September 2020 (and March 2021): the temporary and the permanent impacts of coronavirus

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For very good reasons all attention is on the immediate containment of the coronavirus and protecting lives. It is also about holding the economy together and helping people and businesses faced with an unprecedented combination of demand and supply shocks, which are local, national and global.

But it also worth thinking through what comes *afterwards*, when the virus is tamed but probably never eliminated. What will be the temporary and more importantly the permanent effects once the immediate emergency is over?

Fast forward to September 2020. Very sadly, by then a lot of people will have died, but we will know whether social distancing works, infections should be falling, and lots of economies should be getting back to work, following the lead from China. We will be a lot further down the road to the scientific understanding of the virus, and on the path to vaccines. By then ventilator production should be much higher, health services should be gaining traction, and there will be lots more testing and lots more people who have contracted the virus will have recovered.

By March 2021, there should be vaccines and a whole infrastructure in place to handle what might by then have become part of the regular round of endemic infections we humans suffer from. Unless coronavirus is genuinely different and more deadly than previous viruses (and of course it could be), the world will be back to facing up to both the inescapable problems that existed in January 2020 as well as the aftermath of the virus itself. We should plan on being on the way back to some sort of normalcy by September 2020 and back robustly by March 2021.

The world in January 2020

It is worth recalling what these January 2020 problems were and why they will be back in September 2020. For the UK there is the post BREXIT cliff edge for EU trade negotiations. Unless the PM reaches for the pause button in July, what was going to be a rushed and skeleton trade deal with EU partners, looks like it is going to be even less prepared. Then there is the trade deal with President Trump in the teeth of a highly contested US Presidential Election.

At the EU level the in-box was already brimming in January 2020. The new EU Commission had decided to make the climate change package the central organising theme of its term of office, and it had published its ideas, and gone on to spell out the legal regulation it wants to put in place, against a background of trying to agree not just to net zero in 2050 but more controversially a tight 2030 carbon target. All of this was to be ahead of the curve on COP26 scheduled for the end of 2020 in Glasgow, now very likely to be postponed.

These climate change preoccupations in the UK and the EU came after the protest movements in 2019 heightened the focus on climate change, and the great emphasis on corporate ESG and trying to force disinvestment from the western independent quoted oil companies (some 10% of global oil). ESG was by January 2020 one of the most pressing issues in most large company boardrooms. It isn't now.

Behind these policy preoccupations – BREXIT and climate change – there were some more fundamental imbalances which would probably have caused crises in 2020 anyway. These included the inflated equity markets, the rush to ever greater corporate borrowing and growing indebtedness, and the great share buy backs (and executive salaries) that this facilitated.

After the dotcom crash in 2000, the world embarked on a wholly new macroeconomic strategy of zero to negative real interest rates. This inflated another great asset bubble up to 2007, and when that burst governments resorted to quantitative easing (QE) and large fiscal spending. This in turn created a world where debt was almost free, and equity could be extracted, creating the equity market bubble that crashed this year. In 2019 alone, equity market rose between 10-15%. In 2020 this bubble was very likely going to burst anyway.

A second fundamental apparent by January 2020 was the cracks in the global trade system. This was not just all about Trump and China. Behind the tweets and the bombast lay a deep-seated structural change, as digital technologies reduced the importance of cheap compliant labour, and as US shale oil and gas gave reshoring back to the US a whole new impetus.

Shale oil in turn contributed to the third fundamental, which was the growing stress in the oil markets, as ever more US oil and gas poured onto a saturated global market, worsened as China was already slowing down. As predicted in my book ***Burn Out***, oil prices should already have been falling and now they have. As the marginal cost was well below the $60-70 range (more like $5-20) it was only a matter of time before the oil market cracked. It would very likely have happened in 2020 anyway.

What all this tells you is that the world economy was already in a bad way in January 2020. What the virus has done has provided the trigger for the capital market crash, and the background against which the Saudi Arabian and Russian oil producers will have to work out how to stabilise the oil market. Some sort of global recession was probably on the cards anyway. The virus has made it a whole lot worse.

Short term reactions to the economic crash

The immediate reaction to the economic crash has been to abandon any and all constraints on fiscal policy, and to turn back to QE and even lower interest rates. It is like 2000 and 2007 all over again, howbeit on a bigger scale and onto a policy structure which is already weakened by the last two episodes. It is unclear if these stimuli will make much impact when the collapse of demand is due to the lock-downs and the inability of people to spend. It is like pushing a piece of string. What government has done is put a floor under consumption, by propping up companies to prevent immediate widespread bankruptcies and to provide some floor to wages.

Much of this is inevitable and probably necessary, but it is temporary, and the exit will have to be faced at some stage. There will be even more debt and with the return on bonds and cash turning negative, at some point it might promote another big surge in equity values, as it did after 2000 and 2007. Better, investors may conclude, to get a pittance of a dividend to paying the bank and the government to hold your money for you.

It is of course not the end of the world. There is doom and gloom and we will all be poorer. But when the immediate crisis is over in September 2020 or March 2021, the houses will still be standing, the factories will still exist, the digital economy will remain, and of course the pipes, wires, cables, and power stations will all be there too. The physical economy will remain intact. It is not like after a war when the physical assets are in ruins. Indeed, there are many reasons for thinking that not only will the physical and digital assets remain, but the underlying productivity will have gained a big potential boost. There is nothing like a real live experiment for people to clock onto the scope for remote working, video conferencing and the huge potential savings from not travelling. There will be no going back to the *status quo ex ante* and many people will as a result be both more digitally skilled and have to commute less. The question in September 2020 might be more: what is the point of an office?

The permanent effects of the virus

Gazing beyond March 2021 it is possible to hazard some guesses about how the world will have been permanently changed. We should not exaggerate this: Spanish Flu did not permanently change the world, though it was much worse and took out the young rather than the old, the young having already disproportionately suffered and been killed in the First World War. Until coronavirus came along, few histories of the 1920s and 1930s made much mention of Spanish Flu, and if they did only in passing. It may just be that there are few if any large-scale permanent effects. We will have to wait to find out.

We can however speculate on what future historians will write about our time. There are several possible more permanent impacts, though again each of these was already progressing and, as with the market crash, likely to happen anyway. The permanent effect is to accelerate and exaggerate these. They include: the increased return of the state; the greater exacerbation of intergenerational conflict; and the future retreat from globalisation. To these may be added a reconsideration of climate change policies.

(i) The return of the state and renationalisation

In wars (to which politicians have been making lots of questionable comparisons), it is governments that take charge across vast areas of the economy. Markets are not good at warfare. The collapse of businesses, the collapse of incomes, and need for emergency planning of production and distribution are problems only government can deal with, using the powers of its financial muscle, direction and coercion.

Governments build on what is already in place and use the levers that the current structure of the economy makes immediately open. In the early days of the virus, these were largely about information, persuasion and coordinating private companies. The NHS is front and centre in all this intervention, since it has never been designed to deal with a pandemic (like most but not all other health services around the world). It lacks resilience, and it lacks key equipment, and it needs more staff and the private health service and companies to step in. It takes government money and government coercion to make it happen.

Little of this is new. It is only the speed not direction of travel that is novel. The shift in the economic borders of the state that had already begun to happen before the virus. Look back to the 2019 General Election and compare the manifestos of Labour and the Conservatives. Both proposed a major extension of the role of the state in the economy. Labour proposed nationalisation of railways, water and some elements of the energy industry. Labour proposed a major infrastructure spend, supported by a relaxation of the financial discipline that had been the hallmark of the Conservative-led governments since the financial crash of the last decade. Labour proposed raising the top rate of tax, and expanding spending on the NHS. The Conservatives proposed quite a lot of this too, but stayed clear of nationalisation and raising the top rate taxation (and indeed VAT, corporation tax and national insurance too).

Behind the usual political heat of an election campaign, there was already quite a lot of common ground. The Spring Budget, which was prepared ahead of the full virus crisis, shared the ambition of a big increase in infrastructure spending and a large-scale relaxation of fiscal discipline. The state under the Conservatives was already back and expanding, before coronavirus struck. Since the virus struck, the Conservatives have taken further steps towards expanding the economic borders of the state. Already renationalisation of the remaining parts of the railway industry had begun, and now it will probably be carried to practical completion. The state is now the large-scale lender to the private sector, the guarantor of wages, and every day new commitments are added.

As the virus runs its course, there will be a lot more interventions made up on the hoof in response to events. There always are in crises and rightly so. New information is coming all the time and quick responses are what is needed.

These quick responses are designed to plug the gaps in demand and supply. On the demand side, keeping people in work, and providing income support for those who are laid off are things government can and must do. On the supply side, the need for more direction and coordination in everything from medical supplies, and health service labour supply, to food are the sorts of things that, in a war, governments take control of. Then there are the bankruptcies and business failures, the casualties of the emergency as demand for their services collapses. Temporary loans, payment holidays and other measures buy time. They create a loan book which in theory can be unwound.

Quite a lot of these temporary emergency measures are likely to become permanent. For a number of businesses, this shock pushes them over an edge they had already reached. The great fashion for financial engineering, utilising the cheap debt that resulted from the historically unprecedented monetary stimuli and negative real interest rates of the last decade, have all fuelled a rise in gearing. Less noticed is that when a shock comes along, this modern financial model has little resilience. A sharp hit on the demand side is enough to finish off quite a few businesses off, and when combined with a supply shock too, the emperor (or rather the masters of financial engineering) have nowhere to hide.

Recall that after the banks were renationalised it has taken a decade to unwind some of the interventions, and RBS remains on the state's books 12 years later.

In times of stress, state owned companies carry on, with the government as the shareholder able to directly support their activities. Imagine if British Telecom, British Airports Authority, British Gas, British Rail, the Central Electricity Generating Board and the Water Boards still existed. The government would instruct them to carry on, keep their workers rather than lay them off, and even ask them to redirect some of their workforce to deal with the wider national requirements in the emergency. For much of the twentieth century (and for some of these industries in Europe still), nationalised industries were the norm.

Are we going back to this model? The answer is not immediately, but there are some signs of the direction of travel and the virus may have given this a nudge forward. In railways, this is definitely the case. As noted, the industry was on the path toward nationalisation anyway.

Now as the companies appeal for state aid, it is going to happen. In water, whilst the three quoted water companies have proved very robust in the financial crisis, it is not clear that some of the others are going to fare so well. Several have already appealed to the CMA, and some have already moved to a temporary "not-for-dividend" status. It is not an enormous step to think that the "not-for-dividend" status may be coming for a few more, and perhaps permanently.

Could the airports and airlines get renationalised? Again, not immediately. But what if they need bailing out, or even go bust? State intervention may lead to partial state control through minority equity stakes (even paid for with QE money), and then there is the RBS problem – the aim would be to re-privatise any short-term stakes, but the temporary state ownership can turn out to look more and more permanent.

All this state intervention has already pushed quite a lot of competition regulation aside. There are massive state aids all across Europe. A return to threatening big companies with the full force of the CMA looks likely to come up against the realities of the damage to them done by the crisis and a post BREXIT UK government is capable of taking back control, even if it turns out to be corporatist.

(ii) Intergenerational conflicts

How is all this extra spending going to be paid for? How is the debt to be repaid? The immediate answer is that if the government sticks to its January 2020 position, the main tax rates are not going to go up. This pledge was already in difficulty when the recent Budget was drawn up before the main impact of the virus. Now it looks in tatters. It is inevitable that tax will have to rise, and the trigger is likely to be when the financial markets finally rumble the inability of the government to stand behind its debts without raising the revenue.

The big expansion of the national debt at the Second World War (to 245% of GDP at peak) was gradually paid down through the proceeds of economic growth in the great post war boom, and by inflation. The chances of a boom now are not great (though not impossible), and the chances of inflation in the short term are low. That leaves tax.

By 1979, the top rate of tax was 83% and the rate on unearned income was even higher. For most of the period from the Second World War until the end of the 1970s, it was always above 70%. Current top tax rates are low by comparison. But the trouble here is that already the top 1% of earners pay the bulk of income tax, and for the post war period there was no VAT, and now there is. The politically unpalatable fact is that there is going to be a lot more tax burden on everyone. There just aren’t enough rich enough people to plug all the gap alone. They will pay more, but so will the rest of us.

The trouble here is that the bulk of the population might not like this. They prefer borrowing to paying, and have little room to absorb more costs if they are to maintain their standard of living. But if they vote not to pay, then this is that it is another shift of burden from the current generation to the next. The young are already challenged by inflated asset values (notably houses), by stagnant wages, and all the pollution we are bequeathing them. The older generation has the bulk of the votes, and they go out and vote – to protect their pensions, fuel allowances and other benefits.

This can only result in a sharper generational divide. It is not inconceivable that the generational political divide may replace the class one, and especially when it comes to taxation and pensions.

(iii) The retreat from globalisation

The third longer term impact of the virus is going to be to push faster away from globalisation. This is not just because globalisation has increased the spread of the virus, and made it a global pandemic. It is because globalisation is synonymous with just-in-time production, long supply chains and a corresponding weakness of resilience. Relying on global supply chains for urgent medical needs is just one of the concerns that the virus has thrown up.

In the UK, the most obvious and immediate impact is on food supplies. It is less that the UK produces 60% of its food, but rather the food industry which transforms raw production into the food we consume is highly global. Even simple chocolate spreads can have many countries involved in sourcing and manufacturing and distributing it. This is not an argument for dig-for-victory campaigns and even more home production, but rather for more food security. This is a different thing and turns on stocks and materials and supply chains. Indeed, if it were about UK production of raw food, the fact that a lot of farmed land is used for non-food purposes and the soils have been degraded would be the places to start. Food security is ultimately about *resilience,* and modern farming and the CAP have undermined resilience.

Broader resilience starts with infrastructures. These have largely stood up to the immediate crisis. The reason is in part that demand has gone down, and especially in electricity. But in broadband and fibre the opposite is the case. Bandwidth has proved a problem and resilience in a modern digital economy requires capacity margins and redundancy in systems to withstand shocks like this. It is a "no brainer" that fibre should be a priority, and the cost at say £30 billion looks a much better bet than the

£108 billion on HS2. (Much of HS2 and the Heathrow runway may both be casualties of the virus).

Fibre builds resilience, and it also goes with the grain of the underlying technological trends. As noted above, the reason globalisation was already on the retreat was because digital technologies – robots, 3D printing, AI and the internet of things – are all more amenable to local production close to local consumption. Robots don't need wages, social security, sleep and they do not catch coronavirus, or its successors.

This deglobalisation fits with the new politics post the 2007/08 crash. A return to nations and local communities was already underway, encouraged in part by some of the social and political consequences of globalisation. Now the technology and the virus will give it a further, permanent push.

(iv) Decarbonisation

A long-term trend everyone is now familiar with is climate change. We are well on the way to 2 degrees warming, and it is likely to be a greater threat to human lives (and potentially kill many more) than coronavirus. (Whether future viruses kill more depends upon preparation, science and luck).

This longer-term trend is reflected in the relentless march of carbon concentrations in the atmosphere ever upwards for the last 30 years. It is true that the virus will create a dent in the emissions, though possibility not in the concentration of carbon in the atmosphere (these are not the same thing and it is the concentration that matters). However, it would be rash to see the virus contributing to getting the world on board for really dealing with climate change.

Why? Because the virus has created an economic crisis, and people will be less willing pay for saving future generations. There are more immediate pressing problems. Because too that the oil price has fallen, and hence the incentive of countries to free ride on others will be increased. Might the virus mark the point of passing peak net zero?

That would be a dreadful legacy of the virus. For those who think that climate change is a much more serious problem than the virus (very serious though the virus of course is) the priority must be to come up with much more effective and efficient climate mitigation policies. Net zero territorial carbon production targets are not the right answer: it needs to be net zero carbon *consumption*, and that is altogether more demanding. It is what my new book ***Net Zero*** is all about.

Conclusions

The coronavirus crisis will come to an end even if coronavirus does not. Like all major crises it changes the course of history, if only to press the pause button. But such change can be exaggerated, and more often crises accelerate changes of course already underway. The return of the state and renationalisation, intergenerational conflicts and deglobalisation were already underway. All of these will be further advanced by this crisis. Whether in a decade or so this particular crisis will be more than a footnote in history books remains to be seen. Possibly not: like Spanish Flu collective amnesia may set in as future crises unfold (and perhaps deadlier future viruses too).

What will not be forgotten by future historians is climate change and the destruction of the natural environment and its biodiversity we continue to cause, and it remains to be seen whether this particular crisis leads to a broader and a more fundamental rethink. We have not paid enough to support the health service, preferring lower taxes. There is a broader lesson here too, and a really great legacy of this crisis would be that we learn it. Prevention and resilience are what we need, to mitigate not just viruses, but also the destruction of the wider natural environment.

Burn Out – the endgame for fossil fuels, was published by Yale University Press, 2017, revised paperback edition 2018)
Net Zero – how we stop causing climate change, will be published by William Collins in May 2020.