Macroeconomic consequences of Coronavirus crisis

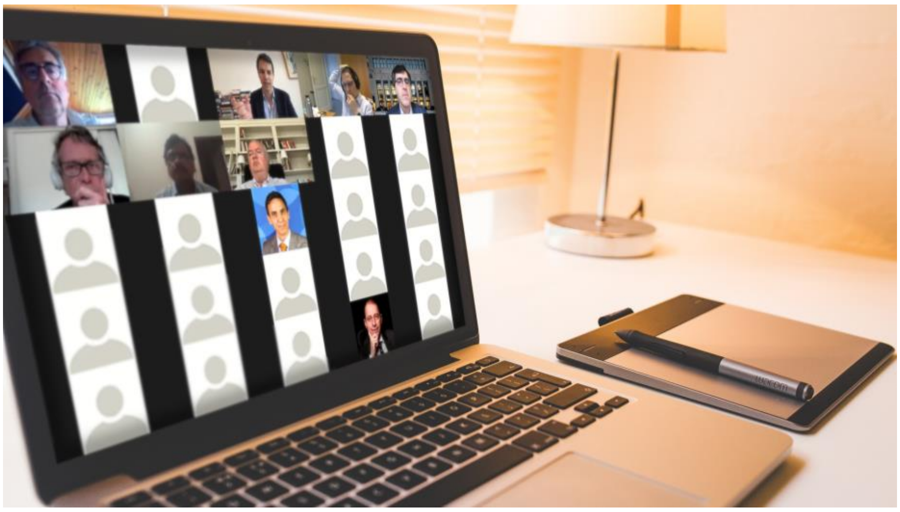
On May 4, 2020, **Jesus Fernández-Villaverde** (University of Pennsylvania), **Benjamin Moll** (London School of Economics), **Facundo Piguillem** (EIEF Rome) and **Denis Kessler** (SCOR) were invited to discuss about macroeconomic consequences of Coronavirus crisis. The panel was moderated by **Gilles Saint-Paul** (PSE, ENS).

THE COVID-19 PANDEMIC HAS PROVOKED AN ECONOMIC CRISIS. SOME PROJECTIONS FOR THE FRENCH ECONOMY ANTICIPATE THAT GDP WILL FALL BY 20% IN 2020. HOW BAD IS THE RECESSION? CAN WE EXPECT A RAPID RECOVERY OR DO WE EXPECT LONG-LASTING NEGATIVE EFFECTS ON OUTPUT AND UNEMPLOYMENT?

The crisis could actually be worse than suggested by these projections, according to **Ben Moll**. Indeed, a back-of-the-envelope computation shows that an annualized growth rate of -20% translates into a growth of rate of -5% a quarter. Given the large reductions in labor supply in some sectors, he believes more realistic estimates could be closer to -15% in a quarter. But as emphasized by **Gilles Saint-Paul and Jesus Fernandez-Villaverde, this relative optimism may stem from accounting conventions** - and in particular how GDP is computed - which may not be really relevant in this context. Indeed, a huge fraction of GDP is incompressible because it is composed of imputed rents and the public sector. The divergence with welfare is striking: schools are closed but statistical agencies around the world still consider that they contribute to GDP.

Jesus Fernandez-Villaverde is however cautiously optimistic about the recovery. Based on the example of post-war growth episodes, he estimates that economies will have recovered by 2022. **This claim was discussed by Facundo Piguillem**, who does not believe in a quick recovery because of the **looming risk of the virus coming back.** Contrary to post-war periods, lifting the lockdown does not mean that the virus is gone: people may still be scared and refrain from going to restaurants, etc. Ultimately, this will depend on whether market economies will adapt in order to keep generating worth, e.g. restaurants doing take-out. Having said that, all panelists agreed on the fact that a lot of uncertainty remained on both the future clinical evolution and political consequences of the crisis.

Denis Kessler concluded by stressing how unique the present shock is. Contrary to the 2008 recession, it is fully exogenous to the economic system but also serial, delocalized and, unlike war shocks, it is invisible and preserves physical capital intact. He shares with Gilles Saint-Paul the idea that this unprecedented shock will also have deep structural consequences. Because of adverse effects on financial markets, protectionism or government intervention, the recovery will most likely be U-shaped rather than V-shaped. Any comeback to normality is unlikely before we find a vaccine or a treatment. Due to non-linearity and hysteresis effects, the economy may even be trending toward a new long-run low per capita GDP, high debt and high tax trajectory.

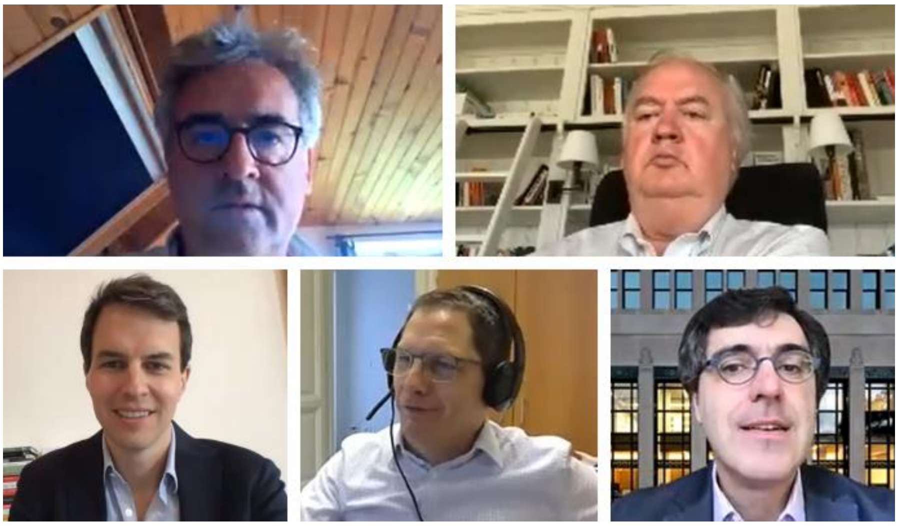


THE LOCKDOWN IS PUTTING PUBLIC FINANCES UNDER STRAIN. IN ORDER TO AVOID AN ECONOMIC AND SOCIAL CATASTROPHE, GOVERNMENTS INCREASED THEIR SPENDING WHILE THEIR TAX REVENUES FELL, WHICH RESULTED IN A HUGE ACCUMULATION OF DEBT. WHAT ABOUT THE LONG RUN FISCAL SUSTAINABILITY OF SUCH POLICY, ESPECIALLY IN LIGHT OF THE EUROPEAN SOVEREIGN CRISIS? BESIDES, WHAT ROLE FOR MONETARY POLICY? IS DEBT AN ISSUE?

Facundo Piguillem reminds the audience that an optimal tax policy must weigh the trade-off between raising revenues and increasing tax distortions. In the present context of rising sovereign debt and negative labor supply shocks, he supports the idea of **increasing capital taxation while decreasing labor taxation. According to Jesus Fernandez-Villaverde, the inter-generational aspect of the crisis** must not be overlooked: the economic costs will linger on people under 50 - towards which transfers should be oriented. As such, he favors a tax on real-estate Nevertheless, both panelists agree that political constraints will be binding.

Facundo Piguillem does not expect large western countries to default on their debt in the near future. Similarly, **Jesus Fernandez-Villaverde does not think that governments will have difficulty refinancing their debt in the short-run**, because there are not many alternatives on financial markets currently. However, governments may come under increasing pressure when investors will start asking whether these countries are willing to sustain the long-run fiscal policies needed to repay the debt. Finally, **Denis Kessler highlighted that short-sighted governments and countries entered the crisis unprepared and with very limited financial flexibility.** European countries *de facto* entered the crisis with heterogeneous fiscal capacities. As such, the crisis will likely widen the gap between those countries. Under such circumstances, the mutualization of debt will be very difficult and the sustainability of Europe may again be challenged.

Why not use the monetary policy to finance the deficits more, asked Facundo Piguillem? Jesus Fernandez-Villaverde stressed that part of today's constraint comes from the supply: stimulating demand will not boost the economy because the resource constraint is relatively fixed. At the same time, some inflation may help readjust relative prices and ease the burden on the liability side. According to Denis Kessler, unconventional monetary should, at some point in time, reignite inflation after 30 years of Great Moderation. If so, this inflation would wipe out the current excess of debt and impose an implicit redistribution of the debt burden on all economic agents. Relatedly, there is no consensus in Europe



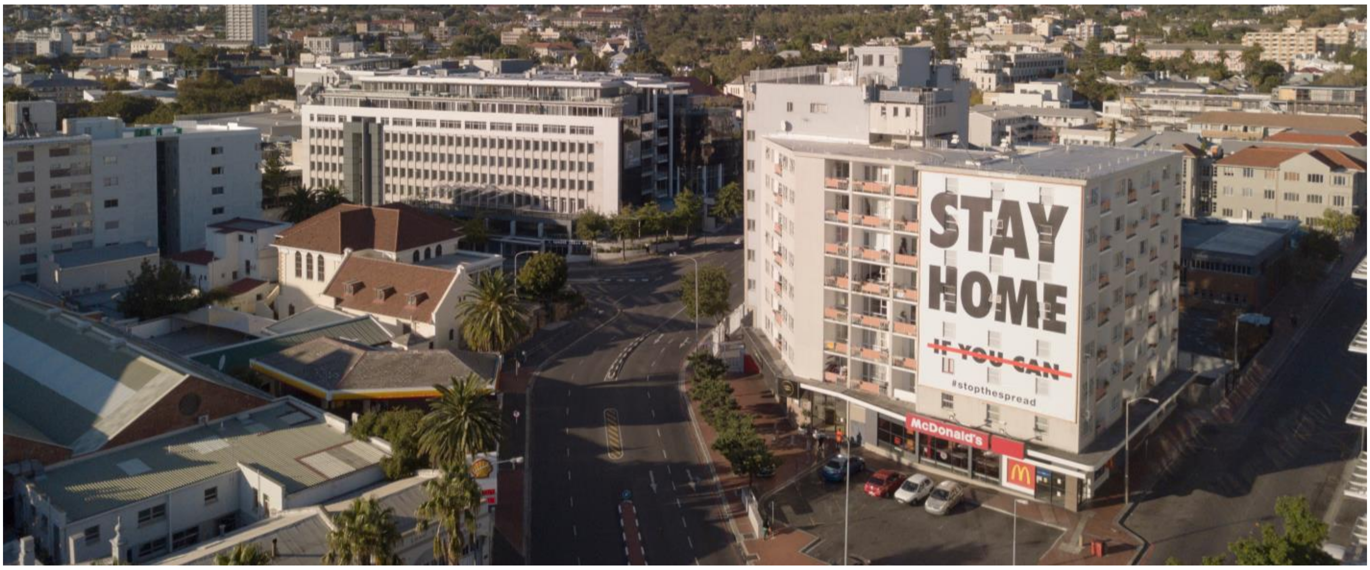
on further uses of monetary policy. **Gilles Saint-Paul** pointed out that the use of **inflationary-prone policy measures is likely to be met with resistance** by countries such as Germany. From his point of view, sharing a common currency is akin to a "tragedy of the common", which is likely to put the European project under additional pressure.

THE LOCKDOWN AIMED AT PROTECTING PUBLIC HEALTH BUT CAME AT IMPORTANT ECONOMIC COSTS. IN LIGHT OF THE RECENT DEATH STATISTICS, DID GOVERNMENTS WEIGH OPTIMALLY THE TRADE-OFF BETWEEN SAVING LIVES AND SAVING THE ECONOMY? HOW ABOUT A LIBERTARIAN, DO-NOTHING POLICY INSTEAD?

Jesus Fernandez-Villaverde believes that state intervention was a bit tougher than would have been optimal but reminded the audience that early indicators were quite alarming. Moreover, he stresses that the measures were taken by public health experts who are not used to thinking in terms of trade-offs. By lack of logistic thinking, they may have overlooked hard constraints, such as food, electricity, etc. This opinion is shared by **Denis Kessler**, who points out, quoting James Tobin, **that in states of emergency, decision-makers often forget about rationality and trade-offs.** As such, governments' decisions to save lives at whatever costs implicitly mean that the price of human life skyrocketed during the crisis.

However, **Facundo Piguillem** suggests, building on his current work on optimal state intervention, that **the measures taken by politicians were actually quite reasonable.** Had they not been concerned about trade-offs, they would have implement Wuhan-style lockdowns. Furthermore, **Ben Moll** contends with the idea that there existed a trade-off in the short-run at all. Using a model of the economy as a laboratory, he found out that do-nothing policies would also have generated a large recession - because people are scared to go out. According to him, the main trade-off is about duration: **a sharp but short-lived recession vs. smoothing out the costs over time.**

Finally, **Ben Moll** claims that do-nothing scenarios are not optimal because of **strong externality effects.** Indeed, people do not sufficiently take into account how much they are going to infect others – which leaves some room for welfare-enhancing state intervention. Yet, Gilles Saint-Paul argues that this argument misses the reality of state intervention.



Governments were unequally good at managing the crisis, e.g. organizing masks production or testing. These wide differences between European countries stem from a series of small, yet tough decisions taken by governments, asserts **Denis Kessler**, who points out the different levels of preparedness as well as the very different ways governments have reacted to this crisis (e.g. the German and Swedish ways vs. the French way). For his part, Jesus Fernandez-Villaverde thinks these trends reflect worrying divergence in "state capabilities" across Europe: more proficient - not larger - states did manage the crisis more successfully.

DUE TO THE CRISIS, A LARGE FRACTION OF ACTIVITIES HAS BEEN TRANSFERRED ONLINE. DOES THE CRISIS ACCELERATE DIGITAL TRANSFORMATION? DO YOU SEE OTHER LONG-TERM STRUCTURAL EFFECTS, E.G. WITH RESPECT TO INCOME INEQUALITY?

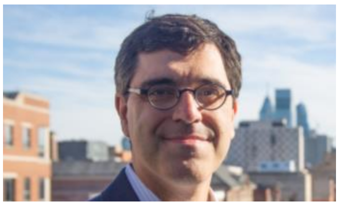
All panelists agreed that the crisis will have **deep and long-lasting effects on the use of new technologies.** Ben Moll and Denis Kessler believe that people will be less reluctant to online meetings as an alternative to long-distance travel around the globe. Denis Kessler adds that we may now enter a world of "social distancing". Open spaces could decline in favor of "flex activity". It is also likely that teleworking will become more common. As emphasized by Jesus Fernandez-Villaverde, this represents above all a cultural shift in how these new technologies are viewed. By speeding up digital transformation, the crisis may turn out to have positive long-term consequences, suggests Facundo Piguillem - provided short-term costs eventually disappear.

Nevertheless, Gilles Saint-Paul warns that many sectors could unravel as a result of the digital transformation. Building on the example of the music industry, he stresses that easier access will increase competition at the global level: the number of professors could be divided by 10 while the market share of survivors would increase by as much. However, a number of activities cannot easily be digitalized, argues **Jesus Fernandez-Villaverde**. For example, building professional networks or getting a haircut require in-person interactions. He predicts **large changes in the urban landscape** though: remote work could signify the end of dense cities and big offices.

Denis Kessler believes that for business and industry, **this pandemic shock will unquestionably lead to a reorganization of production chains** and, consequently, of **the international division of labor.** Covid-19 has made many companies realize, to their cost, that when certain irreplaceable components are no longer manufactured, because Chinese factories are closed, most or all of their production capacity will come to a standstill. Many companies, particularly manufacturing companies, will therefore re-evaluate the structure, organization and geographic distribution of their supply chains, their production lines, their distribution networks and their inventories.

Finally, **Ben Moll** thinks that **the crisis could have considerable effects on income inequality.** In recent work, he documents that there are stark differences in people's ability to work from home, depending on their occupation. On top of that, he reports evidence that people holding the most economically vulnerable occupations - e.g. restauration or transport - also have the lowest levels of liquid wealth. This means the crisis could have enduring long-term negative consequences through balance sheet effects.

SHORT BIOGRAPHIES

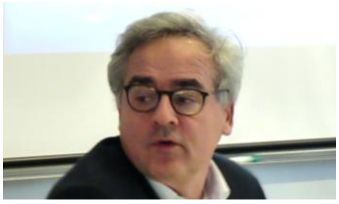


Jesús Fernandez-Villaverde is Professor at the University of Pennsylvania, Research Associate for the National Bureau of Economic Research (NBER) and Penn's Population Studies Center, and a Research Affiliate for the Centre for Economic Policy Research (CEPR). His research agenda is in macroeconomics and econometrics, with a focus on the computation and estimation of dynamic stochastic general equilibrium (DSGE) models.

Denis Kessler is Chairman & Chief Executive Officer at SCOR. He is a graduate of HEC business school (École des Hautes Études Commerciales), holds a PhD in economics and advanced degrees in economics and social sciences, and is a Fellow of the French Institute of Actuaries. He was Chairman of the Fédération Française de l'Assurance (FFA), Senior Executive Vice-President and member of the Executive Committee of the AXA Group and Executive Vice-President of MEDEF (Mouvement des Entreprises de France). He joined SCOR as Chairman and Chief Executive Officer on November 4, 2002. In January 2016, he was elected to join the Academy of Moral and Political Sciences of the Institut de France.

Benjamin Moll is Professor of Economics at the London School of Economics and Political Science (LSE). He is also a Research Associate at the National Bureau of Economic Research (NBER), a Research Fellow for the Centre for Economic Policy Research (CEPR), an Affiliate at the Bureau for Research and Economic Analysis of Development (BREAD) and Researcher at the Research Department of Norway Statistics. His research focuses on cross-country income differences and heterogeneity in macroeconomics. Mr Moll received a bachelor's degree from University College London, UK, and a PhD in economics from the University of Chicago.

Facundo Piguillem is Associate Professor at the Einaudi Institute for Economic and Finance (EIEF) and Research Fellow at the Center for Economic Policy Research (CEPR). He received a bachelor's degree from the Universidad Nacional de Córdoba, a MA from the ILADES-Georgetown University, a PhD in Economics from the University of Minnesota, and since then he has been at EIEF. He is a macroeconomist working on improving government policies and regulations, which touches issues related to political economy and optimal taxation.



Gilles Saint-Paul, the scientific director of the SCOR-PSE Chair, is Professor at the Paris School of Economics and Ecole Normale Supérieure, and a Global University Professor at NYU Abu Dhabi. He is also a research fellow of many think-tanks such as the Centre for Economic Policy Research (CEPR). He is a former member of the Council of Economic Advisors to the Prime Minister of France. He served as consultant for various central banks, ministries, and international institutions. His research spans a variety of macroeconomics topics from labor markets to political economy to bubbles to fiscal policy.