

Parturiunt montes, nascetur ridiculus mus

## L'économie au temps du choléra COVID 19

de Jean Baneth

**Résumé en français.** *L'article complet en anglais figure à la suite.*

J'avais décidé il y a quelques années de ne plus prétendre comprendre l'économie ni prendre de nouvelles décisions financières. Pourtant je me suis récemment engagé dans deux paris: que le taux de change de l'Euro et les valeurs boursières des grandes entreprises européennes allaient remonter. Voici en quelques mots le raisonnement sous-jacent.

Je parle de raisonnement mais bien des éléments sur lesquels il est basé restent inconnus des spécialistes, dont les connaissances restent inconnues de moi. L'évolution économique dépend de l'évolution de la situation et des politiques sanitaires. Je ne les connais pas – donc l'analyse économique et les décisions qui y sont liées tiennent pour beaucoup de paris sur pile ou face.

Partout les économies s'effondrent, conséquence directe de l'épidémie et plus encore des mesures de confinement prises pour la contenir. L'INSEE donne un reflet de cet effondrement tel qu'il l'estime en France au 26 mars: une baisse d'un tiers de l'activité économique. Une telle baisse d'activité n'a sans doute été enregistrée qu'une seule fois et bien plus brièvement en France, en mai 1968 et jadis pendant la grande dépression quand fin 1931 par rapport à 1929 la production industrielle avait baissé de 42 % en Allemagne, 37 % aux États-Unis, 33 % en Belgique, 27 % en Italie et 23 % en France.

L'évolution de la crise ne suivra pas le chemin des années trente, car tous les pays riches prennent des mesures financières gigantesques pour stimuler leurs économies et remplacer les revenus détruits par l'épidémie et les mesures visant à la contenir. Les mesures européennes visent surtout à inciter les entreprises à continuer à verser à leurs employés presque tous leurs salaires en les remboursant sur fonds publiques. C'est préférable à ce qui se fait aux états-Unis: mise à pied et assurance-chômage améliorée et au financement complété par de nouveaux fonds publics. Les mesures financières déjà votées sont gigantesques mais seront insuffisantes: d'autres suivront sans aucun doute. Les Banques Centrales promettent de faire tout ce qu'il faut (*whatever it takes*) pour assurer le financement de ces programmes et celui des crédits bancaires aux entreprises – eux-mêmes souvent garantis par les gouvernements.

Contrairement aux récessions classiques, cette crise n'est pas due à un effondrement de la demande mais à celui de l'offre. Les consommateurs n'ont pas déserté bars, théâtres, avions, hôtels, magasins : les gouvernements leur ont ordonné de fermer. D'autres productions souffrent de mesures qui limitent les déplacements. Vrai, cet effondrement des productions se répercute souvent sur la demande – on commande forcément moins d'avions quand ceux qu'on a sont cloués au sol. Encore vrai, la demande pour certains biens et services a fortement augmenté – ceux directement liés à l'épidémie, mais aussi d'autres, moins prévisibles: Amazon essaie d'engager 100 000 employés supplémentaires. Le phénomène essentiel est tout de même constitué par les limitations de la production combinées à d'immenses efforts pour maintenir les revenus qui y sont normalement liés.

Offre de biens et services en forte baisse, revenus correspondants maintenus: cette inégalité ne peut être résolue que par la hausse des prix. Ce qui n'est pas un mal en soi; les pays riches déploient depuis des années des efforts infructueux pour faire accélérer l'inflation. Mais si une élévation du niveau des prix semble inévitable et même désirable, il ne faudra pas laisser l'inflation s'emballer.

Même quand on dépend tant de décisions publiques on doit décider de son action individuelle, et même l'inaction en est une. On ne peut éviter de faire un pari sur l'avenir. Je souligne «pari». Tout ou presque dépend de la nature même de la maladie (*la guérison confère-t-elle l'immunité? pour combien de temps?*) et de *quand* (optimiste, je n'écris pas «*si*») *viendront vaccins et remèdes?*, de l'évolution de l'épidémie et des mesures prises pour la juguler. A ces incertitudes exogènes à l'économie s'ajoute une autre. Depuis la fin de la seconde guerre mondiale les états-Unis ont considéré que leurs propres intérêts étaient bien servis par la construction d'un ordre international fondé sur des règles communes et ouvert aux échanges, et ils ont bien souvent agi en ce sens. Ils ont renoncé à jouer ce rôle juste quand une grande crise frappe l'humanité entière. Ils ne pourront pas reprendre entièrement le rôle qu'ils jouaient naguère, mais le déroulement des crises – sanitaire, économique, politique – dépendra aussi de l'orientation politique américaine à partir de janvier prochain.

Alors, quel pari ? Je parie sur un niveau de prix en zone Euro 10% à 15% plus élevé en 2022 qu'en 2019. Je parie aussi sur une reprise assez rapide de l'activité économique à partir de septembre, précédée de peu par la levée progressive et partielle des mesures de confinement. Je parie sur une remontée de l'Euro vers ce que je considère sa parité d'équilibre, environ \$

1,35 par Euro et sur une remontée plus rapide (exprimée en la même devise) des bourses européennes que celle des bourses américaines.

*Qui vivra, verra!*

### **COVID 19: Economic impact and policies.**

A few years ago I decided that I was too old to take rational financial decisions, and that I would no longer actively manage my small portfolio. Then last month I did otherwise. I made two bets: that the Euro currency and Eurozone economies would recover from their slumps. The rebounds I expected were not spectacular, at least for the stock market. Had there been even modest positive returns to be expected from safe fixed income assets I would have stuck with them. But none were on offer.

More recently, I decided to write a note on the economics of Covid 19. Both decisions appear to have been premature because the Covid 19 crisis depend more than had been expected (at least by me) and because its present state and future evolution remain clouded. I will curtail efforts to dissert about the economic consequences of an unfolding series of exogenous events much of whose past, present and future are still unknown. But I am reluctant to discard what I wrote so far – here it is.

Scientists know little about much concerning the Covid 19 virus and I know little of that little. We do not know the share of asymptomatic carriers and therefore mortality rates and their distribution; how much immunity cured patients acquire, for how long; which if any medicine, existing or yet to be developed, cures the disease or even reduces its impact, nor when and even whether a vaccine can be developed. Yet a consensus has started to emerge that confinement in place is a good way to reduce infections peaks, and thus avoid overburdening hospitals.

It is too early to evaluate the longer-term economic consequences of the disease itself and of measures applied to control it. How long such exceptional measures need to last, with what other measures they will be complemented, what more – or less – needs to be done once public health threats have abated, cannot yet be determined with any confidence. But the immediate economic impact of the health crisis and related confinement measures create needs for immediate economic countermeasures. To these Central Banks and Governments are responding by providing financial resources and incomes in ways more or less sharply targeted at individuals and firms directly harmed by the crisis.

Unlike in demand in recessions like those of 1929 and 2008, collapsing overall demand is not the direct cause of this crisis. Customers did not decide to shun restaurants, retail shops and transport: governments forced suppliers to stop or drastically reduce production. The world economy is receiving a supply shock, not unlike the impact of a major war.

Workers prevented from working need incomes to help them survive. Producers prevented from producing need being protected from bankruptcy by abundant loans on easy terms, government guarantees and subsidies to replace lost incomes. When goods and services whose production used to generate incomes disappear while the incomes are maintained inflationary pressures follow. This cannot stand in the way of immediate relief. Some acceleration of inflation is even welcome: rich economies have long been undershooting their inflation targets. Yet inflation should not be allowed to get out of hand. Resurgent inflation would be harmful by itself. Even worse, it would comfort those who even now resist active financial policies.

Governments and firms need to be better prepared to deal with future crises. If that lesson is to be learnt, it may be necessary to mete out some punishment to those least well prepared this time. Too many firms used too little of their past revenues to strengthen their balance sheets and too much to distribute dividends, buy back stocks and recompense their managers.

There also arise broader questions about future economic arrangements. In the past fifty years “*globalization*” and “*just-in-time*” became ubiquitous in economic and management vocabularies. Jointly they greatly contributed to raising productivity and world incomes – particularly those of the very poor. This crisis and the accompanying lockdowns and embargoes on key products highlight risks in this system. Legitimate criticism of its lacunae already feeds into rampant protectionist rhetoric. By ill luck, this global crisis happens at a time when the United States has already deliberately abandoned the place of world leadership it held since World War II and turned into a major source of nationalist rhetoric and, often, policies. Alternate post-crisis directions are still possible: larger strategic inventories or movement towards autarchy, protectionism or stronger and more binding international agreements... Politics in the US and, to a lesser extent in the EU will much influence choices between routes to be taken.

## **COVID 19’S ECONOMIC IMPACT**

The present health crisis reduces supplies, some because workers fall ill or fear to venture out, mostly because of direct Governments orders: airlines, cruise ships, restaurants, entertainment, retail shops must close or drastically

reduce the services they offer... All workers are instructed to work from home whenever possible, non-essential workers to stay home even if they cannot work. These measures in turn affect other firms through demand and supply: caterers to airlines and restaurants, builders of airplanes, producers of the goods normally bought in retail shops... Goods transports are mostly exempted from deliberate travel restrictions but suffer unavoidable delays. Such supply difficulties in turn hamper other producers, like China's partial lockdown cascaded into global input shortages.

A snapshot by the French statistical institute INSEE shows that on 26 March roughly one third of economic activities continued on their habitual workplace, one third had shifted to remote working, one third had stopped. Overall production and income generation were about a third below normal. Changes were unequal: construction was down by 89%, non-food manufacturing by 52%, commercial services (transports, restaurants, leisure activities, banking, insurance...) by 36%... This is surely not an exact image of France's economy, even less of other countries', but it is a useful and frightening illustration.

Meanwhile demand for specific goods and services has risen and supply responds more or less adequately. Shortages are present or looming for all things related to the epidemic: respirators, gloves, masks, aprons, disinfectant gel, hospital space and beds, even funeral facilities... Medical and nursing specialists are also in short supply, despite the recall of youngish retirees and the mobilization of not quite graduated students. More resources are also needed for research and for the production of needed supplies and equipment.

Need for less skilled labor has also increased in some occupations, to clean and maintain hospitals, to drive ambulances, and in some unexpected fields: few would have predicted that an epidemic would cause Amazon to hire 100 000 additional staff, that supermarket chains would be hiring as they replace closed open-air markets and small shops, or that the production of toilet paper would increase in response to hoarding. While overall unemployment has risen precipitously, other fields face labor shortages, because of higher demand for their products and because of barriers to the movement of people. Those hampering the entry of Latin American and East European workers who do much seasonal agricultural labor in the US and Western Europe already raise concerns for the harvest of seasonal crops. Paradoxically when overall unemployment is reaching record highs France just raised from 48 to 60 hours the maximum authorized extent of weekly work to deal with sectorial shortages.

The epidemic and countermeasures have rendered much labor redundant and reduced the incomes of firms. If not countered, this fall in incomes would further reduce demand and lead to even more precipitous declines of economic activity. Even financially solid firms would lose much of their capacity to invest and expand, thus complicating and slowing recovery; the less solid would disappear. Workers left without salaries and self-employed left without incomes would starve, particularly in places where unemployment insurance, health insurance and sick leave are inadequate.

## **POLICY RESPONSES**

Each country responds through somewhat different policies, imperfectly described in various news reports imperfectly understood by me. The following is an impressionistic summary of the measures I see and sometimes judge.

### **Help to individual=TLS s and small businesses.**

Public financing of replacement incomes for those partly or wholly idled by the epidemic is the best way to help them. When tied to measures that cause firms to retain them, this will also help smooth recovery. Germany long had such a scheme (*Kurzarbeit*) and made much use of it to good effect in 2009. France has a similar scheme (*chômage technique* or *chômage partiel*). Most other European Union member countries and the United Kingdom (UK) have variants. In such schemes firms continue to pay most of their wages to idled employees and are reimbursed from public funds, e.g. 80% in France. These schemes have time limits but those will surely be prolonged if needed. One advantage they have over standard unemployment compensation (existing or topped up) is that employers advance the funds and are reimbursed, thus avoiding administrative delays. The French scheme (and for all I know others too) even applies to household helpers whose work hours are curtailed. There is also merit to a simple quasi-universal income as instituted in the US (for one time), though the amount is unneeded by one large group and insufficient for another. That scheme also covers all, including the self-employed and small business owners.

Schemes like *Kurzarbeit* do not. Most governments promise to come up with schemes for very small businesses and the self-employed but calculating entitlements and ensuring fairness is difficult – in inverse proportions to the size and income of the business, and therefore to the need: successful lawyers keep better accounts and can afford to wait longer than taxi drivers... Paying out allowances on the basis of declared past incomes would minimize delays. It is more difficult to proceed for those below the income tax floor, yet solutions can be found, as they must, to mitigate economic chaos and human

costs. Thus the New York Times just reported that the City-State of Berlin processes applications in record time and here in Paris my newspaper seller is confident he will get the promised € 1500 per month if he is forced to shutter his kiosk.

Yet some other places report serious difficulties. The US system seemed simple: Federal guarantee to all loans to small businesses and a promise that the government will reimburse debtors that kept their employees. Yet banks are reported to apply eligibility criteria not specified by law, and their administrative capacity is overburdened. Many small businesses do not have the reserves to pay wages while waiting for loan applications to be processed, and may prefer to dismiss their employees, all the more so as terminating employment is very easy in most of the US. The US scheme also includes no inducement for large corporations to keep their employees. To compensate the unemployed, whose numbers saw an unexampled surge, it goes through habitual procedures, though topped up and extended by the Federal government. State administrations, already weakened by the epidemic, may have difficulty to administer this upsurge in cases. Administrative bottlenecks may also arise to various degrees in other countries.

A word about those who do not stop: workers in essential occupations unable to work remotely, from high-skilled reanimation specialists to street cleaners, food warehouse staff, domestic caregivers. The French Government encourages employers to pay such workers a monthly premium of up to € 2000, exempt from social security contributions and taxes. This should help attract idled urbanites to help replace immigrant workers in seasonal agricultural tasks...

### **Help to larger firms.**

Destruction is often creative, but it would be highly destructive at the scale that would occur if public intervention did not mitigate the economic impact of the health crisis. Firms, large and small, can be relieved of much of their wage burdens. In most affected countries they are also allowed to delay tax, social security and similar payments. But idle businesses still face immediate costs: bills, rent, maintenance of facilities, debt service... Meeting these, and later also the delayed costs, will prove impossible for many firms even if their businesses recover after the crisis – let alone if they do not: who knows when or even whether airlines will return to profitability, when they will need and pay for new airplanes, when the myriad suppliers of Boeing and Airbus will again work fully... The timing and extent of the recovery of demand are uncertain. So too are future supplies of essential inputs. Supply chains are global and as long as any one region in one country is still under lockdown no country's

economy can fully return to normal – often to a new “*normal*” significantly different from the old.

Kurzarbeit and similar schemes do not merely assist individuals. By keeping workers in place they should greatly facilitate recovery. But most firms need additional public help. A great deal of this now takes the form of easy credits. Monetary policy is facilitating commercial bank lending to an unprecedented extent. Central Banks are doing “*whatever it takes*” to ensure that money is in adequate supply to finance credits to firms and cover the needs of Treasuries. But as long as the path to recovery remains clouded few firms will appear fully creditworthy.

Loan guarantees form part of public assistance. One of their advantages over straight grants is that they do not require advance selection of those in actual need of grants. Banks can rapidly process loans in the knowledge that government will substitute for those debtors that cannot repay – as is sure to be the case for many. But it is important to decide who gets the guarantee. In the UK, for instance, it is the lending bank – up to 80 percent of the loan. But most firms sure to go bankrupt sooner or later will choose sooner; and if the crisis is prolonged many original optimists may well change track. Even among those that survive the crisis by taking out government-guaranteed loans many will be unable to service them later and go bankrupt: this would greatly hinder recovery.

One way or another a large share of government guarantees will come into play, and it seems best that government money should go directly to non-financial firms rather than to the lenders who would bankrupt them; that guarantees do not simply offset the banks’ losses, but directly those caused to nonfinancial borrowers by the Act of God that is the epidemic. It would be best for banks to act only as agents for government loans for a paid a fee, though they may be required to bear small share of the ultimate risk.

In such schemes the government would be the ultimate lender and would end up with the debts that cannot be repaid – which is likely to be a large share of the total. Some debtors will then best be put into bankruptcy – those least well prepared to return to health, either because they were already badly adapted to the old demands of market or are unable to adapt to new ones. But most firms will have to be saved, protected from being destroyed by an unprecedented and unforeseen crisis.

So what to do with such government loans? Two roads are open: transforming them into grants or repaying them with shares. Grants should be viewed as compensation for government-ordered lockdowns and other consequences of



the health crisis. Already, the US stimulus law provides \$ 30 billions to airlines in grant form, small compensation for the travel bans which have forced them to ground most planes. The Government of the U.K. followed another road with railways, presumably because it wants to maintain essential services which could not by themselves be run profitably: though the ruling Party has over the past thirty years privatized large economic sectors it temporarily nationalized all railways – few expect the temporary not to stretch out.

The criteria will remain fuzzy and partly subjective for deciding between ultimate bankruptcy and safekeeping through grants or injections of public equity. Most governments already decided that corporations assisted in whatever way must suspend the distribution of dividends and stock buybacks. It would indeed be indecent to take money from the government with one hand and distribute it to shareholders with the other. Such restraint will need to be prolonged for quite some time, and best be complemented with restraint on executive incomes. But the question of past behavior will also arise. Should corporations that had strengthened their balance sheets and set aside capital for emergencies be treated in the same way as those that used easy borrowing to distribute dividends, buy back shares and recompense their managers? The choice is not only a question of morality – it will influence future behaviour.

Otherwise viable firms must not be allowed to disappear because of the financial burden laid on them by the past. Yet all too often past public interventions to preserve ailing firms have only drawn out the agony, wasted resources and often hindered the emergence of more dynamic alternatives. Distinguishing when to intervene to save firms and when to cease doing so, for which firms, will be vital – and very difficult.

If future behavior is to improve, financially imprudent firms must not receive the same treatment as those that were prudent. Nor should too much effort go into maintaining alive ultimately non-viable firms. During the crisis it is best to lean toward facilitating the survival of most, but exit strategies need to be different. Some firms will need to be wound up; others should be asked to repay some public help by ceding some of their equity. The argument that such partial nationalizations and Government intrusion into management are bound to lower efficiency is somewhat weak when dealing with firms that past management has not protected from bankruptcy.

## AFTER THE CRISIS

Not much can be said about exit from the economic crisis until we glimpse how the health crisis will end. Now we do not even know crucial elements of what

has already happened: How widespread is really the infection? How much immunity do cured patients get, for how long? Will the virus be stable or will it mutate? Can effective vaccines be developed? If so, when? Same questions for effective anti-viral drugs and for cheap and fast tests...

One can be sure that the economic costs of the lockdowns increase with time, while one can hope that health risks will decrease. The intersection of those two trends and the weights attributed to each will determine exit strategies from lockdowns. Exits are likely to be partial and drawn out. Like everywhere at the beginning of the process and in China at the end stage, specific areas within countries may be kept in lockdown while others are freed, movements between some regions will remain restricted, almost certainly international frontiers will open only after the lifting of most domestic barriers, and with differentiation between countries and with burdensome screening of travelers.

Health-related containment measures also interact with other considerations to determine the evolution of supply constraints. Where full lockdown continues most productions will remain limited – remember last winter's supply disruptions due to China's partial lockdown. Movement of people will be disrupted and restricted even longer than the production and movement of goods. Tourist-related activities are will continue to suffer from intertwined restrictions on supply (airlines, cruise lines, even railway and bus lines...) and demand (producers of aircraft and buses, hotels, taxis, tourist attractions...).

Meanwhile deeper and longer-lasting changes also loom. Did globalization and *just-in-time* logistics become excessive, creating weak spots whose disruption now leads to dramatic consequences like the shortage of masks and disinfectant gel? Will realization of such excesses require targeted corrections or a more radical turning away from international trade already urged by many on the extreme left and right, as exemplified in the US by Presidential candidate Sanders (and once upon a time Perot) and President Trump, in Europe by Marine Le Pen, Salvini and Mélanchon? Or will governments strive for binding international agreements to deal with future crises and ensure the optimal management of strategic supplies? Asked at the global level, this same question also arises at the level of the European Union.

### **Inflation.**

Credit will have been enormously increased during the crisis. Much of this increase will have financed incomes distributed by governments and loans that did not go towards increasing production capacity, but just towards current expenses, in replacement of incomes from production. These replacement

incomes are not reacting to autonomous declines in demand like in the case of classical recessions. They react to **declines in supply**.

Governments and circumstances are forcing large segments of the economy to stop producing while the government replaces a high proportion of the lost incomes; all strive to cause overall money incomes to decline much less than the production that normally corresponds to those incomes. More incomes would have been generated than goods and services produced – that is a tautology when incomes are “*replacement*”. These incomes are complemented by unusually abundant credits. One cannot exclude an uptick of personal and business savings after the crisis, and budgets will also move away from the extraordinary deficits of these extraordinary times – though the reverse is also possible. However an upward pressure on prices is a certain result.

This pressure does not show up immediately. While restaurants, airlines theatres are closed their prices remain virtual: none or very little of their products can be sold anyway. In effect, a sort of rationing is applied to them at zero level. But once economies re-start, without higher prices possible extra savings will not fully absorb all the incomes generated without corresponding products. And Central Banks, having long undershot their inflation targets, are unlikely to bridle at a few years’ overshooting them right after intense efforts to facilitate the uptake of debt by all.

None of this constitutes criticism of the provision of replacement incomes to all who need them, and of efforts to prevent bankruptcies. Minimizing the economic crisis created by the health crisis must be the absolute priority. Indeed, the overall thrust of the economic measures taken so far nowhere comes near what is and will be necessary, even if some specific components may be ill-advised or excessive... Exceptional measures are needed to fight the health crisis; exceptional measures are also needed to fight the concomitant economic crisis. Nor need a bout of mild inflation be a bad thing. But it should be foreseen, planned for and when the time comes prevented from turning into a self-sustaining inflationary cycle.

## **CONCLUSION**

Standard economic forecasts consider endogenous factors. Occasionally, partly or wholly exogenous political forces are also taken into account: revolutions, international tensions, trade wars, real wars... This time the exogenous factor is as big as most wars. One can hope it will prove temporary but even optimists keep postponing the expected date of full control over the epidemic. Structural modifications of demand are also quite uncertain: will people get used to home entertainment, home delivery and at-home vacations,

or will they on the contrary wish to make up for lost time in theatres, restaurants, retail shops, exotic sea-shores?

Political developments are also among the major uncertainties. Nationalist, inner-oriented, often authoritarian parties have been making gains in many countries. Under its President the US has turned from a leader promoting a law-based open international system into an advocate of exacerbated nationalism contemptuous even of existing international laws. More will depend on the next US elections than was usually the case since WW II.

So what? My own bets are colored by optimism but they are bets, with not much more rational justification than a bet on heads or tails. I bet on the epidemic being brought almost under control by September; on fairly rapid recovery of production starting even before then; and on governments meanwhile providing the indispensable substitute incomes and support to firms. I also bet, with much longer odds, on such support being made more onerous to the profligate. I also bet on the US recouping some – by no means all – of its leadership by next year and on slow but material progress towards stronger EU solidarity. The result should be a return to pre-crisis production levels by late next year, and overall Eurozone price levels ten to fifteen percent higher in 2022 than in 2019.

I shall end where I begun, with forecasts for Eurostocks and the Euro currency. Despite modest falls since I bet on them I still expect them to justify my bets before too long – say eighteen months or two years.

Qui vivra, verra!

Survivors will see!