Principles of War and Operational Art in the Context of the Future Security Environment: Central and East European Perspective

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Magdalena Redo[1]
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COVID-19 CRISIS AS A THREAT TO THE ECONOMIC SECURITY OF THE CITIZEN, THE STATE AND THE WORLD[2]

Abstract

Purpose: The aim of the article was to identify the main threats to the economic security of citizens, the state and the world, caused or reinforced by the outbreak of the COVID-19 crisis and the related lockdown, as well as by unprecedented actions taken as part of the economic policy of states.

Design/methodology/approach: The research used the method of statistical comparative analysis of economic data and the method of content analysis. On this basis, using inductive inference, an attempt was made to identify the main threats to the economic security of citizens, the state and the world related to the COVID-19 crisis.

Findings: The COVID-19 crisis will deepen the debt crisis, with less credible countries, businesses and citizens paying the price. This will increase the instability and vulnerability of weaker countries and their entities to turbulence in the global economy. This will exacerbate the problem of social stratification in a single country and the distance in the development between weaker countries and highly-developed ones with developed and/or wealthy financial markets. The next gigantic stimulus packages of governments and additional money printing by central banks will loosen the discipline in economic policy, which will further discourage people from working and slow down the progress of civilization. This will limit business growth and marginalize equity markets. It will increase the acceptable level of indebtedness and intensify the phenomenon of investment risk in financial markets reaching an extreme level, which will increase the frequency and scale of subsequent crises. Is there any positive? Although the coronavirus crisis will result in bankruptcies of some enterprises, it will be an opportunity for other, new, creative and technologically advanced ones. Therefore, this time we shall allow the world economy to at least partially eliminate ineffective solutions hampering the world's social and economic development and, finally, begin to educate societies from an early age in the financial and economic sphere, so that a greater part of economic entities would be able to resist the next crisis and use it as an opportunity for development.

Keywords: COVID-19 crisis, lockdown, economic stimulus packages, quantitative easing, indebtedness, investment risk, financial vulnerability, sudden stop.

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[2] The paper is an extended version of the article translated from Polish, reprinted from *Przegląd Sił Zbrojnych* (*Armed Forces Review*) bi-monthly, by the permission of the publisher.

1. Introduction

The COVID-19 crisis will deepen the debt crisis, with less credible countries, businesses and citizens paying the price. This will increase the instability and vulnerability of weaker countries and their entities to turbulence in the global economy. This will exacerbate the problem of social stratification in a single country and the distance in the development between weaker countries and highly-developed ones with developed and/or wealthy financial markets. The next gigantic stimulus packages of governments and additional money printing by central banks will loosen the discipline in economic policy, which will further discourage people from working and slow down the progress of civilization. This will limit business growth and marginalize equity markets. It will increase the acceptable level of indebtedness and intensify the phenomenon of investment risk in financial markets reaching an extreme level, which will increase the frequency and scale of subsequent crises. Is there any positive? Although the coronavirus crisis will result in bankruptcies of some enterprises, it will be an opportunity for other, new, creative and technologically advanced ones. Therefore, this time we shall allow the world economy to at least partially eliminate ineffective solutions hampering the world's social and economic development and, finally, begin to educate societies from an early age in the financial and economic sphere, so that a greater part of economic entities would be able to resist the next crisis and use it as an opportunity for development.

2. Deepening the world crisis

The economic crisis caused by the coronavirus pandemic will reduce the incomes of all economic actors – households, businesses, banks and governments – and force many of them to incur further liabilities. It suffices to look at the significant increase in public indebtedness of many countries after the 2008 crisis. At the end of 2019, in Australia and Latvia it was 4.5 times higher than in 2007, in Romania, Slovenia, Luxembourg, Spain and Ireland almost 3 times higher, and in the case of Lithuania, Estonia, United Kingdom, Croatia, Cyprus, Finland, China, Greece and the USA – about twice as high (cf. Figure 1).

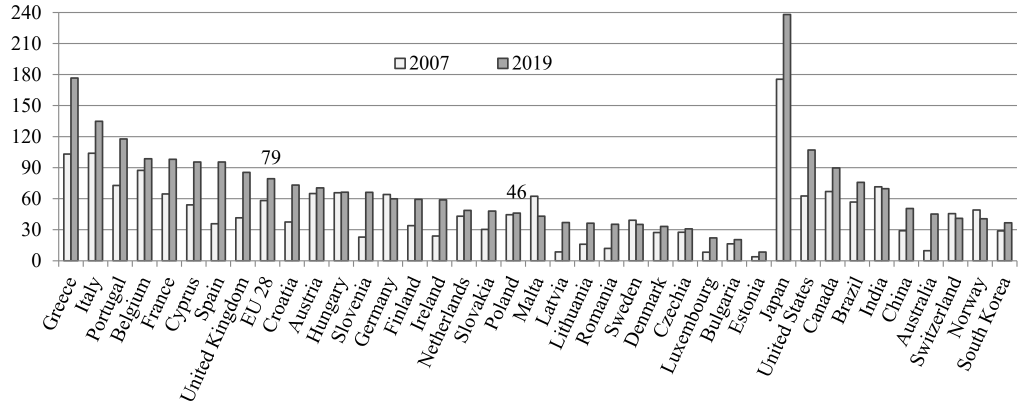

Figure 1. Comparison of public debt levels in 2007 and 2019 in the EU countries and other selected countries (in GDP %; *general government gross debt*)

Source: Author's own study based on Eurostat and Tradingeconomics data.

However, the effects of the increase in debt will not be evenly spread. First of all, a higher price will be paid by less credible economies of developing countries, having lower creditworthiness, and thus limited possibilities to incur further liabilities, and more importantly paying higher interest charges on borrowed capital. Secondly, the highest price will be paid by households, i.e. ordinary citizens, who will lose their jobs, their salaries will be reduced, or the coronavirus will limit their careers and career advancement opportunities, and they will be forced to pay higher commission fees in banks and higher taxes. They will also pay higher prices for many products and services due to their temporary limited availability. However, these prices will not fall down anymore. So the purchasing power of our income will diminish, which will affect the poorer sections of society in particular.

3. Polarization of governments' creditworthiness in the event of shocks

The problem of the income collapse of most entities around the world in the context of the coronavirus lockdown, and thus tax revenues, will be aggravated by unprecedented **stimulus packages of governments**. However, it should be remembered that despite the general consent of international opinion at the level of governments and international institutions, the debt market and the financial market are still governed by the same market laws as before (Redo, 2019b).

In the era of the Internet and IT technology, and thus more and more transparency of financial markets, including debt markets, this means an increasing supply of treasury bonds in financial markets and stronger competition between issuers, and consequently freer and faster transfers of capital towards safer havens during the period of turbulence. Treasury issues of credible governments at unprecedented levels will change **the structure of the debt market**. The share of the safest bonds will increase significantly, making it much more difficult for less credible governments to place their issues. They will have to pay even higher interest on their bonds, but what is worse, it means less stable access of these governments to external financing and an increase in the risk of a *sudden stop* phenomenon, i.e. an abrupt reduction in net capital flows into an economy in the event of shocks. Greater supply of safer treasury securities will intensify the phenomenon of shifting capital in the event of turbulence towards the markets of more stable countries (safe havens). This means that less credible countries (and their economic entities) will be most affected by the increase in the cost of capital and limited access to it in the most difficult crisis periods.

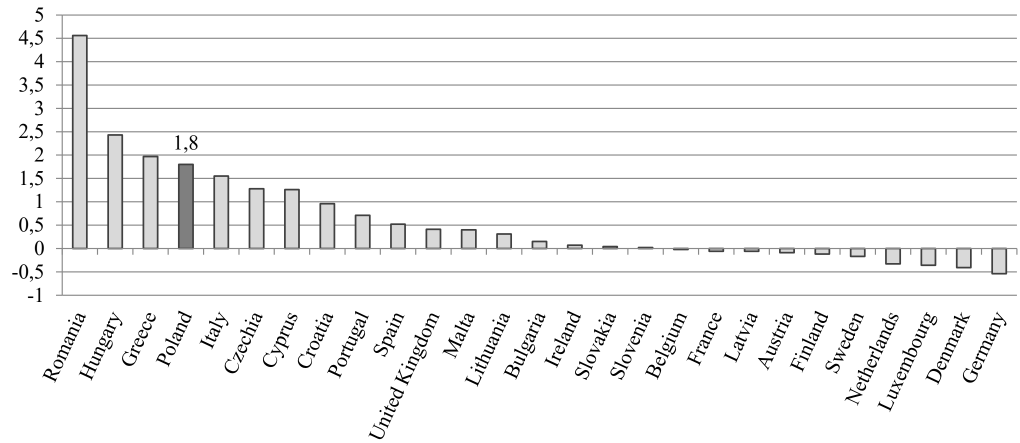

Figure 2. Comparison of 10-year treasury bond yields of the EU countries (and the United Kingdom) in March 2020 (in %; *long term government bond yields*)

Source: Author's own study based on Eurostat data.

The above problem will be aggravated by the fact of seemingly relatively easy access to external financing in periods of a "normal" market situation – i.e. in periods between crises and other shocks. The multiplication of capital in financial markets, accelerated by another massive money reprint by central banks, will force the acceptance of an even higher level of risk than before. This will give the illusion of free access to financing also for less credible governments and other economic entities. This will lull their vigilance and create a false image of their own creditworthiness, which will be brutally exposed in the event of subsequent shocks.

This will lead to a more frequent and amplified *sudden stop* phenomenon, causing painful consequences for less credible countries, where economic development and debt rollover are highly dependent on foreign capital (as in the case of Poland – cf. Redo, 2018a; Redo, 2018b). They must get used to the fact that in the event of external shocks, the capital will flee from their market quickly and in large amounts, condemning them to greater volatility of the exchange rate, debt market, stock market, as well as the volume of sales, income and investments, and thus the pace of economic development (Redo, 2018c). The mere awareness of this will additionally increase the disproportion in the valuation of investment risk and the cost of capital – cf. Figure 2 (Redo, 2017b; Redo, 2017c; Redo, 2017d; Redo, 2016), which will limit the development opportunities of less credible countries (Redo, 2019a; Redo, 2017a). This will polarize the credibility of governments and their ability to raise finance in times of shocks.

4. Deepening the socio-economic stratification

The coronavirus crisis will limit development opportunities of developing countries and, consequently, the entire world economy, and will deepen social stratification not only in a single country. It will also deepen the distance in the development of weaker countries to highly developed countries with developed financial markets, to which capital will always return – especially in emergencies looking for safe havens.

Countries differ in economic and political credibility. Painful experiences of each successive crisis and the increase in debts mean a higher valuation of risk for less credible countries and, as a result, condemn them to a slower catching-up process and a lower citizens' wealth level. In the long run, this will lead to the economic marginalization of less credible, more and more indebted developing countries, as in shock situations they are incomparably more severely affected by the *sudden stop* phenomenon. This is because mobile capital looks for a safe haven in economies with developed financial centers. Moreover, a part of this capital does not return to more sensitive markets of developing economies (cf. Redo, 2020), as the years after the 2008 financial crisis showed. It was the world's major financial centers that offered a quick and really dynamic rebound, allowing for a quick recovery (often with a considerable surplus), which cannot be said about the financial markets of many other not only developing countries. This raises legitimate concerns regarding a more rapid course of the *sudden stop* phenomenon with subsequent shocks, as well as its wider scale, because surely a bigger number of investors will seek to profit from a strong rebound in the most developed financial markets. It will further strengthen the scale of rebound in quotations, as well as accelerate it, and at the same time it will strengthen the scale of capital outflow from other countries' markets. So it seems to be **the rational awareness of the possibility to generate very high profits** in an extremely short period of time that will be the main magnet of the most attractive financial markets – much stronger than the sense of security offered by the so-called safe havens.

5. Intensification of the investment risk extremization phenomenon

For decades, we have witnessed a growing level of acceptable investment risk. This is confirmed by the still symbolic interest rate on treasury bonds issued by many governments – despite a significant increase in their public debt. However, the problem of decade-to-decade lower interest rates is much more widespread. Undoubtedly, the huge increase in household, corporate and government debts caused by the coronavirus crisis will relativize the assessment of the amount of debts – similarly to the situation after 2008. Thus, the acceptable level of indebtedness will be shifted again, as well as the acceptable level of investment risk. The necessity to accept higher risk for higher profitability of the investment will be forced. This will intensify the phenomenon of investment risk extremization in financial markets (*risk taking* – Redo, 2013), which will increase speculation in financial markets and make subsequent crises even more turbulent.

6. Intensification of subsequent speculations and crises

Extremely wealthy financial markets are fed by massive money reprint (*quantitative easing*) by a bigger number of central banks and on a larger scale than after the 2008 crisis, when assets in central banking systems – where the multiplier effect applies – increased by the equivalent of several trillion dollars (Redo, 2017e). It should be emphasized that the National Bank of Poland also has started printing money (since March 2020).

The current money printing by central banks in response to the outbreak of the coronavirus pandemic will aggravate the growing problem of threats related to the excessive and growing amount of capital invested in financial markets, circulating faster and faster around the world in search of profits and accepting ever higher investment risk. This will result in more frequent speculative bubbles, stronger collapses, and above all the lack of real ideas for an effective recovery and stimulation of the global economic situation in the case of a deepening with successive crises powerlessness in the economic policy of an increasing number of countries – including the impotence of fiscal policy (in a situation of high public debts), as well as monetary policy (interest rates approaching 0 percent) (Redo, 2020).

7. Loosening the discipline in economic policy and decline in the willingness to work

Awareness of the powerlessness of the existing fiscal policy tools of indebted governments and the automaticity of launching government aid packages of unprecedented size and additional money printing by central banks in the event of successive crises will strengthen the observed phenomenon of moral hazard, i.e. taking more risky economic decisions due to the awareness that the state (i.e. government and central bank) will always help. On the other hand, it will discourage people from working, making intellectual effort and creativity. As a result, the level of people's knowledge and skills, and thus the quality of the services provided, will decrease. Consequently, socio-economic progress will be slower than it could be. It will also loosen the discipline in economic policy – it will lower the governments' propensity to take difficult rationalizing actions and increase support for populist decisions, reducing the efficiency of resource allocation in the economy and forcing authorities to levy higher taxes. As a result of the above, a lower propensity to establish and develop business activity will occur.

8. Marginalization of equity markets, dependence of enterprises on bank financing and limiting their development

The next collapse in the equity markets in recent years (at the turn of February and March 2020) will strengthen the marginalization of the equity markets' role, already painfully affected by the financial crisis of 2008. This applies in particular to equity markets in countries with weaker financial markets, i.e. the situation in the vast majority of countries where share prices of many companies have not returned over the past decade to the level before autumn 2008 (such as in the Warsaw Stock Exchange). As a result, companies have started to withdraw from stock exchanges. Moreover, companies are less willing to go public and issue shares in order to raise capital for development directly from the market, bypassing financial intermediaries. This is confirmed by the higher number of companies' withdrawals from the Warsaw Stock Exchange in recent years and several times lower number of IPOs (ang. *initial public offering*) than a few years ago – see Figure 3.

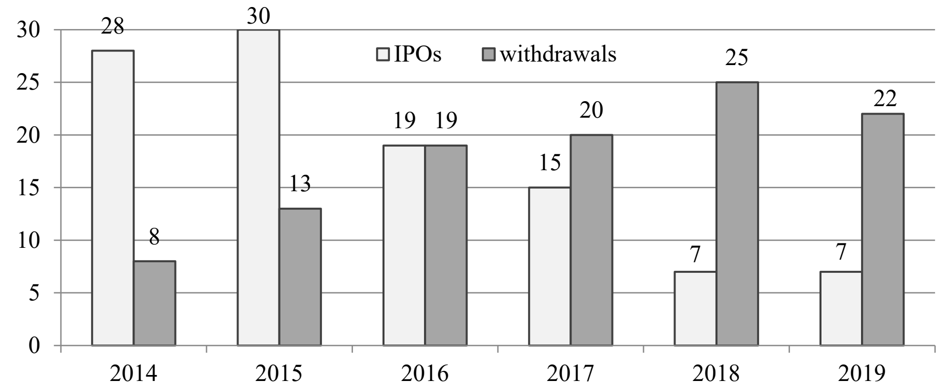

Figure 3. Number of IPOs in the Warsaw Stock Exchange and the number of withdrawals in 2014–2019 (the total number of companies in the Warsaw Stock Exchange at the end of 2019 = 449)

Source: Author's own study based on data from the Warsaw Stock Exchange.

A similar situation is recorded in many stock markets around the world. Apart from the lower valuation of shares on stock exchanges, new issues are additionally discouraged by ultra-low interest rates, which even provoke getting into debt to finance the companies' development. This will result in an even greater dependence of enterprises on bank financing and strengthening of the banking sector position, limiting the independence and development of enterprises – especially those with innovative business ideas in countries with less developed financial markets. At the same time, the growing indebtedness of companies will destroy the goodwill and lower their market valuation in the event of subsequent crises. This will increase the risk of takeover in periods of companies being undervalued, those which were created by successive generations, which will additionally discourage from the tedious long-term development of enterprises in the future. Especially since financial engineering is an easier alternative for earning money, which, most importantly, offers opportunities to multiply your capital much faster in financial markets. The vision of easy and quick profits will discourage people from inventing new businesses and their painstaking development. This will lead to a reduction in the world's socio-economic development stability and, as a result, a reduction in the financial stability of employees and state budgets. Finally, it raises legitimate concerns that equity markets will lose their extremely important role in financing the world's economic development and the role of a barometer of the economic situation. Equity markets, especially in countries with the most developed financial markets, have long ceased to reflect the real value of enterprises and the economic situation of the industry or countries.

9. Chance for market clearing

Bankruptcy of some businesses is an obvious problem for their owners, employees and state budgets. However, it is also an opportunity for new, creative and knowledgeable entrepreneurs. The lockdown caused by the coronavirus pandemics may, therefore, contribute to the desired clearing of the markets of ineffective solutions and the elimination of unprofitable economic entities that should not exist with such low profitability, and their managers, employees and capital should engage in new and more effective businesses, generating higher profits and greater satisfaction, at the same time, dynamizing the socio-economic development. By keeping entities operating on the verge of profitability alive for years, we clip our wings and discourage ourselves from effort, reaching high, breaking down barriers. So we promote tameness, dullness and mediocrity. By allowing an ineffective allocation of resources, we limit the world's socio-economic development and the standard of living. So we deprive many people of a chance for a better tomorrow and slow down the civilization progress. May the current crisis lead to at least a partial clearing of the markets, which we did not allow during the financial crisis of 2008. It would free human, financial and material capital, which the new space would motivate to greater creativity and more intensive work on effective solutions, which would perhaps accelerate the emergence of an epochal invention or new technology that would revolutionize the world economy and stimulate the economic situation for the next several dozen years – as it was the case with, for example, IT technology (and before that, motorization, railway or steam engine). If we fail to do this, we will deprive ourselves of this chance.

10. Conclusions

Although tomorrow an innovative technology may appear that will revolutionize the world and accelerate the socio-economic development for the next several dozen years (hopefully!), the problem will not disappear. It will only be postponed and will come back at the end of another long business cycle. It will be necessary to look ahead, take advantage of good times and implement reforms improving economic and political efficiency and stability, generate financial surpluses, pay off excessive debts and collect a financial cushion to increase creditworthiness, so that in times of the next economic downturn or crisis or less optimism in the markets, be among the countries recognized by investors as a safe haven, and not among those affected by the painful *sudden stop* phenomenon. However, the implementation of these activities needs social acceptance, which requires the widespread increase in economic knowledge and understanding of economic mechanisms, which is not possible without regular financial and economic education of societies. Therefore, the first step today should be to introduce the basics of finance, economics and law into the teaching canon from the first grade of a primary school throughout the entire cycle of education, so that the next generations are more aware of the world around them, understand the phenomena taking place in it and are able to make changes.

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