FROM TODAY to TOMORROW

Philippe Waechter Chief Economist December 22, 2020

THE THREE RUPTURES OF THE HEALTH CRISIS - WE MUST REBUILD THE ECONOMY

The health crisis has turned 2020 upside down and subjected the economy to a negative shock like never before outside of global conflicts. We can nevertheless be surprised because if the stop was sudden and brutal, the economy remained on good rails. In this real-life experience, the management of the situation through economic policy made it possible to limit the slippages and the persistence of the upheaval. Certainly the economies will be affected by this crisis for a long time, but certainly not up to the shock experienced by the economies in the second quarter.

The institutions were strong and the management of the crisis was seen as credible. There was no mistrust of the action taken by the authorities to limit the extent of the shock. In other words, the health crisis has not caused political upheaval except perhaps the defeat of Donald Trump in the presidential election. This dimension relating to the credibility and effectiveness of actions will be major in the long term to avoid the risk of a social and political crisis. It is the major constraint for governments and central banks.

However, the economy has changed dramatically with this health crisis. This has upset the hierarchy of economic policies, accentuated the polarization of the global economy and revolutionized the labor market.

The economic policy new hierarchy

The coronavirus has forced the economic policy to focus on the economy. It was necessary to compensate for the negative effects of the decisions taken to fight the pandemic. These measures were mainly focused on the real economy, ie the labor market and companies' situation. In a way, government action had to replace that of market mechanisms for the economy to continue to function.
In 2008/2009, during the financial crisis, a similar situation occurred on the money markets. Central banks had replaced this latter so that the banking system continues to function while the banks no longer had confidence in each other. The emphasis then placed more on finance than on the economy.
The last two crises were of such magnitude that the usual market mechanisms were unable to cope quickly. These two situations suggest new rules so that the regulation can be endogenous, thus avoiding ruptures that are not favorable for anyone.

The need for large-scale fiscal policy measures has changed the hierarchy of economic policy. The part devolved to central banks is now conditional on government choices. Central banks calibrate the amount of asset purchases that they make conditional on the expectations of fiscal deficits while their benchmark interest rates are now close to 0%.
This is **a major change on two fronts**. The first comes from the fact that **monetary policy has reached the end of its possibilities**. The fall in long-term interest rates orchestrated by the action of central banks in the context of financial globalization has been completed. It had given the financial system considerable weight since the fall in interest rates from more than 15% in the early 1980s to 0% 40 years later revalued all financial assets, making all financial activities profitable. This period is over and it is now fiscal policy that will take the lead. The pendulum has changed direction.
This new hierarchy should allow governments which have intervened on a massive scale to regain room for maneuver in the long term. The negative real interest rates will be lasting. This will give **more weight to the real economy compared to the financial economy. Priorities have changed.**

The polarization of the global economy

The health crisis has accelerated trends already perceptible before, particularly in the global economy. In the United States, President Trump was elected in 2016 on the proposal to refocus the American economy on itself. The middle class had been penalized by economic globalization and the then candidate wanted to set up the repatriation of American jobs abroad, especially in industry. America had to produce at home and export in order to fully benefit the economy from the effects of innovation and the induced growth. That hasn't really worked when you look at the growing US trade deficit.
We are waiting for **the choices that will be made by the new president**. In an article published in "Foreign Affairs" in March / April 2020, while he was a candidate for the Democratic candidacy, Joe Biden spoke of an economic policy for the middle class, that is to say a policy for those who had been weakened through globalization. **The methods will certainly be different, but the reflections between the two presidents are not necessarily distant.**
In China, the objective, since the arrival of Xi Jinping to the presidency, is to implement the necessary means so that the Chinese economy has global leadership in the industry. This was the basis of the "Made in China 2025" directive and was also reflected in the desire to develop China's economic and political influence through the Silk Roads initiatives (Belt and Road Initiatives). This has resulted in a considerable public investment to facilitate research and innovations.

This way of shaking up American hegemony has gradually resulted in an accentuation of the balance of power between the two countries. The tariff options decided by the White House and the Chinese reprisals have soured relations between the two countries.
The trade agreement signed on February 14, 2020 between the two countries aimed to significantly increase Chinese imports from the USA (200 billion (USD) more in 2020 and 2021 compared to 2017). It did not work. In October 2020, the actual purchases of the Chinese represented only about 55% of the commitments that had been made.
The Chinese have gradually deployed a strategy aimed at reducing their dependence on the rest of the world. They increase the production of goods substituting for imports. Growth has picked up since the second quarter but imports have barely increased. In November 2020, Chinese imports measured in renminbi were lower than in November 2019 and somewhat above this benchmark by a dollar measure. China exports a lot but does not import on the same scale. This translates into a **trade balance surplus representing 6% of Chinese GDP** and given the size of this economy, **this surplus is a drag for the rest of the world.** (For a given production, the Chinese surplus is the counterpart of a deficit of the rest of the world with respect to China, more imports and fewer exports).
Contrary to what had been observed in 2009/2010, the Chinese economy is not a source of growth for the rest of the world.
The world will remain global but it is moving towards another equilibrium in which each country / region will tend **to favor its own growth** even if it is to the detriment of the rest of the world. In Europe, the changes can be seen on two levels. The first is that as the global situation has changed, there will be fewer growth impulses from the rest of the world. More autonomous growth is needed, hence the importance of stimulus packages. The other dimension is the **change in Germany**, which perceives today that its situation is more conditioned by that of its neighbors, unlike 2010. Angela Merkel's greater flexibility, particularly on budgetary policy, is surprising when we remember that in 2011 it was on her initiative that the budgetary measures leading to the long recession from mid-2011 to the end of 2012 were taken.
What has changed is therefore the equilibrium which means that, **from now on, the local choice is systematically more powerful than the choice of globalization**. The health crisis accelerated this trend since each country had to react according to the constraints caused by the epidemic.

The new equilibrium in the labor market

The labor market has been disrupted by three phenomena. They did not necessarily all take place in the same country but they definitely change the functioning of this market.
The first phenomenon reflects the change on the labor market associated with furlough employment on a very large scale and decided by governments. The funding of this new scheme was made by the State and this organization substitutes to normal jobs which cannot be done because of the health constraints governments put in place. This strategy was initiated by Germany in 2009 in order to be able to capture the recovery when it occurred and to limit the costs of layoffs during the fall in activity and the costs of research during the resumption of growth. This method was generalized in 2020, especially in Europe.
The specificity of this episode with such a procedure is that **the economy is in recession with no equivalent adjustment in the labor market.** Is this reproducible on the scale of all recessions in the future or does it only reflect the magnitude of the negative shock on activity which requires massive intervention by the State? It is the question of the new rules to be implemented to regulate the economy endogenously.
The second phenomenon, the opposite of the previous one, is the impact of the health crisis on the labor market when there is no safety net of partial employment. In the USA, the fall of 20.5 million jobs in April is exceptional. The situation is only managed after the realization of this risk with unemployment benefits. This seems to translate into a level of employment that will only be found over time. There will be no spontaneous return to the level of pre-crisis employment. The less efficient jobs will not be replaced. This accentuates the polarization of the labor market but increases the productivity of the economy.
Between the two adjustment modes, **the European choice assumes that the crisis will not be long and that the partial unemployment procedure can be effective if it is temporary**. The risk is that productivity suffers if growth does not pick up as quickly as hoped. The rise in unemployment would then take place with delay but the situation in this case would not differ from that of the USA except that it would be several months late. The arrival of the vaccine in Europe is, from this point of view, good news.
The third phenomenon is working from home. It burst into Europe, especially last spring. While it does not apply to all employees, this phenomenon profoundly modifies the relations between employees and their company since the latter is no longer the only place where work is carried out.

This raises several questions.

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First of all, the efficiency of the company since the unity of place creates synergies that increase the capacity for innovation. This is Coase's idea but also the one that can be found by extension in Joel Mokyr's book on the culture of growth. **Exchanges promote innovation and efficiency.** Associated with this arises the question relating to the measurement of the efficiency and productivity of employees. The balance is changed in depth and certainly for a long time because employees have developed a taste for remote working. But **this presupposes new operating rules to avoid a gradual uberization of employees.**

This being the case, remote working is also **an answer to the question of regional planning.** Everyone, within this framework, must be able to set up wherever they wish depending on the constraints of remote working (nevertheless conditioned by the quality of the connections, which is another objective of industrial policy). This then profoundly changes the income dynamic. Income in metropolitan areas is higher than in a village. Is it relevant to pay the same salary for a person whose permanent accommodation switches from the metropolis to the town? The salary paid takes into account at least part of the geographical environment of the company. On this point, the questions are open.

We must also be careful because **remote working is also opposed to employment which cannot benefit from this property. The labor market is probably becoming even less homogeneous.**
The polarization of the labor market which distinguishes three categories: highly qualified jobs for which the unemployment rate is low and high wages, which are direct candidates for work from home; unskilled jobs for which employment growth is positive but where wages are low and which do not benefit from remote working and low-skilled people who have been the big losers in the evolution of the labor market for 20 years . How will the balance be achieved for this last category which represents 60% of the labor market. This is where all training efforts must be made to adapt employment to the economy of tomorrow. The stake of the labor market which was already in this part of the labor market is further accentuated by the new situation. The economy is in turmoil and we must give ourselves the means to ensure that this part of the labor market adapts and benefits from a more stable and more profitable job.

The ruptures caused by the health crisis are deep.

The world that is opening up no longer looks like the one before. The lesson is that we have to rebuild the economy. This will involve negative real interest rates in order to promote growth in the real economy and reverse the directions taken over the past 40 years which have favored the financial sphere. This reconstruction will also result in new relations with the rest of the world. No one wants to play the same cooperative game anymore, neither China nor the United States and consequently Europe will have to adopt a strategy consistent with them. Each country will have to be more autonomous in its way of growing.
Finally, within the economy, the balance between work and capital has been profoundly modified by partial unemployment procedures and remote working.

The economy must be rebuilt around these new trends with the constraint of respecting the long-term sustainability of the economy. This is the challenge for all of us.