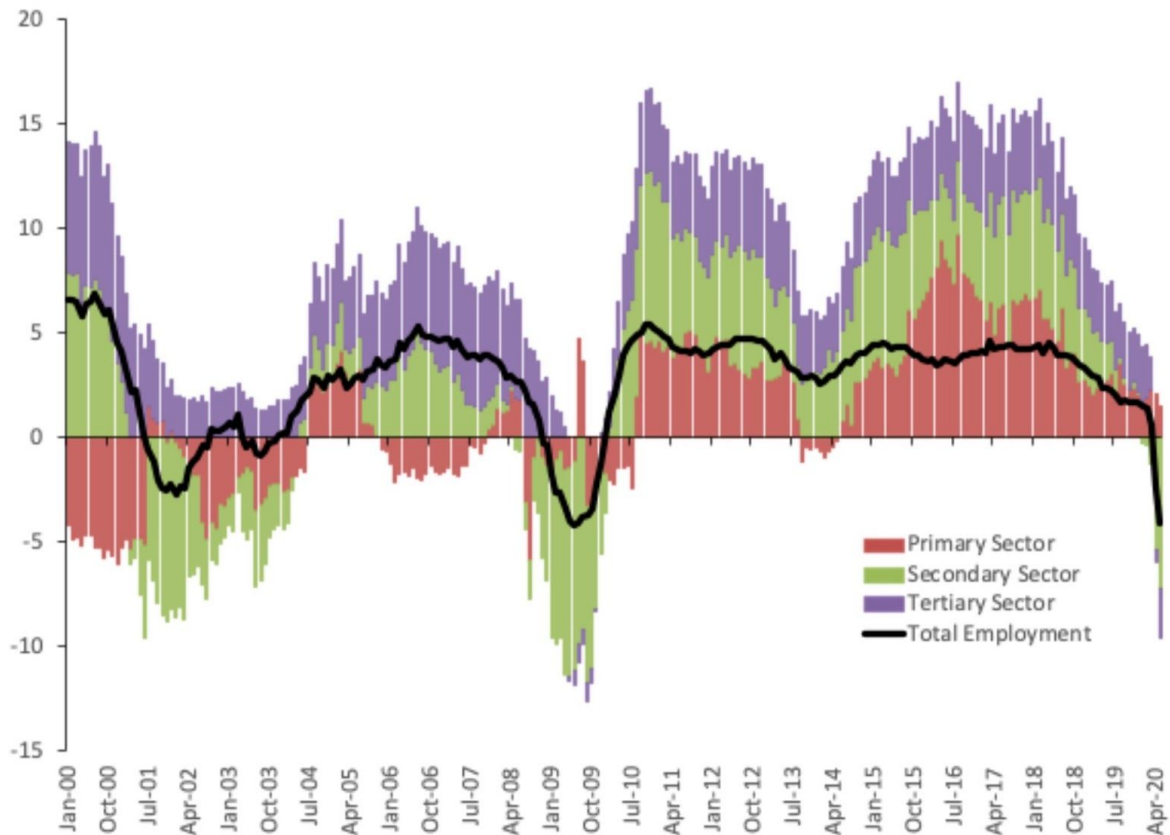
To start with, both formal and informal jobs will be lost. This will be in my opinion one of the worst consequences caused by COVID-19. According to Jiménez et al. (2020), we should expect about 205,863 formal jobs to be lost per each percentage point drop in GDP. There is reason to believe that this can create a chain reaction causing many other sectors to be affected. There is no sign whatsoever that the government intends to help firms maintain their current permanent workers employed. This means that families overall will be worse in terms of income, while also worsening the inequality gap. For every male worker that has lost his job, almost 2 women have lost theirs, according to David Kaplan; and almost 43 times as many people who did not complete elementary school have lost their jobs compared to people who completed, at least, middle-school.

Figure 1 (F. Meza, 2020) presents the Annual % Variation in Employment. This graph presents both total and sectorly disaggregated data.

¹ "Essential Activities" are declared to be: Health, Public Security, Finance, Federal Legislation, Telecom, among a few others.

Figure 1

Annual % Variation



Employment, Total and Disaggregated

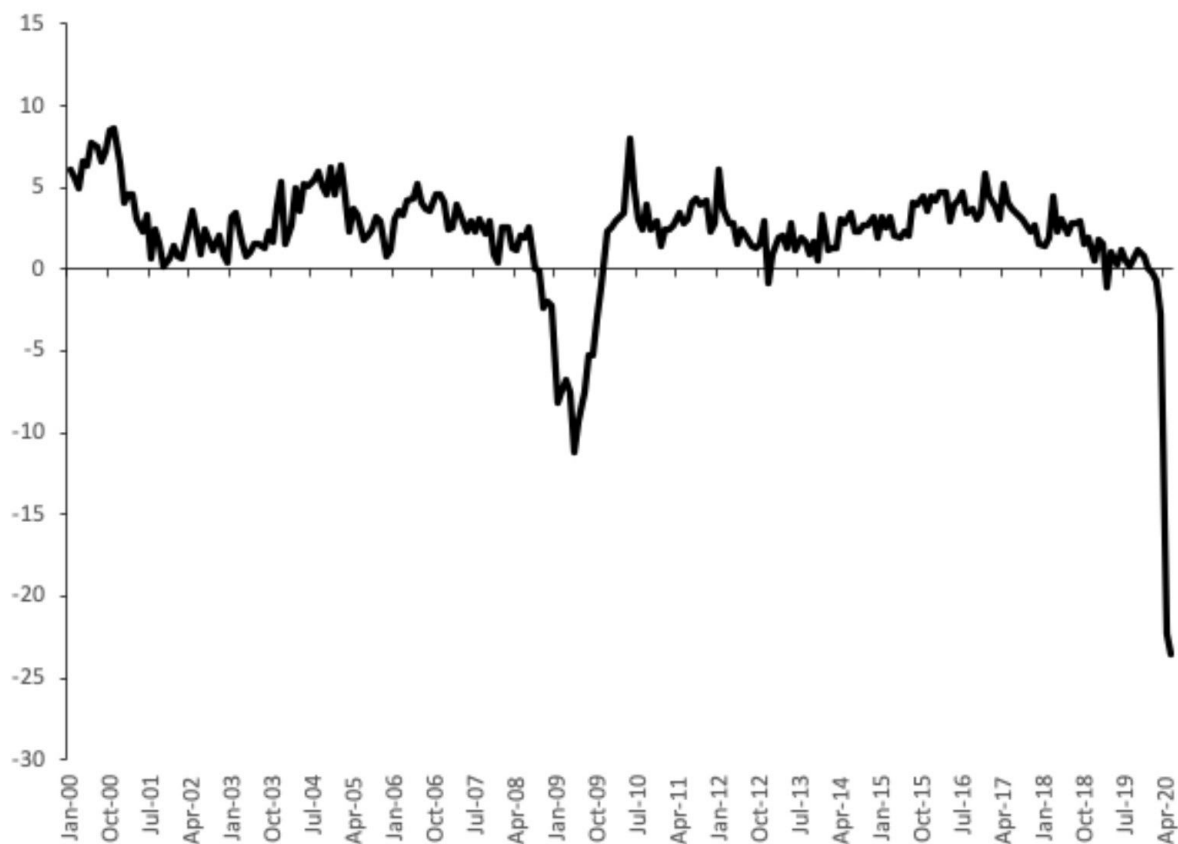
F. Meza, 2020, p. 5

Secondary and Tertiary sectors are the most affected in terms of employment because those two are also highly correlated with economic activity in the United States of America (USA). With the neighbouring country's economy also suffering from the pandemic, it's lower demanded quantity results in mexican industries labour demand and hence output shrinking. Now, another factor to be taken into account is that in case mexican firms fail to fulfill their agreements, USA firms may start looking for substitute firms to trade with elsewhere. Given this scenario, even more jobs could be lost and investment might also suffer from this as it would signal that mexican firms are not being able to deliver.

As stated before, lost jobs will make people consume less both because those who lost their jobs will have less money to spend and those who preserve them will probably start saving a bigger share of their income given the uncertainty introduced by the pandemic and firms firing workers into their future income expectations. As we can see in Figure 2 (F. Meza, 2020), it is quite easy to identify a great reduction in Consumption right from the very beginning of the COVID-19 shock, in March/April.

Figure 2

Annual % Variation in Consumption



F. Meza, 2020, p.5

Also, as F. Meza (2020) states, this liquidity problem could turn into a solvency problem for firms which could be unable to meet their obligations regarding credits. This is a dangerous situation for two main reasons.

On the one hand, many firms, especially Small- and Middle-sized ones could face bankruptcy, increasing the probability that even more people lose their jobs. On the other hand, with many firms closing, markets will become less competitive and we could start seeing more oligopoly-like behaviour within even more industries. Oligopoly-like behaviour means society will have to face deadweight loss and consumer welfare will be reduced even more.

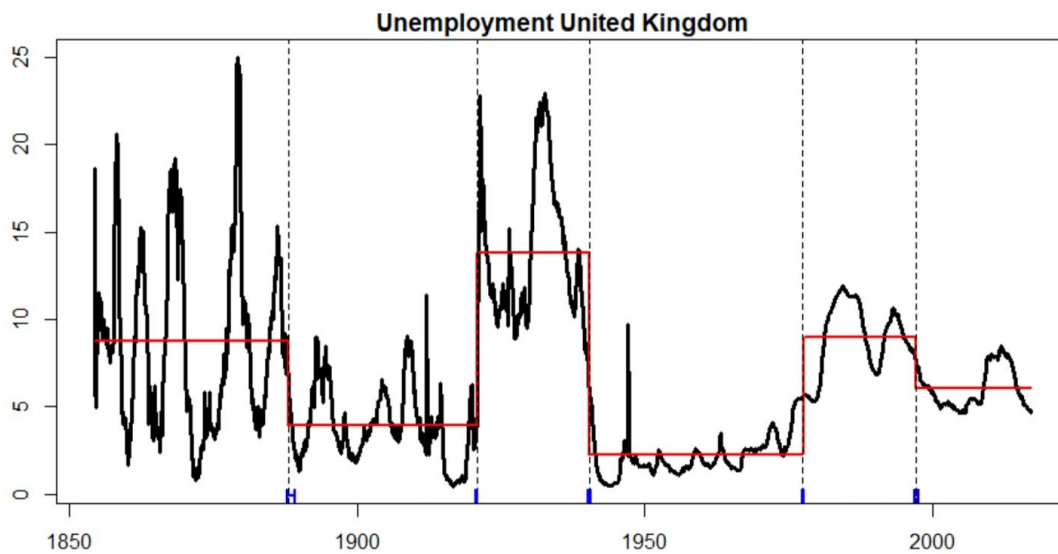
Further developing the bankruptcy case, this scenario could very likely increase interest rates since now banks will have to protect themselves against many debtors defaulting, hence making it even less plausible for relatively smaller firms to access credit in order to survive the pandemic.

On the bright side, however, Mexico has been showing signs of a “V-shaped” recovery. Nonetheless, we should not be very confident this scenario will be in fact achieved both because of the increase in COVID-19 positive cases within the last few weeks and because, as Rodríguez-Caballero and Vera-Valdés (2020) conclude, pandemics tend to create long-term effects in terms of unemployment and growth rates, which usually turn out as “U-shaped” recoveries. Another possible, and perhaps the worst scenario, would be a “W-shaped” recovery. This kind of recovery implies an apparent “V-shaped” recovery but results in a new fall in GDP levels before starting to improve level-wise, further increasing the length of the expected recovery time.

Figure 3 presents evidence from Monthly Unemployment Rates in the United Kingdom analysed by Rodríguez-Caballero and Vera Valdés (2020). Their findings suggest that after pandemics the aggregate effects on labour tend to be harsher and more persistent. This implies that once people have lost their jobs due to a pandemic, the overall scenario causes it to be harder for most of them to obtain a new job in the short-run.

Another thing worth noting is that, even though we may see growth rates increase with the reactivation of economic activity, the level at which this rate is calculated is smaller than at baseline (February 2020) for the same calculation. What this means is that even when we should be excited about the growth rates, we should keep in mind that it will take time to place the economy at the level it had at the beginning of the pandemic.

Figure 3



The dashed lines represent breaks used for the analysis. The ones preceding an increase in unemployment are associated with pandemics such as the Russian Flu and Spanish Flu.

Rodríguez-Caballero and Vera-Valdés, 2020, p. 12

Having analysed the above presented information, the need for a policy that prevents job losses becomes quite clear. The COVID-19 pandemic has the potential to create both a demand- and supply-side crisis for the Mexican economy. Mexican president, Andrés Manuel López Obrador, was quite clear and declared that “firms will not be helped, only people are going to be [helped]”. However, he and his working staff should be aware that protecting firms, especially small- and middle-sized ones is an indirect way of protecting people against the crisis the whole world is going through.

Resources

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Jimenez, A., Martínez, B. and Absalón, C. (2020). An Estimation of Jobs Lost in Mexico during 2020 as a result of the COVID-19: a Cointegration Approach. *Brazilian Journal of Health Review*

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