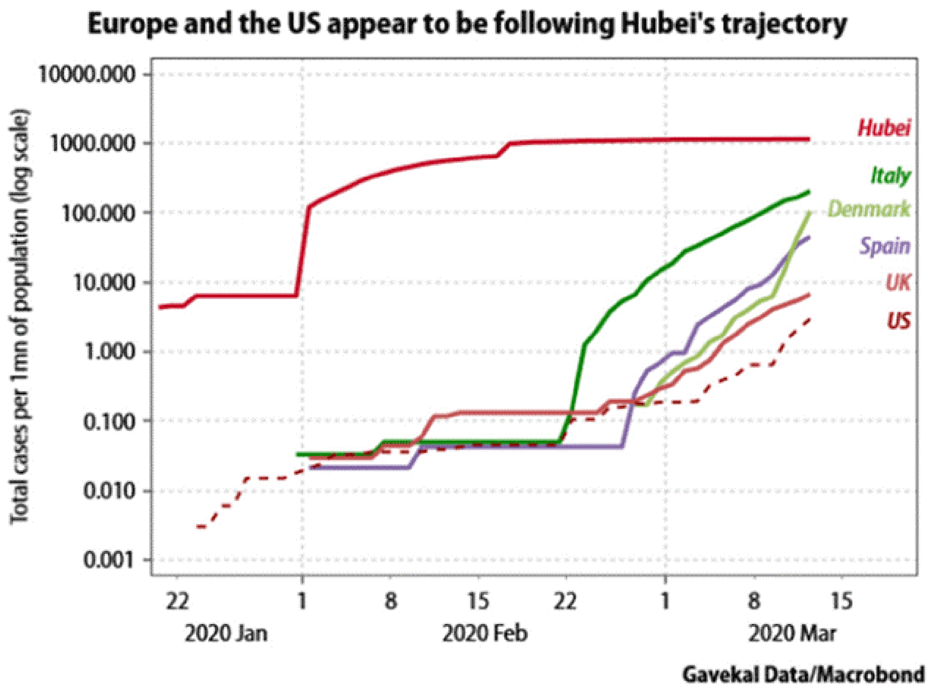
It was the virus that did it

thenextrecession.wordpress.com/2020/03/15/it-was-the-virus-that-did-it

Michael Roberts, March 15, 2020

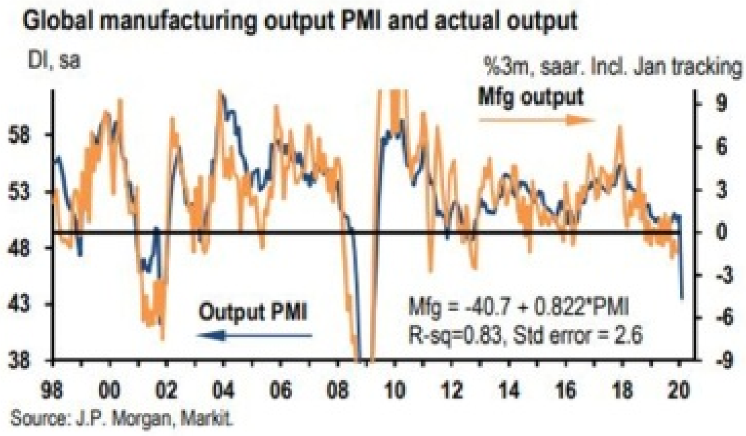
I'm sure when this disaster is over, mainstream economics and the authorities will claim that it was an exogenous crisis nothing to do with any inherent flaws in the capitalist mode of production and the social structure of society. It was the virus that did it. This was the argument of the mainstream after the Great Recession of 2008-9 and it will be repeated in 2020.

As I write the coronavirus pandemic (as it is now officially defined) has still not reached a peak. Apparently starting in China (although there is some evidence that it may have started in other places too), it has now spread across the globe. The number of infections is now larger outside China than inside. China's cases have trickled to a halt; elsewhere there is still an exponential increase.



This biological crisis has created panic in financial markets. Stock markets have plunged as much 30% in the space of weeks. The fantasy world of every rising financial assets funded by ever lower borrowing costs is over.

COVID-19 appears to be an 'unknown unknown', like the 'black swan'-type global financial crash that triggered the Great Recession over ten years ago. But COVID-19, just like that financial crash, is not really a bolt out of the blue – a so-called 'shock' to an otherwise harmoniously growing capitalist economy. Even before the pandemic struck, in most major capitalist economies, whether in the so-called developed world or in the 'developing' economies of the 'Global South', economic activity was slowing to a stop, with some economies already contracting in national output and investment, and many others on the brink.



COVID-19 was the tipping point. One analogy is to imagine a sandpile building up to a peak; then grains of sand start to slip off; and then comes a certain point with one more sand particle added, the whole sandpile falls over. If you are a post-Keynesian you might prefer calling this a 'Minsky moment', after Hyman Minsky, who argued that capitalism appears to be stable until it isn't, because stability breeds instability. A Marxist would say, yes there is instability but that instability turns into an avalanche periodically because of the underlying contradictions in the capitalist mode of production for profit.

Also, in another way, COVID-19 was not an 'unknown unknown'. In early 2018, during a meeting at the World Health Organization in Geneva, a group of experts (the R&D Blueprint) coined the term "Disease X": They predicted that the next pandemic would be caused by an unknown, novel pathogen that hadn't yet entered the human population. Disease X would likely result from a virus originating in animals and would emerge somewhere on the planet where economic development drives people and wildlife together.

Disease X would probably be confused with other diseases early in the outbreak and would spread quickly and silently; exploiting networks of human travel and trade, it would reach multiple countries and thwart containment. Disease X would have a mortality rate higher than a seasonal flu but would spread as easily as the flu. It would shake financial markets even before it achieved pandemic status. In a nutshell, Covid-19 is Disease X.

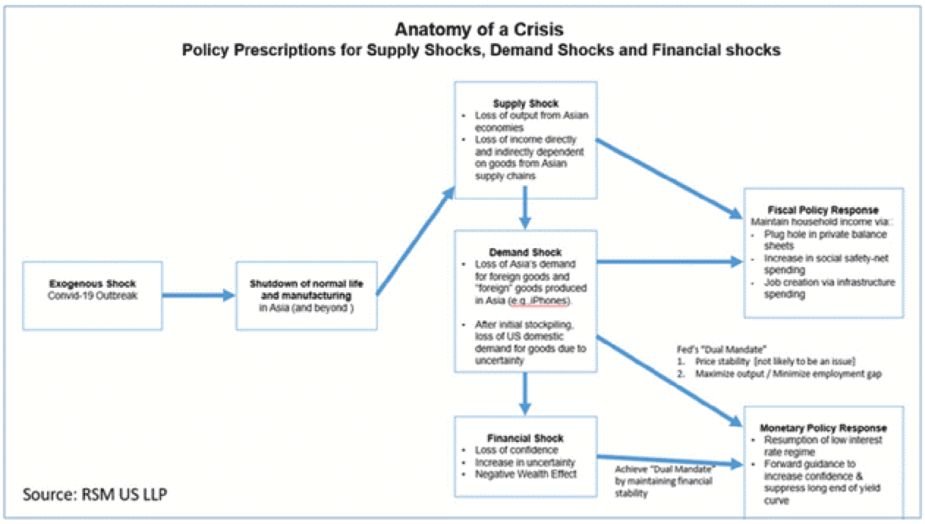
As socialist biologist, Rob Wallace, has argued, plagues are not only part of our culture; they are caused by it. The Black Death spread into Europe in the mid-14th century with the growth of trade along the Silk Road. New strains of influenza have emerged from livestock farming. Ebola, SARS, MERS and now Covid-19 has been linked to wildlife. Pandemics usually begin as viruses in animals that jump to people when we make contact with them. These spillovers are increasing exponentially as our ecological footprint brings us closer to wildlife in remote areas and the wildlife trade brings these animals into urban centers. Unprecedented road-building, deforestation, land clearing and agricultural development, as well as globalized travel and trade, make us supremely susceptible to pathogens like corona viruses.

There is a silly argument among mainstream economists about whether the economic impact of COVID-19 is a 'supply shock' or a 'demand shock'. The neoclassical school says it is a shock to supply because it stops production; the Keynesians want to argue it is really a shock to demand because people and businesses won't spend on travel, services etc.

But first, as argued above, it is not really a 'shock' at all, but the inevitable outcome of capital's drive for profit in agriculture and nature and from the already weak state of capitalist production in 2020.

And second, it starts with supply, not demand as the Keynesians want to claim. As Marx said: *"Every child knows a nation which ceased to work, I will not say for a year, but even for a few weeks, would perish."* (K Marx to Kugelmann, London, July 11, 1868). It is production, trade and investment that is first stopped when shops, schools, businesses are locked down in order to contain the pandemic. Of course, then if people cannot work and businesses cannot sell, then incomes drop and spending collapses and that produces a 'demand shock'. Indeed, it is the way with all capitalist crises: they start with a contraction of supply and end up with a fall in consumption – not vice versa.

Here is one mainstream (and accurate) view of the anatomy of crises.



Some optimists in the financial world are arguing that the COVID-19 shock to stock markets will end up like 19 October 1987. On that Black Monday the stock market plunged very quickly, even more than now, but within months it was back up and went on up. Current US Treasury Secretary Steven Mnuchin is sure that the financial panic will end up like 1987. *"You know, I look back at people who bought stocks after the crash in 1987, people who bought stocks after the financial crisis,"* he continued. *"For long-term investors, this will be a great investment opportunity."* *"This is a short-term issue. It may be a couple of months, but we're going to get through this, and the economy will be stronger than ever,"* the Treasury secretary said.

Mnuchin's remarks were echoed by White House economic adviser Larry Kudlow, who urged investors to capitalize on the faltering stock market amid coronavirus fears. *"Long-term investors should think seriously about buying these dips,"* describing the state of the U.S. economy as *"sound."* Kudlow really repeated what he said just two weeks before the September 2008 global financial crash: *"for those of us who prefer to look ahead, through the windshield, the outlook for stocks is getting better and better."*

The 1987 crash was blamed on heightened hostilities in the Persian Gulf leading to a hike in oil prices, fear of higher interest rates, a five-year bull market without a significant correction, and the introduction of computerized trading. As the economy was fundamentally 'healthy' so it did not last. Indeed, the profitability of capital in the major economies was rising and did not peak until the late 1990s (although there was a slump in 1991). So 1987 was what Marx called a pure 'financial crash' due to the instability inherent in speculative capital markets.

But that is not the case in 2020. This time the collapse in the stock market will be followed by an economic recession as in 2008. That's because, as I have argued in previous posts, now the profitability of capital is low and global profits are static at best, even before COVID-19 erupted. Global trade and investment have been falling, not rising. Oil prices have collapsed, not risen. And the economic impact of COVID-19 is found first in the supply chain, not in unstable financial markets.

What will be the magnitude of the slump to come? There is an excellent paper by Pierre-Olivier Gourinchas that models the likely impact. He shows the usual pandemic health diagram doing the rounds. Without any action, the pandemic takes the form of the red line curve, leading to a huge number of cases and deaths. With action on lockdowns and social isolation, the peak of the (blue) curve can be delayed and moderated, even if the pandemic gets spun out for longer. This supposedly reduces the pace of the infection and the number of deaths.

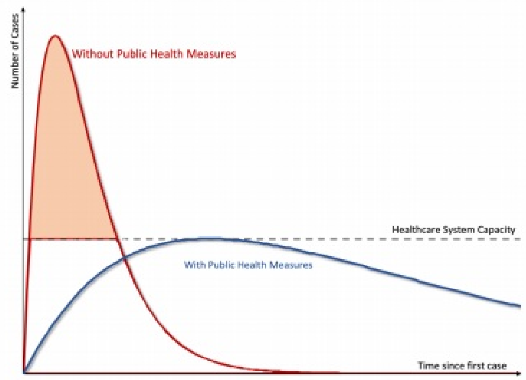
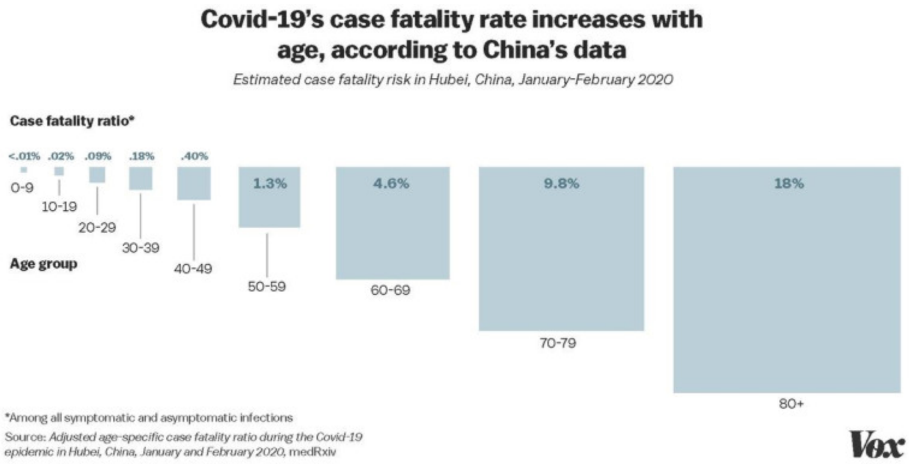


Figure 1: Flattening the Pandemic Curve

Public health policy should aim to "flatten the curve" by imposing drastic social distancing measures and promoting health practices to reduce the transmission rate. Currently Italy is following the Chinese approach of total lockdown, even if it may be closing the stable doors after the virus has bolted. The UK is attempting a very risky approach of self-isolation for the vulnerable and allowing the young and healthy to get infected in order to build up so-called 'herd immunity' and avoid the health system being overwhelmed. What this approach means is basically writing off the old and vulnerable because they are going to die anyway if infected and avoiding a total lockdown that would damage the economy (and profits). The US approach is basically to do nothing at all: no mass testing, no self-isolation, no closure of public events; just wait until people get ill and then deal with the severe cases.

We could call this latter approach the Malthusian answer. The most reactionary of the classical economists in the early 19th century was the Reverend Thomas Malthus, who argued that there were too many 'unproductive' poor people in the world, so regular plagues and disease were necessary and inevitable to make economies more productive.

British Conservative journalist Jeremy Warner argued this for the Covid-19 pandemic which 'primarily kills the elderly'. *"Not to put too fine a point on it, from an entirely disinterested economic perspective, the COVID-19 might even prove mildly beneficial in the long term by disproportionately culling elderly dependents."* Responding to criticism *'Obviously, for those affected it is a human tragedy whatever the age, but this is a piece about economics, not the sum of human misery.'* Indeed, that's why Marx called economics in the early 19th century – the philosophy of misery.



The reason that the US and British governments won't impose (yet) draconian measures, as in China eventually and now in Italy (belatedly) and elsewhere, is because it will inevitably steepen the macroeconomic recession curve. Consider China or Italy: increasing social distances has required closing schools, universities, most non-essential businesses, and asking most of the working-age population to stay at home. While some people may be able to work from home, this remains a small fraction of the overall labour force. Even if working from home is an option, the short-term disruption to work and family routines is major and likely to affect productivity. In short, the best public health policy plunges the economy into a sudden stop. The supply shock.

The economic damage would be considerable. Gourinchas attempts to model the impact. He assumes that relative to a baseline, containment measures reduce economic activity by 50% for one month and 25% for another month, after which the economy returns to the baseline. *"That scenario would still deliver a massive blow to headline GDP numbers, with a decline in annual output growth of the order of 6.5% relative to the previous year. Extend the 25% shutdown for just another month and the decline in annual output growth (relative to the previous year) reaches almost 10%!"* As a point of comparison, the decline in output growth in the U.S. during the 2008-09 `Great Recession' was around 4.5%. Gourinchas concludes that *"we are about to witness a downturn that could dwarf the Great Recession."*

At the peak of the Great Recession, the US economy was shedding jobs at the rate of 800,000 workers per month, but the vast majority of people were still employed and working. The unemployment rate peaked at `just' 10%. By contrast, the coronavirus is creating a situation where – for a brief amount of time – 50% or more of people may not be able to work. The impact on economic activity is comparatively that much larger.

The upshot is that the economy, like the health system, faces a 'flatten the curve' problem. The red curve plots output lost during a sharp an intense downturn, amplified by the economic decisions of millions of economic agents trying to protect themselves by cutting spending, shelving investment, cutting down credit and generally hunkering down.

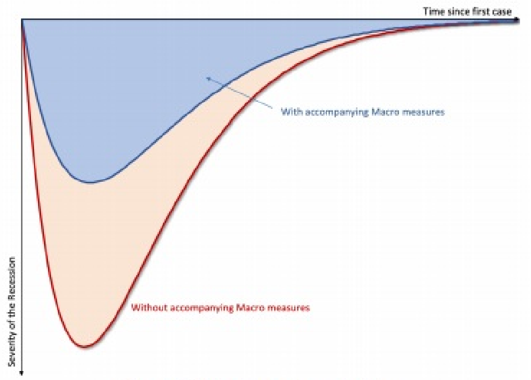
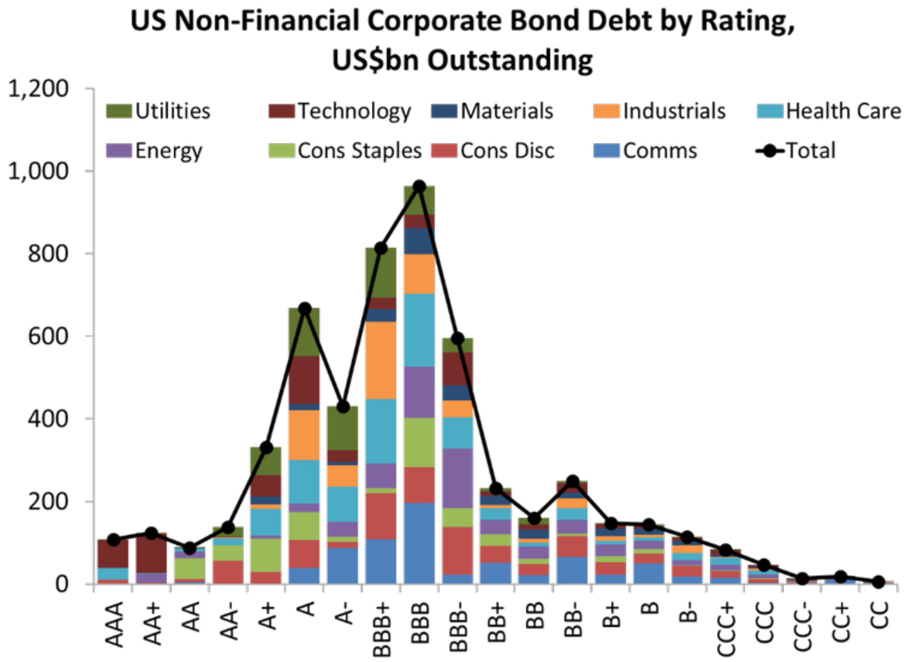


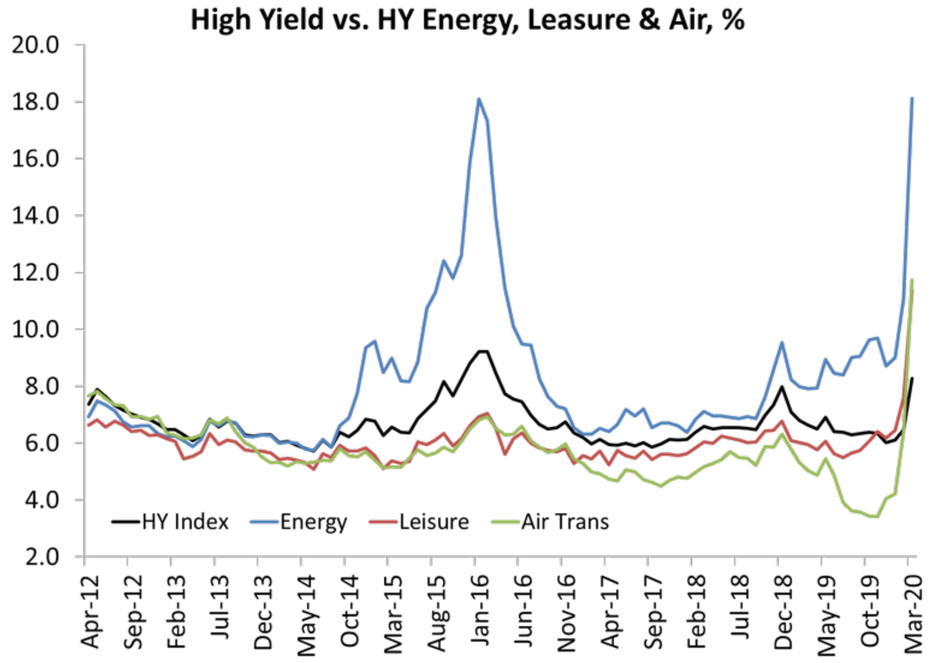
Figure 2: Flattening the Recession Curve

What to do to flatten the curve? Well, central banks can and are providing emergency liquidity to the financial sector. Governments can deploy discretionary targeted fiscal measures or broader programs to support economic activity. These measures could help `flatten the economic curve', i.e. limit the economic loss, as in the blue curve, by keeping workers paid and employed so they can meet bills or have bills delayed or written off for a period. Small businesses could be funded to ride out the storm and banks bailed out, as in the Great Recession.

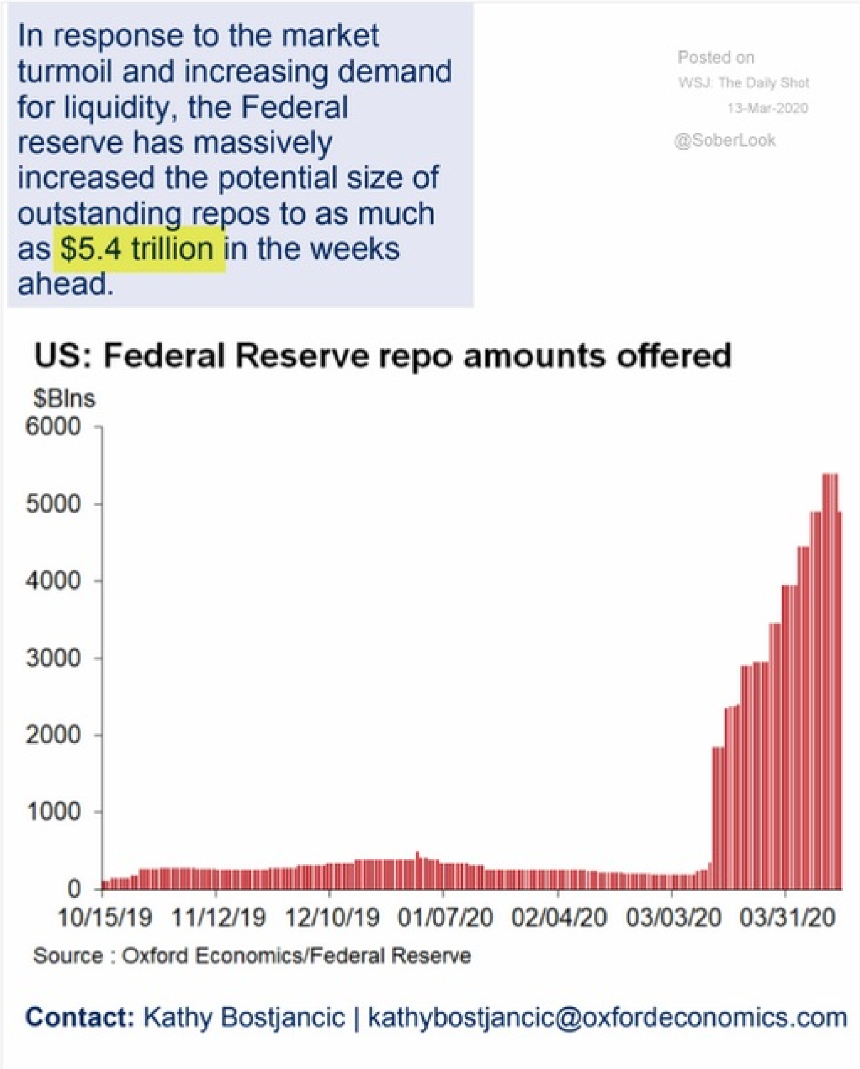
But a financial crisis is still a high risk. In the US, corporate debt has risen and is concentrated in bonds issued by the weaker companies (BBB or lower).



And the energy sector is being hit with a double whammy as oil prices have plunged. Bond risk premia (the cost of borrrowing) have rocketed in the energy and transport sectors.



Monetary easing certainly won't be enough to flatten the curve. Central bank interest rates are already near, at or below zero. And the huge injections of credit or money into the banking system will be like 'pushing on a string' in its effect on production and investment. Cheap financing won't speed up the supply chain or make people want to travel again. Nor will it help corporate earnings if customers aren't spending.



Source: Oxford Economics

The main economic mitigation will have to come from fiscal policy. The international agencies like the IMF and World Bank have offered $50bn. National governments are now launching various fiscal stimulus programmes. The UK government announced a big spend in its latest budget and the US Congress has agreed an emergency spend.

But is it enough to flatten the curve if two months of lockdown knock back most economies by a staggering 10%? None of the current fiscal packages come anywhere near 10% of GDP. Indeed, in the Great Recession, only China delivered such an amount. The UK government's proposals amount to just 1.5% of GDP maximum, while Italy's is 1.4% and the US at less than 1%.

There is a chance that by the end of April we will have seen the global total number of cases peak and begin to decline. That is what governments are hoping and planning for. If that optimistic scenario happens, the coronavirus will not disappear. It become yet another flu-like pathogen (which we know little about) that will hit us each year like its predecessors. But even two months lockdown will incur huge economic damage. And the monetary and fiscal stimulus packages planned are not going to avoid a deep slump, even if they reduce the 'curve' to some extent. The worst is yet to come.