

The Normal Economy Is Never Coming Back

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Adam Tooze, *Foreign Policy*, April 9, 2020

As the coronavirus lockdown began, the first impulse was to search for historical analogies—1914, 1929, 1941? As the weeks have ground on, what has come ever more to the fore is the historical novelty of the shock that we are living through. As a result of the coronavirus pandemic, America's economy is now widely expected to shrink by a quarter. That is as much as during the Great Depression. But whereas the contraction after 1929 stretched over a four-year period, the coronavirus implosion will happen over the next three months. There has never been a crash landing like this before. There is something new under the sun. And it is horrifying.

As recently as five weeks ago, at the beginning of March, U.S. unemployment was at record lows. By the end of March, it had surged to somewhere around 13 percent. That is the highest number recorded since World War II. We don't know the precise figure because our system of unemployment registration was not built to track an increase at this speed. On successive Thursdays, the number of those making initial filings for unemployment insurance has surged first to 3.3 million, then 6.6 million, and now by another 6.6 million. At the current rate, as the economist Justin Wolfers pointed out in the *New York Times*, U.S. unemployment is rising at nearly 0.5 percent per day. It is no longer unimaginable that the overall unemployment rate could reach 30 percent by the summer.

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Thursday's news confirms that the Western economies face a far deeper and more savage economic shock than they have ever previously experienced. Regular business cycles generally start with the more volatile sectors of the economy—real estate and construction, for instance, or heavy engineering that depends on business investment—or sectors that are subject to global competition, such as the motor vehicles industry. In total, those sectors employ less than a quarter of the workforce. The concentrated downturn in those sectors transmits to the rest of the economy as a muffled shock.

The coronavirus lockdown directly affects services—retail, real estate, education, entertainment, restaurants—where 80 percent of Americans work today. Thus the result is immediate and catastrophic. In sectors like retail, which has recently come under fierce pressure from online competition, the temporary lockdown may prove to be terminal. In many cases, the stores that shut down in early March will not reopen. The jobs will be permanently lost. Millions of Americans and their families are facing catastrophe.

The shock is not confined to the United States. Many European economies cushion the effects of a downturn by subsidizing short-time working. This will moderate the surge in unemployment. But the collapse in economic activity cannot be disguised. The north of Italy is not just a luxurious tourist destination. It accounts for 50 percent of Italian GDP. Germany's GDP is predicted to fall by more than that of the United States, dragged down by its dependence on exports. The latest set of forecasts from the Organization for Economic Cooperation and Development are apocalyptic across the board. Hardest hit of all may be Japan, even though the virus has had a moderate impact there.

In rich countries, we can at least attempt to make estimates of the damage. China was the first to initiate shutdowns on Jan. 23. The latest official figures show China's unemployment at 6.2 percent, the highest number since records began in the 1990s, when the Chinese Communist Party reluctantly admitted joblessness was not a problem confined to the capitalist world. But that figure is clearly a gross understatement of the crisis in China. Unofficially, perhaps as many as 205 million migrant workers were furloughed, more than a quarter of the Chinese workforce. How one goes about counting the damage to the Indian economy from Prime Minister Narendra Modi's abrupt 21-day shutdown is anyone's guess. Of India's workforce of 471 million, only 19 percent are covered by social security, two-thirds have no formal employment contract, and at least 100 million are migrant workers. Many of them have been sent in headlong flight back to their villages. There has been nothing like it since partition in 1947.

The economic fallout from these immense human dramas defies calculation. We are left with the humdrum but no less remarkable statistic that this year, for the first time since reasonably reliable records of GDP began to be computed after World War II, the emerging market economies will contract. An entire model of global economic development has been brought skidding to a halt.

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This collapse is not the result of a financial crisis. It is not even the direct result of the pandemic. The collapse is the result of a deliberate policy choice, which is itself a radical novelty. It is easier, it turns out, to stop an economy than it is to stimulate it. But the efforts that are being made to cushion the effects are themselves historically unprecedented. In the United States, the congressional stimulus package agreed within days of the shutdown is by far the largest in U.S. peacetime history. Across the world, there has been a move to open the purse strings. Fiscally conservative Germany has declared an emergency and removed its limits on public debt. Altogether, we are witnessing the largest combined fiscal effort launched since World War II. Its effects will make themselves felt in weeks and months to come. It is already clear that the first round may not be enough.

An even more urgent task is to prevent the slowdown from turning into an immense financial crisis. It is commonly said that the U.S. Federal Reserve under Chairman Jerome Powell is following the 2008 playbook. This is true. Day by day, it spawns new programs to support every corner of the financial market. But what is different is the scale of the Fed's interventions. To counter the epic shock of the shutdown, it has mobilized an immense wave of liquidity. In late March, the Fed was buying assets at a rate of \$90 billion per day. This is more per day than Ben Bernanke's Fed purchased most months. Every single second, the Fed was swapping almost a million dollars' worth of Treasuries and mortgage-backed securities for cash. On the morning of April 9, at the same moment that the latest horrifying unemployment number was released, the Fed announced that it was launching an additional \$2.3 trillion in asset purchases.

This huge and immediate counterbalancing action has so far prevented an immediate global financial meltdown, but we now face a protracted period in which falling consumption and investment drive further contraction. Seventy-three percent of American households report having suffered a loss of income in March. For many, that loss is catastrophic, tipping them into acute need, default, and bankruptcy. Delinquencies on consumer debt will no doubt surge, leading to sustained damage to the financial system. Discretionary expenditure will be deferred. Petrol consumption in Europe has fallen by 88 percent. The market for automobiles is stone dead. Auto manufacturers across Europe and Asia are sitting on giant lots of unsold vehicles.

The longer we sustain the lockdown, the deeper the scarring to the economy and the slower the recovery. In China, regular economic activity is inching back. But given the risk of second- and third-wave outbreaks, no one has any idea how far and fast the resumption of normal life can safely go. It seems likely, barring a dramatic medical breakthrough, that movement restrictions will need to stay in place to manage the unevenness of containment. A protracted and halting recovery seems far more likely at this point than a vigorous V-shaped bounce back.



And even once current production and employment have restarted, we will be dealing with the financial hangover for years to come. The argument over fiscal policy is rarely engaged in the heat of the moment. In a crisis, it is easy to agree to spend money. But that fight is coming. We are engaged in the largest-ever surge in public debt in peacetime. Right now we are parking that debt on the balance sheet of central banks. Those central banks can also hold the interest rate low, which means that the debt service will not be exorbitant. But that defers the question of what to do with them. To the conventional mind debt must be eventually repaid through surpluses generated through tax increases or spending cuts.

History suggests, however, there are also more radical alternatives. One would be a burst of inflation, though how that would be engineered given prevailing economic conditions is not obvious. Another would be a debt jubilee, a polite name for a public default (which would not be as drastic as it sounds if it affects the debts held on the account of the central bank). Some have suggested it would be simpler for the central banks to cut out the business of buying debt issued by the government and instead simply to credit governments with a gigantic cash balance.

And on 9 April that is exactly what the Bank of England announced it would be doing. For all intents and purposes, this means the central bank is simply printing money. That this is even being considered, and under a conservative government, is a measure of how extreme the situation is. It is also symptomatic that, rather than howls of outrage and

immediate panic selling, the Bank of England's decision has so far produced little more than a shrug from financial markets. They are under few illusions about the acrobatics that all the central banks are performing.

This resigned attitude is helpful from the point of view of crisis-fighting. But do not expect the calm to last. When the lid comes off, politics will resume and so will the arguments about "debt burdens" and "sustainability."

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And given the scale of the liabilities that have already been accumulated, we should expect it to get ugly.

What we thought we knew about the economy and finance has been radically disturbed. Since the shock of the 2008 financial crisis, there has been a lot of talk about the need to reckon with radical uncertainty—the kind of risk to which you cannot attach a mathematical probability. Indeed, attaching a specific probability may even encourage complacency and a false sense of omniscience.

After the shocks of Brexit and Donald Trump's election, there was a lot of talk about the unpredictable politics of populism. Trump's aggressive trade policy and the escalation into geopolitical rivalry with China shook conventional assumptions about the future of globalization. By 2019, that uncertainty had mounted to the point at which it was affecting investment and risking a recession. Central banks, which had thought they were on a path to normalization and unwinding the dramatic interventions that followed 2008, were forced to reverse course and resume a policy of ultra-low interest rates. That, in turn, engendered hand-wringing about a new era of dependence on central banks. Would we ever return to "normal" times, with markets broken of their addiction to monetary stimulus and business and trade unmolested by unpredictable elections?

After the coronavirus pandemic, such pleas can only seem quaint. We now know what truly radical uncertainty looks like. A huge part of the world's population has had the basic functioning of its life radically disrupted. None of us can confidently predict when we will be able to return to our pre-coronavirus lives. We may hope that things will "return to normal." But how will we tell? After all, things seemed normal in January, just weeks before the world stopped. If radical uncertainty was a concern before, it will now be an ever present reality. Every flu season will be anxiously watched. To mix medical metaphors, how long will it be before we can declare ourselves in remission?

It is possible that in the aftermath of the lockdown there may be some rebound in expenditure. But is that likely to be sustained? The most obvious reaction to a shock like the one we are experiencing is to retract. One of the striking developments since 2008 has been the deleveraging of households in the United States. The American consumer, the single largest source of demand in the world economy, has become distinctly more

sober. Business investment has been slack, as has productivity growth. The slowdown was not confined to the West. The emerging markets, too, had slowed. We called it secular stagnation.

If the response by business and households to the unprecedented coronavirus shock is a flight to safety, it will compound the forces of stagnation. If the public response to the debts accumulated by the crisis is austerity, that will make matters worse. It makes sense to call instead for a more active, more visionary government to lead the way out of the crisis. But the question, of course, is what form that will take and which political forces will control it.

Update, April 9, 2020: This article was updated to include newly released U.S. unemployment data.