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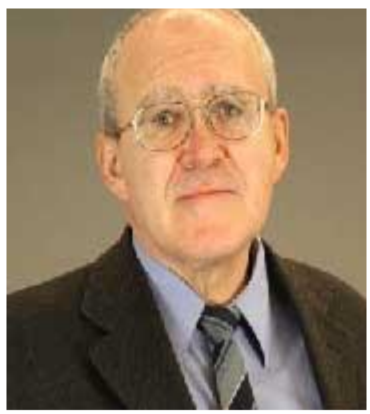
OPINION

Covid-19 Recessions: This Time It's Really Different

By Vladimir Popov and Jomo Kwame Sundaram

BERLIN and KUALA LUMPUR, Jun 4 2020 (IPS) - The world economic contraction so far this year is largely due to measures, especially at the national or local level, to contain or prevent Covid-19 contagion, particularly those restricting business operations, thus reducing economic activity, output, incomes and spending.



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Lower business and worker incomes have reduced spending, for both consumption and investment, and thus overall or aggregate demand. While there has indeed been much novel 'financial folly' in the last decade, responsible for its dreary 'recovery', and financial circumstances will retard recovery, the cruel public health dilemma posed by the viral pandemic is surely its immediate cause.

To be sure, recent economic performance in much of the world had been quite lacklustre, with no strong recovery since the 2008-09 global financial crisis and Great Recession despite the unexpected impact of 'unconventional monetary measures', especially in the north Atlantic economies.

Recessions and recessions
The recessions have been quite uneven, due to different circumstances and responses. Various aspects may bear some resemblance to other supply-side recessions, e.g., those caused or worsened by post-war conversion of armaments industries, oil price shocks (e.g., in 1973, 1979, 2007) and 'shock therapy'-induced 'transformational recessions' in 'post-communist' and other economies in the 1990s.

A general recession typically involves declines in many, if not most industries, sectors and regions. Such output contraction typically implies underutilized production capacities, raising unemployment unevenly during a general recession.

In contrast, a structural recession refers to falling output in one or a few related industries, sectors or regions, not sufficiently offset by other rises. However, not all supply side recessions necessarily involve structural transformation, especially if not deliberately induced by government.

Really different this time?
A structural transformation – with unviable activities declining as more 'competitive' alternatives grow – may not involve overall economic contraction if resource transfers – from declining activities to rising ones – are easy, rapid and low cost.

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Such resource transfers typically require 'repurposing' labour as well as plant, equipment and other 'fixed capital' stock. Typically, unplanned structural transformations result in supply-side recessions as resources are withdrawn without being redeployed for alternative productive ends.

Some examples include post-war recessions when converting military industries to peacetime non-military purposes after wars end. After the Second World War, US output declined for three years, and was 13% lower in 1947 compared to 1944.

The 1990s' recessions in many post-communist economies were similarly due to poor management of structural transformations with declining agriculture and manufacturing, often despite more resource extraction, with some contractions deeper than the 1930s' Great Depression.

In market economies, such adjustments typically increase unemployment as industries become unprofitable – e.g., due to cost spikes – and lay off workers. Growing unemployment lowers wages, while the conventional wisdom claims that cheaper labour costs will induce new investments.

Market resolution of such unexpected, massive disruptions is likely to be poorly coordinated, slow and painful, with high unemployment for years. Alternatively, governments can guide, facilitate and accelerate desired changes with appropriate relief and industrial policy measures.

Keynes needed, but not sufficient

Slumps in travel, tourism, mass entertainment, public events, sit-down eateries, hotels, hospitality, catering, classrooms, personal services and other such activities have been due to physical distancing and other containment requirements.

Such collapses will not be overcome with support, relief and stimulus measures as most such activities cannot fully resume soon, even in the medium term. Expansionary Keynesian fiscal and monetary policies to address collapses in aggregate demand have limited relevance in addressing government-mandated restrictions intended to contain contagion.

Furthermore, as Nobel economics laureate Paul Romer and Alan Garber note, "loan guarantees and direct cash transfers will stave off bankruptcy and default on debt, but these measures cannot restore the output that is lost when social distancing keeps people from producing goods and services".

Of course, relief measures for those losing incomes can help mitigate the effects of the adverse supply and demand shocks involved, but much depends not only on direct, but also indirect, second or even third order effects, partly reflected in Keynes' 'multiplier' muted by other government measures.

A necessary precondition for the multiplier to accelerate broader economic recovery is the prior existence of underutilized productive capacities. Otherwise, increasing demand will simply raise prices when output and efficiency cannot be quickly increased profitably.

One size does not fit all

Newly restructured economies will inevitably emerge from the pandemic, but some will do better than others. There is and will be greater need and demand for new as well as modified goods and services such as medical supplies, health facilities, care services, distance learning and web entertainment.

Economies trying to adjust to the new post-contagion context should use industrial policy or selective investment and technology promotion to expedite restructuring by directing scare resources from unviable, declining, sunset industries to more feasible, emerging, sunrise activities.

Enabling, incentivizing or even requiring needed resource reallocations can help overcome supply bottlenecks. China and other East Asian countries have already had some early successes in thus addressing their Covid-19 downturns.

All workplaces adversely affected by precautionary requirements will need to be safely reconfigured or repurposed accordingly. Structural unemployment problems, due to skill shortages not coinciding with available labour skill supplies, can be better addressed by appropriate government-employer coordination to appropriately identify and meet skill requirements.

Government policies, e.g., using official incentives, can thus encourage or induce adoption of desirable new practices, such as 'clean investments' for 'green' restructuring, e.g., by using renewable energy and energy saving technologies. Without such inducements, stimuli and support for desirable new investments, desired structural shifts may be much more difficult, painful and costly.

Thus, the ongoing Covid-19 crisis should be seen as an opportunity to make much needed, if not long overdue investments in desirable sunrise industries, services and enterprises, including personnel retraining and capability enhancement as well as workplace repurposing.

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