When China sneezes, middle east states get the cold

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The main objective of this study is to extend an economic perspective on the outbreak of COVID-19 pandemic in the Middle East economies. The COVID-19 pandemic, which was initially considered as a Chinese-centric problem, has now affected more than 200 countries worldwide. The impact of the virus on human sufferings is unaccountable. However, economists consider the repercussion of the outbreak as contagious economically as it has been medically. Throughout this paper, we mainly address a few important research questions about the economic aspects of COVID-19. We further highlight three critical channels through which the economic effect of the outbreak can be assessed. Finally, we explain the case of Middle East states and demonstrate the pathways that explain the economic repercussion of this global pandemic on the region. We conclude the paper by providing a few policy recommendations for the Middle East economies to fight the crisis.

1 COVID-19: AN OVERVIEW

The novel coronavirus, which is officially known as COVID-19, initially emerged in the city of Wuhan in late November 2019. With its initial outbreak in China, the virus is now spreading widely across countries. This virus is a highly transmittable and pathogenic viral infection caused by severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2) (Sheeren et al., 2020). With more than 1 million confirmed cases worldwide, the outbreak has brought considerable human sufferings. After China, the top six economies that are severely affected by the outbreak of COVID-19 are USA, Italy, Spain, China, Germany, and Iran, respectively. Every day new cases are being emerged and reported from different countries, affecting more than 200 countries so far. In the wake of the alarming international concern over the public health emergency, the World Health Organization (WHO) has declared the outbreak as a global pandemic. As of 2nd April 2020, there have been more than 9,00,000 reported cases exceeding 47,795 total deaths worldwide (source: worldometer). Figure 1 highlights the total number of confirmed cases and mortality worldwide.

2 ECONOMIC ARGUMENTS BEHIND COVID-19

In an increasingly globalized world, the impact of COVID-19 will not only be confined to the public health crisis but also will exert a devastating effect on the global economy. At the time, when China has experienced a drastic economic slowdown due to the closure of several manufacturing industries, the operations of the global supply chain have also got affected. As a result, industries across the world, regardless of their size classes, have experienced a contraction in their production. Sectors that are primarily dependent on inputs from China are mostly affected. Restrictions on both domestic and international travelling as declared by many countries have also positively contributed to the economic slowdown. The outbreak has also created market anomalies and disrupted the confidence in the consumption pattern of the consumers globally. The international financial market has also responded to the shock, and the stock market is seen to be at stake worldwide (McKibbin & Fernando, 2020). Beck (2020) has explained three possible factors through which the effect of COVID-19 on the global financial market can be evaluated. These factors are first, the extent to which the virus will spread further and its impact on economic activities. Second, the responsiveness of monetary and fiscal policies to the crisis. Third, the regulatory reactions to the possible bank fragility. According to Beck, as there has been lesser scope to monetary policy actions to deal with the crisis as compared to the global financial crisis, regulatory reactions will play a vital role to deal with the situation. Bolton, Freixas, Gambacorta, and Mistrulli (2016) and Beck, Degryse, De Haas, and Van Horen (2018) have emphasized that the most effective way to handle the financial crises is to target relationship building with the borrowers, especially with the small firms.

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By simulating a global economic model, McKibbin and Fernando (2020) demonstrated seven possible scenarios regarding the outbreak of COVID-19 and its economic consequences on GDP loss. The G-cubed model comprising two additional models, that is, dynamic stochastic general equilibrium model (DSGE) and computable general equilibrium (CGE) model as propounded by McKibbin and Wilcoxen (1999, 2013) and later extended by McKibbin and Triggs (2018) to the G-20 economies. The economic effect of COVID-19 on economic activities in the Middle East states has been displayed in Table 1.

Apart from considerable human sufferings, the virus has caused an enormous economic loss. Every nation is relentlessly taking some precautionary measures while assessing the financial cost of this global pandemic. An important question that arises in this regard is how long and how widely the pandemic will spread and what could be the most effective containment measures. Since having an accurate prediction is very challenging on the part of the economist, Boone (OECD, 2020) provides a tentative economic approach to address these questions. OECD (2020) has demonstrated two cases, that is, best-case scenario and downside scenario to describe the effect of COVID-19 on economic activities. Under the best-case scenario, it has been assumed that based on our available knowledge until very recently, the spread of the virus will contain mostly in China with its minor outbreak in the neighboring countries. In such a scenario, there will be an emergence of a global economic slowdown in the first half of 2020 and post the effect, the economies across the world will recover eventually. Figure 2 presents the best-case scenario, diagrammatically.

On the other hand, under the framework of a downside scenario, if the pandemic spreads outside China and the deadly effect of the virus spreads across the Asia-Pacific region and other advanced economies in Europe and Middle East economies, then the economic impact of the outbreak will lead to a prolonged slowdown.

### Table 1 Loss in GDP in the Middle East States under seven scenarios

| Country     | S01 | S02 | S03 | S04 | S05 | S06 | S07 |
|-------------|-----|-----|-----|-----|-----|-----|-----|
| China       | −0.4| −0.19| −6.0| −1.6| −3.6| −6.2| −2.2|
| Saudi Arabia| −0.2| −0.2| −0.3| −0.7| −1.4| −2.4| −1.3|
| Turkey      | −0.1| −0.1| −0.2| −1.4| −3.2| −5.5| −1.2|
| Iran        | −0.2| −0.2| −0.4| −1.8| −4.1| −7.1| −1.6|
| Rest world  | −0.2| −0.2| −0.4| −1.4| −3.2| −5.5| −1.3|

Note: This table shows the loss in GDP under seven scenarios. The number reflects the change in GDP in 2020 as a percentage change from the baseline. The table exhibits the magnitude and scale of the different pandemic scenarios on reducing GDP in the global economy. For more details, see McKibbin and Fernando (2020).
Boone (2020) argues that under the best-case scenario, the slowdown in growth will majorly occur to China as a result of the contraction in demand. Eventually, it will have a global impact on the world equity market and commodity prices. The economic impact of the pandemic and the measures taken to curb the spread will be associated with the adverse supply-side shock, and gradually, this shock in supply-side will get reflected in demand-side. There will be an abrupt decline in consumer confidence as they have foregone their work hours. Restriction on travels will hit the tourism sector, a sharp disruption in the financial industry and hence less cash-flow coupled with poor investment decisions by firms. Boone (2020) identifies three relevant channels through which the pandemic can affect economic activities across the countries.

2.1 | Supply channel

The first important channel is the supply channel. With the disruptions in the production unit, closures of factories irrespective of sizes, cutbacks in the service sector, especially the financial sector, can result in a significant disruption in the global supply chain.

2.2 | Demand channel

As a consequence of the outbreak, there will be a fall in demand in the travel and tourism sector, the decline in the education services, decline in trade, contraction in the demand for entertainment and leisure services.

2.3 | Confidence channel

The third crucial channel is the confidence channel. Amidst the global uncertainty, there is a fall in the confidence pattern of consumers as there is less consumption of goods and services. To contain the spread, several containment measures have been adopted by several countries, which are likely to affect the consumer and financial market confidence.

3 | EFFECT OF COVID-19 ON MIDDLE EAST STATES

In a strongly connected world, the impact of this highly transmittable virus will not only be confined to a few numbers of morbidity and mortality. At the time, when the Chinese economy is already observing an economic slowdown, caused by the sudden disruption in the production units, the rest of the world has started experiencing the same in the functioning of the global value chain. International traveling from virus affected countries is fundamentally giving rise to the further spread of COVID-19 to the Middle East region. The total number of confirmed cases as of 2nd April stand around 83,800 in the Middle East states. Among all Middle East economies, Iran has been the worst victim of COVID-19 outbreak. As of 2nd April, there have been a total of 50,468 reported cases of infections in Iran with 3,160 cases of deaths and 16,711 recovered cases. Table 2 reports the total number of infections along with the number of deaths and recoveries in the Middle East region. The spread will be likely to hurt

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**FIGURE 2** Contained outbreak scenario. World GDP in 2020 (% difference from baseline and contributions in % pts). Note: The simulations in the figure imply due to the spread of COVID-19, there will be 4 and 2% fall in China in the first and second quarters, respectively. Ten percent decline in the global equity and commodity prices in the first half of 2020. Ten percent increase in uncertainty (rise in investment risk premium) across all countries in the first half of 2020. It has been assumed that all shocks are likely to be faded away gradually by early 2021. Source: OECD calculations using the NiGEM global macroeconomic model.

**FIGURE 3** Downside Scenario, World GDP in 2020 (% difference from baseline and contributions in % pts). Note: The simulation in the figure denotes that there is a likely fall of 4 and 2% in domestic demand in China in the first and second quarters, respectively. Two percent fall in domestic demand in the Asia Pacific region and in other advanced economies in the second and third quarters of 2020. Twenty percent fall in the equity market globally and 50 bps rise in uncertainty across other economies. All the shocks are assumed to decline eventually in the first half of 2021. Source: OECD calculations using the NiGEM global macroeconomic model.
East states has strengthened over time (Fulton, 2019). The strong bilateral relationship between China and Middle East states. Given the position of China as World's largest consumer, its economic relationship with the Middle East states has strengthened over time (Fulton, 2019). The strong bilateral relation between China and Middle East states can be better viewed from the presence of Chinese consumers and industrial products in the Middle East states. GCC-China trade is different. The gulf economies predominantly rely on energy exports and more than 85% federal budget revenue comes from the energy exports. Between August 2018 and July 2019, there was a dramatic increase in oil imports from Saudi Arabia to China due to the diplomatic stand of the US against Iran. Before the outbreak of COVID-19, the Chinese import of oil from Saudi Arabia averaged between 1.8 and 2 million barrels per day, has now dropped by 500,000 bpd.

When it comes to Middle East states, people remember “Arab Spring” which disrupted the entire political landscape of the region since the fall of the Ottoman Empire at the end of World War 1. In recent times, the situation appears riskier than it used to be earlier. The region has now found itself on the verge of a set of cascading challenges that will leave a devastating impact on the public health, in general, and on the economy, in particular. Iran and Egypt have deplorable health care records. Statistically, approximately 10% of the Egyptian population suffer from hepatitis C due to bad hygiene conditions. Moreover, a massive influx of refugees and internally displaced community coming from Libya through Syria to Iran are vulnerable to cold and other diseases hence posing a significant threat to public health in the times of emergency. Apart from the public health crisis, the COVID-19 will affect the economy of the Middle East through the following channels.

### 3.1 Oil price

One of the important channels through which COVID-19 can affect the economy of the Middle East states is the current fluctuations in the prices of their energy products in the international market. Oil prices started falling as the government escalated lockdowns to mitigate the spread of the coronavirus that has dampened the demand conditions of oil. As the significant portion of budget revenue of the Middle East states comes from the gas and oil exports, a sudden fall in the gas and oil prices is expected to have an unfavorable effect on their economy. Since the outbreak of the virus in China, the oil price has fallen drastically in the Middle East states. The economy of Saudi Arabia is already plunging as the kingdom is buckled with oil prices collapsing in the light of coronavirus pandemic. Oil prices have witnessed a significant fall since the outbreak of COVID-19 in January, and the price war was led by Riyadh and Moscow. One of the prominent reasons behind the fall in oil prices is the lack of oil demand from the Chinese side. However, the oil prices are expected to decline further as producers are committed to produce drastically and create an oversupply situation. Figure 4 shows how the crude oil prices have responded till January to March as the concerns over coronavirus emerged.

### Table 2: Number of infections in the Middle East

| Name of the countries | Number of cases | Number of deaths | Recovery |
|-----------------------|-----------------|-----------------|---------|
| Bahrain               | 643             | 04              | 381     |
| Cyprus                | 356             | 11              | 28      |
| Egypt                 | 850             | 52              | 179     |
| Iran                  | 50,468          | 3,160           | 16,711  |
| Iraq                  | 772             | 54              | 202     |
| Israel                | 6,808           | 34              | 289     |
| Jordan                | 299             | 05              | 45      |
| Kuwait                | 342             | 00              | 81      |
| Lebanon               | 494             | 16              | 46      |
| Oman                  | 231             | 01              | 57      |
| Palestine             | 160             | 01              | 18      |
| Qatar                 | 835             | 02              | 71      |
| Saudi Arabia          | 1885            | 21              | 328     |
| Syria                 | 16              | 02              | N/A     |
| Turkey                | 18,827          | 536             | 4,013   |
| UAE                   | 814             | 08              | 61      |
| **Total**             | **83,800**      | **3,907**       | **22,510** |

Source: Worldometer (As of 2nd April).

consumption, production, and international trade mainly. As the situation is getting intensified from the last few days, the government in Iran has closed down all schools, colleges, and universities; cancelled all public events; and suspended all international and domestic travels as precautionary measures to stop the virus. All the neighboring countries that share their borders with Iran has closed their borders now.

As the region is going through a massive public health crisis, the ability to curb the outbreak will solely depend upon the strength of the public health system and immediate government steps taken during the period of crisis. According to WHO, Middle East states relatively hold higher ranks among the world’s 191 health system except for Yemen, which ranks 120th among all countries. However, given the political instability in the region, especially the war and conflicts in Yemen, some Middle East states might find it challenging to curb the spread of COVID-19. The current conflicts in certain countries of the region will impede the effective functioning of the health care system. According to Abdinasir Abubakar of WHO’s Regional Office, the US embargo on Iran may affect the ability of Iran to purchase the required technology and equipment to produce the medicines.

China plays a very vital role in the Middle East economy. Although the China and Middle East bilateral trade relationship is relatively new, China has appeared to be a major economic and political actor in the Middle East states. Given the position of China as World’s largest consumer and importer of energy, its economic relationship with the Middle East states has strengthened over time (Fulton, 2019). The strong bilateral relation between China and the Middle East has resulted in the growing number of Chinese financial intuitions being set up throughout the region. Dubai alone has several branches of Chinese four largest banks, more than 4,200 Chinese companies. Over the years, China has maintained a long-standing economic relation with the Middle East economies. The most glaring economic partnership between China and Gulf Cooperation Council (GCC) is characterized by the standard political and diplomatic outreach. Such resilient economic coordination, however, has been affected by the ongoing spread of coronavirus. The economic outcome of the region is also going to be affected by the Chinese economic slowdown. The bilateral relation between China and Middle East states can be better viewed from the presence of Chinese consumers and industrial products in the Middle East states. GCC-China trade is different. The gulf economies predominantly rely on energy exports and more than 85% federal budget revenue comes from the energy exports.

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Source: Worldometer (As of 2nd April).
On the other hand, the non-OPEC member and world’s second-biggest oil producer Russia has denied the proposal of Saudi Arabia and urged it to cut the oil prices to boost output. As a result of the price war, both countries have witnessed oil prices to the lowest level since 2003. Other oil-producing countries such as Iran, Iraq, Kuwait, and UAE are observing a sharp fall in government revenues due to the weaker demand for oil in the international market. Additionally, as witnessed, the price of Brent oil registered a fall to $50.5 a barrel on 28th February from $68.90 a barrel on 1st January. In due course of anticipation about an adverse impact on oil demand amidst the outbreak, crude oil prices also noticed a drop by $20 barrel during January and February.

There are a series of reasons that can potentially be attributed to the fall in oil price in the region. The outbreak of COVID-19 in China and its precautionary steps toward shutting down the production in many manufacturing industries as an effort to contain the spread of the virus significantly lowered the demand for oil in China. International Energy Agency (IEA) documents that China constitutes a total 14% of global oil demand. Moreover, IEA, 2020 reports that the growth in oil demand in China currently accounts for more than 75% of the global growth in oil demand. Given the significant role of the Chinese economy in the global market, any shocks to the Chinese economy is anticipated to have substantial negative externalities to the rest of the world (Arezki & Liu, 2018). In the event of mounting public fear and global uncertainty, the investment decisions of firms in China and the rest of the world will further shrink oil prices. IEA projects a sharp fall in the global demand for oil price by 435,000 barrels per day year-on-year in the first quarter of 2020. The risk is gathered momentum as the coronavirus crisis is inducing many oil-producing countries and OPEC+ to take into account an additional cut in the oil production of 600,000 barrels a day as an emergency measure on the top of the 1.7 million barrels a day already pledged (International Energy Agency, 2020).

### 3.2 Travel and tourism

The impact of the COVID-19 will also depend on the extent the cross borders are connected to China. Middle East economies are exposed to China through a robust supply chain, tourism, and other travel-related services. This is why it has been anticipated that COVID-19 will have an impact on the travel and tourism sector in the Middle East states. However, Arezki and Nguyen (2020) emphasize that the Middle East countries are likely to restrict tourism from China in two critical ways. The first way will be implemented through the pull factor as the Middle East economies are all set to ban the travel from China. Saudi Arabia has already imposed a ban on travel to prevent the entry of pilgrims to the holy sites. UAE has been the first country to announce the suspension of all flights to and from China except Beijing. They did so in an effort to contain the outbreak of the virus in the Middle East states. The second factor is a push factor that implies that a contraction in the economic performance in China demonstrates the case of fewer tourists travelling to other countries, including the Middle East. However, the degree of the economic slowdown in China will not be much affected by the fall in tourists visit in the Middle East from China. Lopez-Cordova (2020a, b) have estimated the fall in per capita GDP in China as a result of Chinese arrivals in the Middle East and the rest of the world. Additionally, many Middle East states, especially Saudi Arabia and UAE, will witness a significant downfall in the tourism sector as the crisis has it the pilgrimage season and Expo 2020 Dubai, respectively. However, it is worth mentioning that the economic slowdown in China as caused by the reduction in the tourists’ arrivals from the Middle East states to China is expected to be limited. A loss in travel and tourism in the Middle East will further contribute to depress the oil prices.

### 3.3 Value chains and capital markets

As the supply chain is heavily disrupted all over China, countries with a strong connection to China for intermediate inputs are getting affected. The COVID-19 pandemic has transformed the business world across the world in an unprecedented way. The scale and speed of COVID-19 on global value chains are yet unknowable. The outbreak has compelled the business enterprises to halt, caused contractions in factory outputs, disrupted the functioning of manufacturing companies and their supply networks globally. China supplies a large bulk of raw or processed materials to the Middle East states. As a
result, the manufacturers in the Middle East region have faced a similar contraction in their industrial output. According to the estimates published by UNCTAD on 4th March, the manufacturing slowdown in China caused by the COVID-19 outbreak is disrupting the world trade and could result in a $US50 billion decrease in exports across the global value chain. In February, the PMI (Purchasing Manager’s Index) of China’s manufacturing declined by about 22 points to 37.5, the lowest reading since 2004. This fall in PMI implies a drop in exports by 2% on an annual basis. This effect would be much pronounced for the Asian economies, which share a strong value chain connection with China. However, the outcome is less likely for the Middle East states, as these economies have limited outreach in a global value chain process. A sudden shock to the global value chain has caused a fall in the oil price due to the weaker demand arising from China. On the other hand, as the capital markets across the globe are experiencing extreme volatility, it has been predicted that big corporations in the Middle East States including Bahrain, Oman, and UAE might witness a similar experience in their capital markets. Additionally, if the virus continues to spread, the loss in human capital could be significant. As many countries have decided to shut down schools, colleges, and universities, such steps might impact the innovation and research and development in the short- and medium-term worldwide.

4 SOME POLICY RECOMMENDATIONS

Effective implementations of some timely and stringent monetary and fiscal policies can go a long way to rescue the economy from this global pandemic. Policymakers and regulators should focus on formulating policies that could speed up the recovery of economic slowdown post the pandemic. First and foremost, the government in the Middle East states should increase government expenditure on public health and ensure people having all essential health care facilities to prevent and mitigate the spread of COVID-19. Due importance should be given to research and innovation so that scientist and researchers can find an effective way to address the crisis. In addition to public health, the government should also help vulnerable households by providing them with temporary direct benefit transfers. Such actions of the government would support the households to compensate for the loss of their incomes arising out of work shutdowns and layoffs. Micro and small enterprises need an immediate boost. In this regard, interest rates cut can help to induce more liquidity buffers to small firms in the affected sectors. As far as the financial markets are concerned, effective implementations of monetary policies through interest rate cuts can revive the economy. An easy monetary policy can boost the confidence of financial market participants to cushion the shock international cooperation and development aid from the developed countries to less developed countries can be proven effective during this crisis.

ENDNOTES

1 As of second April 2020, WHO reports 2,26,141 cases in USA, 110,574 cases in Italy, 110,238 cases in Spain, 81,728 cases in Germany, and, 50,468 confirmed cases in Iran.

2 https://worldometers.info/coronavirus/country/iran/

3 https://www.worldometers.info/coronavirus/country/iran-virus-concerns-rise-200223160135283.html

4 https://www.brinknews.com/china-is-becoming-a-major-player-in-the-middle-east/

5 https://www.cnbc.com/2020/04/01/5-charts-that-explain-the-saudi-arabia-russia-oil-price-war-so-far.html

6 see https://www.iea.org/reports/oil-2020 for details

7 https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2297

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