Pandemic Economics

Michael Roberts

Abstract: There have been over one million deaths from the COVID-19 infection so far. The pandemic forced governments across the world into emergency lockdowns that pushed nearly all parts of the world economy into the deepest slump in production, investment, consumption, and employment since the 1930s. There is optimism that world economy will bounce back in 2021 in a V-shaped recovery. But that seems unlikely because global capitalism was in trouble before the pandemic hit and was already heading into a recession. The lockdown slump was just a tipping point. Also, the pandemic is not yet over and infections continue to mount. The impact of the pandemic lockdowns on employment and incomes, particularly for the poorest countries and the poorest in all countries has been devastating and will leave permanent scarring on economies and livelihoods. And there is no internationally coordinated plan to contain the pandemic and to restore livelihoods. Market-led economies and health systems have failed. Only a social economy where there is public ownership and community control of finance and industry can turn the world economy around for working people.

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Keywords: pandemic, economy, recession, depression, Keynes, stimulus

The global response to COVID-19

As of October 2020, there have now been more than 35 million cases of COVID-19 infections, with more than one million deaths. That's a death rate of 3.3%. Each year influenza kills about 0.1% of people who catch it. By this measure, COVID-19 virus is clearly much more deadly. Of course, not everybody has been infected, but micro-studies suggest that around 0.5%-1% of those infected with COVID-19 would die; that is about five to ten times more deadly than annual influenza. Quick math shows that with a world population of about 7.2bn and assuming 'herd immunity' is achieved at 65% of the population, then an uncontained virus could have killed 35m people.

But the impact of COVID-19 has been contained – if in many cases more by luck than judgement. Governments around the world have been warned for decades that new pathogens deadly to humans were emerging ever more frequently and likely to turn into pandemics. From SARS, MERS, Ebola, and now COVID-19, epidemiologists and health organisations have been warning of the impending danger. The UN set up a Global Preparedness Monitoring Board (GPMD) which reported only last September 2019 and warned of a viral pandemic and commented: "[P]reparedness is hampered by the lack of continued political will at all levels... Although national leaders respond to health crises when fear and panic grow strong enough, most countries do not devote the consistent energy and resources needed to keep outbreaks from escalating into disasters."[1]

Yes, the dangers were ignored. And there are several reasons why. First, it has become clear that these new pathogens have emerged because

1 https://apps.who.int/gpmb/assets/annual_report/GPMB_annualreport_2019.pdf

of the relentless expansion of capitalist production and industrialisation into all parts of the globe, uncontrolled and with no regard for the environment and nature. Fossil fuel, mineral exploration, and timber logging, plus industrial plantation farming and sprawling urbanisation have brought pathogens, which for thousands of years have been in wild life like bats and other remotely based animals, into contact with farm animals and then with humans through wildlife food markets and farming. But governments did not want to know because effective action would mean the curbing of profitable industrial expansion.

And the lack of preparation was also exhibited in the failure of big pharmaceutical firms to invest in research and production of effective vaccines to provide humans with immunity. The technology is there to do this – as we now see with the mad rush by many pharmaceutical companies to produce a vaccine. But before the pandemic, 16 out of the top 20 American pharmaceutical companies did no research at all in vaccines to deal with such diseases because they were previously concentrated in the poor parts of world where there was no profit to be made. They preferred to concentrate on anti-depressants, opioids, diabetes, and cancers; the diseases of the 'global north'.

And then there was the state of health systems around the world. In the advanced capitalist countries, public health systems have been starved of funding, privatised and hollowed out over the last 40 years to the benefit of private profit and the market. A 2015 study of tuberculosis rates in 99 countries found that cuts in public spending on healthcare and the privatization of the health sector were related to a higher prevalence of TB.[2] This was set against decades of privatization of health-care systems in developing countries, often encouraged by the World Bank and IMF.

So most health systems were already stretched to the limit in dealing with illness and disease – indeed, it was 'efficient' to run health capacity at 99%, with no room for major emergencies. Many health systems had no stock of necessary equipment for virus pandemics like masks, PPE, ventilators, or even medicines to ameliorate the impact of the virus. When the pandemic hit, many health systems in Europe were overwhelmed, forcing governments either to allow people to die (not a good political move) or impose drastic lockdowns – or both, unfortunately. Also, health systems were then forced to concentrate on the COVID-19 patients to the detriment of other seriously ill patients, leading to secondary deaths.

Recent studies have shown that a 10% increase in the percentage of hospital beds per 1,000 people results in a 1.7% decrease in COVID-19 deaths.[3] Some of the highest mortality rates are in the US, Italy, and Spain (which have around 3 hospital beds per 1,000 people), whereas less privatized systems have a much higher ratio of hospital beds per people, e.g. Germany (8.2), South Korea (10.9), and Japan (13.4). In other words, the

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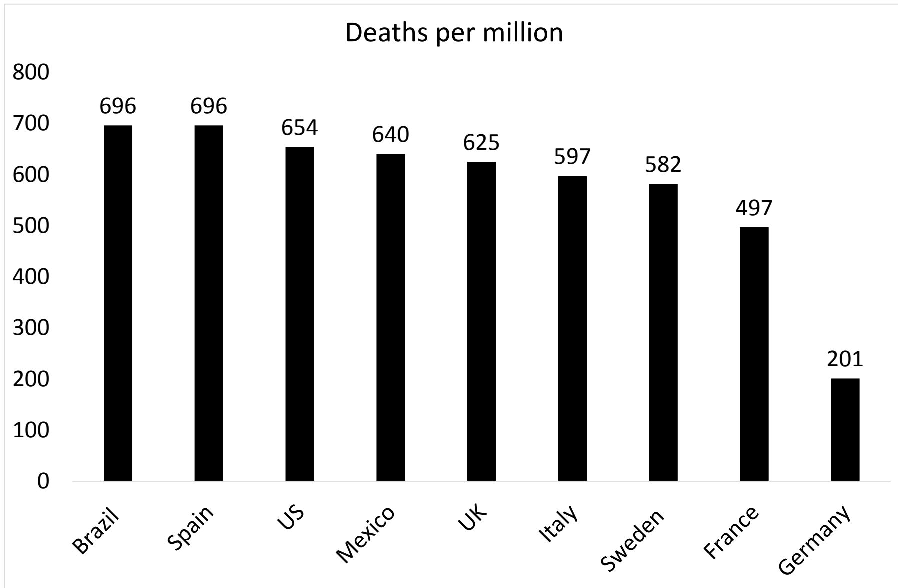
2 https://developingeconomics.org/2020/06/21/privatization-and-the-pandemic/

3 https://developingeconomics.org/2020/06/21/privatization-and-the-pandemic/

more a health system is public and properly funded and resourced, the more success it has in saving lives. Privatisation kills.

Of course, there was talk among the corporate boardrooms and government committees in some countries, that as COVID-19 only killed mostly the old, sick and infirm and did little damage to the young and those healthy and of working age, it would be better to go for 'herd immunity'. Indeed, wiping out the old and sick would save public money eventually and boost productivity! But such a 'Malthusian solution' was generally rejected as too dangerous politically to adopt.

Some governments like Sweden tried to claim that lockdowns were unnecessary and social distancing would be enough. That has not proved to be the case, as Sweden's death rate has been ten times higher than its neighbours of 'locked down' Denmark, Norway, or Finland – and indeed Sweden's death rate is now close to initially hard-hit Italy. Other autocratic and right-wing governments like those in Brazil or the US have claimed that COVID-19 is a 'hoax', or no worse than flu and so there was no need for any containment. Again, policies based on that view have proved to be disastrous for the death rates of these countries.



But lockdowns alone were no answer to containing the pandemic. The countries that have succeeded most in controlling the virus and saving lives have been those that had early lockdowns, but also effective mass testing and tracing of infections, fully serviced health systems, and massive community cooperation. China, where the virus started, has had only 5000 deaths or 3 per million. Taiwan, South Korea, New Zealand, and in Europe, the Scandinavian countries (except Sweden), have also succeeded to varying degrees.[4]

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4 https://www.worldometers.info/coronavirus/#countries

However, in the so-called Global South, lockdowns have not been successful in containing the virus because it is impossible for most households to work from home with broadband and millions are casual informal labourers who have to go to work, come what may. And living in slums close together is no environment for effective isolation or social distancing. Moreover, health systems in these countries are inadequate and mainly private, so there is minimal testing and those infected severely cannot get treatment. Thus, hundreds of millions in Peru (the worst affected country in the world), Mexico, India, South Africa, etc. are still being infected. Cases continue to skyrocket there, even if the relatively young populations mean that death rates are low.

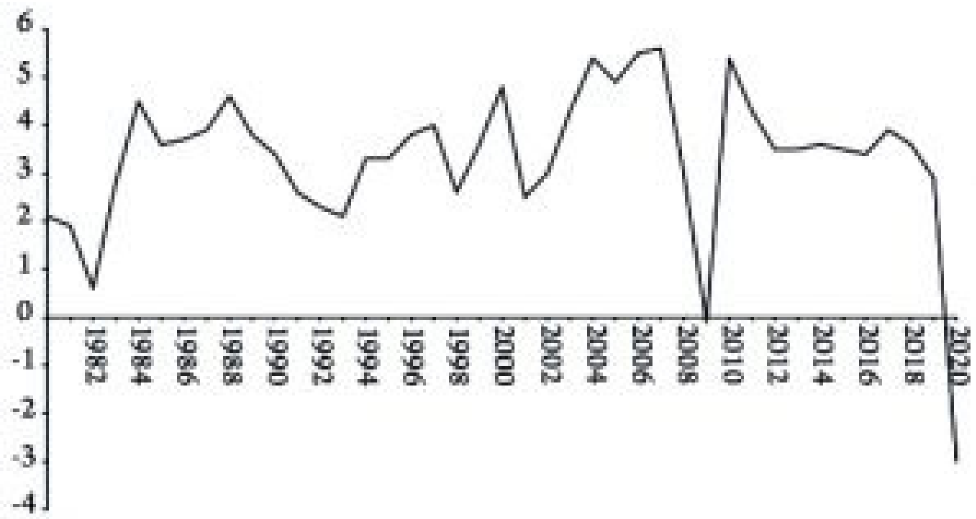
In the advanced capitalist countries of North America, Europe, and Asia, the lockdowns have been gradually relaxed. This has led to a new wave of localised virus eruptions, but death rates are not so high now as the virus now mainly affects the young and healthy, with the old self-isolating, and health systems are better prepared. Even so, the old and the sick are still forced to stay at home or in residential units with no prospect of having 'a life'. And many of those who were severely affected by the virus have been left with permanent damage to respiratory and heart systems and other 'mysterious illnesses'. There is permanent scarring.

And there is permanent scarring to the world economy and people's livelihoods. The world capitalist economy is suffering the largest contraction in output and income in over 100 years (since the 'Spanish flu' epidemic). Over 500m people globally are being driven back into 'official poverty' (earning less than $5.50 a day). Millions of people have lost and will lose their jobs globally, as well as small businesses closing for good. Government bailouts with cash hand-outs for the unemployed and loans to companies have been inadequate to save jobs and incomes and cannot go on for much longer. So bankruptcies will explode and a new global financial crisis is on the horizon.

Everybody is waiting for the vaccines that will give us immunity. But experience shows that vaccines are never fully effective (for example annual flu vaccines are only 60% effective). Moreover, there will be more pandemics to come, based on new pathogens. Health systems remain underfunded and inadequate to deal with them. And there is no international cooperation or plan to control the expansion of fossil fuel exploration (on the contrary) or industrial farming that brought the viruses in the first place. There is no end in sight.

Around 2.7 billion workers worldwide have been affected by full or partial lockdown measures to combat the coronavirus pandemic, i.e., around 81% of the world's 3.3 billion workforce. The world economy has seen nothing like this. Nearly all economic forecasts for global gross domestic product (GDP) in 2020 are for a contraction much worse than in the Great Recession of 2008-9.

Global real GDP growth (percentage)
Source: International Monetary Fund data.



During the lockdowns, output in most economies fell by a quarter according to the Organisation for Economic Cooperation and Development (OECD), with the effects felt in sectors amounting to a third of GDP in the major economies. For each month of containment, there is a loss of 2 percentage points in annual GDP growth. Kenneth Rogoff, co-author with Carmen Reinhart of work on the history of economic crises, reckons that the short-term collapse in global output is likely to rival or exceed any recession in the past 150 years.[5] International Monetary Fund (IMF) chief Kristalina Georgieva projects that "over 170 countries will experience *negative* per capita income growth this year."[6] Investment bank JPMorgan's economists predict that the pandemic will cost the world at least $5.5 trillion in lost output, greater than the annual output of Japan. And that would be lost forever. That is almost 8% of GDP through to the end of 2021. The cost to developed economies alone will be greater than that lost in the recessions of 2008-9 and 1974-5 combined. One recent study argues that the lockdowns in the US will leave production 25-28% below pre-COVID levels in the short run. US employment fell by 30 million in the first half of 2020 and so far has only recovered by less than half.[7] At the current rate of recovery, US employment will not return to its trend level before the end of 2022.

5 Rogoff, 2020a; Reinhart and Rogoff, 2010

6 Georgieva, 2020

7 Mulligan, 2002.

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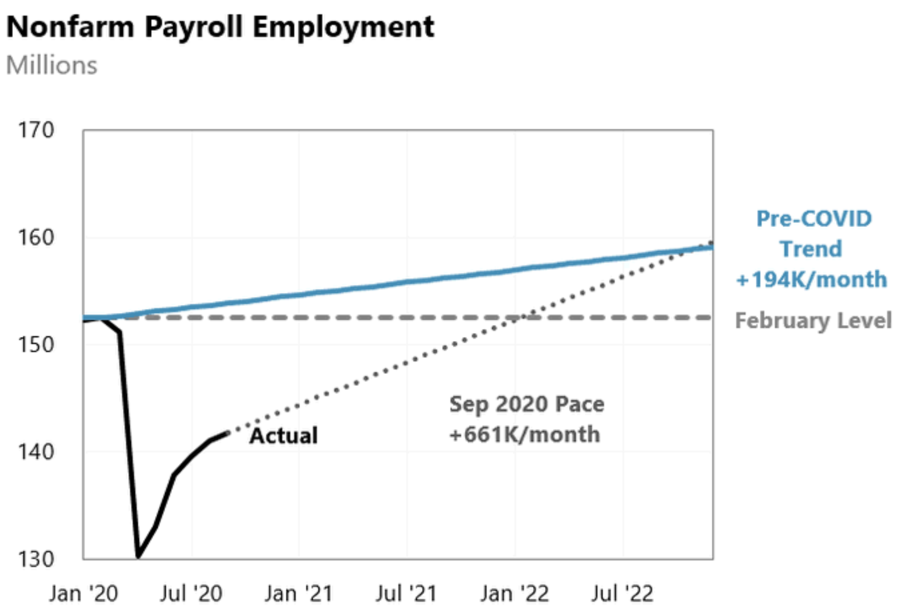


Source: BLS, Evercore ISI.

In my 2016 book *The Long Depression*,[8] I found that the loss of GDP from the beginning of the Great Recession in 2008 through the 18 months to the trough in mid-2009 was over 6% in the major economies. Global real GDP fell by about 3.5% over that period, as the so-called emerging market economies did not contract—mainly because China continued to expand.

The United Nations Conference on Trade and Development (UNCTAD) reckons the global economy's real GDP will contract by about 4.3% this year, leaving global output by year's end over $6 trillion short (in current US dollars) of what economists had expected it to be before the COVID-19 pathogen began to spread. *"In short, the world is grappling with the equivalent of a complete wipe out of the Brazilian, Indian, and Mexican economies. And as domestic activity contracts, so goes the international economy; trade will shrink by around one fifth this year, foreign direct investment flows by up to 40 per cent and remittances will drop by over $100 billion."*[9]

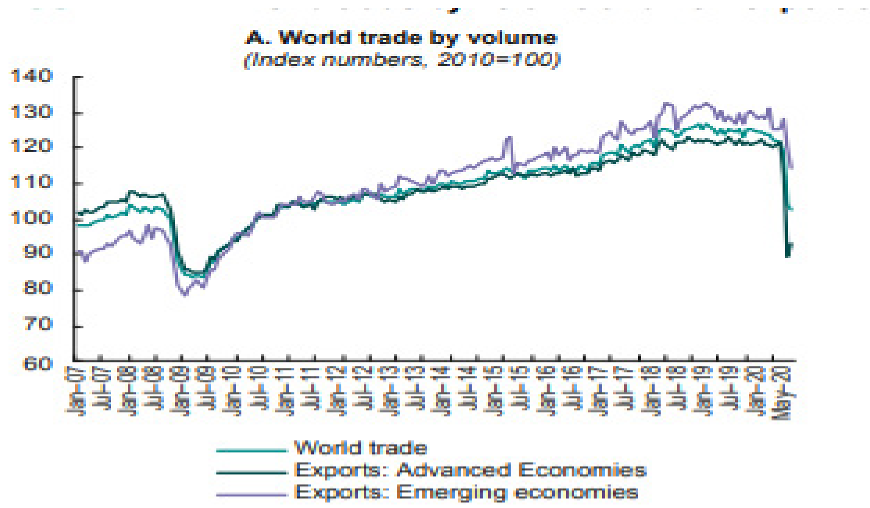
World trade was already falling at a 2% annual rate before the pandemic because of weakening economies and the US-China trade war. Now trade is expected to contract by over 13% this year, faster than during the Great Recession.[10] The collapse in goods trade is particularly damaging to the so-called developing or emerging economies of the

8 Roberts, 2016.

9 https://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=2853

10 World Trade Organisation, 2020.

'Global South'. Many are exporters of basic commodities such as fuel, industrial metals, and agricultural products, whose prices have plummeted since the end of the Great Recession.



Emerging markets disaster

Many larger economies in the Global South—such as Mexico, Argentina, and South Africa—were already in a recession when the pandemic hit. Oxford Economics now forecasts that output in emerging markets will have fallen by 1.5% in 2020, the first decline since reliable records began in 1951. This figure includes the giant economies of China and India. It was their growth during the Great Recession that ensured that there was no average contraction among developing economies then. This time it is different.

As for the smaller emerging economies, the situation is already deteriorating fast. The World Bank believes that the pandemic will push sub-Saharan Africa into recession in 2020 for the first time in 25 years. In its *Africa's Pulse* report, the Bank said the region's economy will contract by 2.1-5.1%, compared to growth of 2.4% last year, and that coronavirus will cost sub-Saharan Africa $37-79 billion in lost output this year due to trade losses, value chain disruption, and other factors.[11] More than 90 'emerging' countries, nearly half the world's nations, have enquired about bailouts from the IMF—and at least 60 have sought to avail themselves of World Bank programmes. These two institutions together have resources of up to $1.2 trillion available to battle the economic fallout but only $50 billion of this can be deployed to "emerging markets", and only $10 billion to low-income members. These figures are tiny compared with the losses in income, GDP, and capital outflows. Since January, nearly $100 billion of capital has flowed out of emerging markets, according to data from the Institute of International Finance (IIF), compared to $26 billion

11 World Bank, 2020

outflow during the global financial crisis of a decade ago. According to Rogoff, "an avalanche of government-debt crises is sure to follow…the system just cannot handle this many defaults and restructurings at the same time".[12] Moreover, the last thing that distressed economies need is another loan from the IMF, as the example of Pakistan demonstrates. The IMF is still demanding austerity measures from the Pakistan government in the middle of this pandemic in return for previous loans.[13]

In addition to this government debt crisis, there has been a growth of private debt since the Great Recession, and this has been taking place fastest in the so-called developing economies. As a number of economists at the World Bank point out: "Most of the increase in debt since 2010 has been in emerging market and developing economies (EMDEs), which saw their debt rise by 54 percentage points of GDP to a record high of about 170% of GDP in 2018. This increase has been broad-based, affecting around 80 percent of EMDEs".[14] Much of this debt is denominated in US dollars, and as that hegemonic currency increases in value as a "safe haven" during the crisis, the burden of repayment will mount for these economies.

There is little room to boost government spending to alleviate the hit. The "developing" economies are in a much weaker position than during the global financial crisis of 2008-9. In 2007, 40 emerging market and middle-income countries had a combined central government fiscal *surplus* of 0.3% of gross domestic product. Last year, the same economies posted a fiscal *deficit* of 4.9% of GDP. The government deficit across "emerging market" economies in Asia went from 0.7% of GDP in 2007 to 5.8% in 2019; in Latin America, it rose from 1.2% of GDP to 4.9%; and in Europe it went from a surplus of 1.9% of GDP to a deficit of 1%.

Global unemployment is also rocketing. The International Labour Organisation (ILO) reckons that the income earned by workers round the world fell more than 10 per cent in the first nine months of 2020 because of the coronavirus pandemic — a loss worth more than $3.5tn, or 5.5% of world GDP. The estimated total working-hour losses in the second quarter of 2020 (relative to the fourth quarter of 2019) are now 17.3%, or 495 million full-time equivalent (FTE) jobs. Working-hour losses are expected to remain high in the third quarter of 2020, at 12.1 per cent or 345 million FTE jobs. More than 400 million enterprises—made up of companies and self-employed people—are in "at risk" sectors such as manufacturing, retail, restaurants and hotels.[15]

Underemployment is also expected to increase on a large scale. And, as witnessed in previous crises, the shock to labour demand is likely

12 Rogoff, 2020b.

13 See Ali Jan, 2020; Roberts, 2018

14 Kose and others, 2020

15 ILO, 2020

to translate into significant downward adjustments to wages and working hours. The strain on incomes resulting from the decline in economic activity will devastate workers close to or below the poverty line. Under the "mid and high" economic damage projections from the ILO, there will be 20-30 million more people in working poverty than before the pre-COVID-19 estimate for 2020.

There are few or no "safety nets" in these countries. The hit to working people in the advanced capitalist countries from a global slump, even if short-lived, will be severe, especially after years of austerity and wage suppression. For the billions in the "developing" countries, it will be devastating.

The World Bank reckons that the pandemic will push between 88m and 115m people into extreme poverty this year, which the bank defines as living on less than $1.90 a day (a ridiculously low threshold). More than 80% of those who will fall into extreme poverty are in middle-income countries, with south Asia the worst-hit region, followed by sub-Saharan Africa. That would set poverty levels back to their 2017 levels. Nearly 7% of the world's population will live on less than $1.90 a day by 2030, the report said, compared with a target of less than 3% under the UN's Sustainable Development Goals.[16]

Progress in reducing poverty had been slowing before the pandemic anyway. About 52m people worldwide rose out of (World Bank) poverty between 2015 and 2017 but the rate of poverty reduction had slowed to less than half a percentage point a year during that period, after reductions of about 1% a year between 1990 and 2015. And all the reduction in poverty rates have been in Asia, in particular East Asia, and in particular China. Strip China out and there has been little or no improvement in absolute poverty in 30 years.

A quick recovery?

Nonetheless, mainstream economic forecasters have remained optimistic proclaiming a sharp recovery in this second half of 2020. China is recovering fast, the argument goes, and the major capitalist economies will bounce back once the pandemic subsides or the authorities are able to contain it.

Optimism has been seen in global stock markets too, particularly in the US. After falling around 30% when the lockdowns were imposed, the US stock market jumped back to new highs by the summer. There were two reasons. The first was the belief that the lockdowns would soon be over; treatments and vaccines were on their way to stop the virus and the pandemic would soon be forgotten. For example, the US treasury secretary, Steven Mnuchin, argued at the beginning of the lockdowns, that "you're going to see the economy really bounce back in July, August and September." Senior White House economics advisor Kevin Hassett

16 https://www.worldbank.org/en/news/feature/2020/10/07/global-action-urgently-needed-to-halt-historic-threats-to-poverty-reduction

stated that by the fourth quarter of 2020, the US economy "is going to be really strong and next year is going to be a tremendous year." Chief economist at the Bank of England, Andy Haldane reckons that Britain's rapid recovery from its COVID-19 slump is being put at risk by undue pessimism and a "Chicken Licken" fear that the sky is about to fall in. "Pessimism can be as contagious as the disease – and as damaging to our economic fortunes. Avoiding economic anxiety is crucial to support the ongoing recovery."[17]

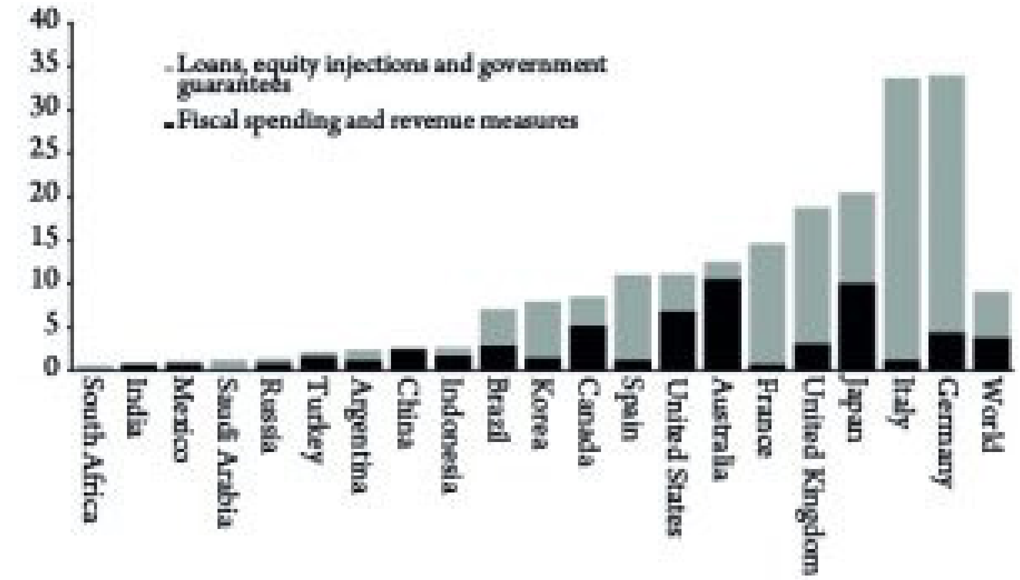
The second reason was the recent credit injections by the Federal Reserve (the US central bank) and the government's fiscal measures. Central banks and even the international agencies such as the IMF and the World Bank have jumped in to inject credit through the purchases of government bonds, corporate bonds, student loans, and even more exotic financial assets on a scale never seen before, even during 2008-9. The Federal Reserve's treasury purchases are already racing ahead of previous quantitative easing programmes. Economists project the central bank's portfolio of bonds, loans, and new programmes will swell to between $8-11 trillion from less than $4 trillion last year. In that range, the portfolio would be twice the size reached following the previous crisis and nearly half the value of US annual output. This would make the central bank's role in the economy greater than during the Great Depression or Second World War. "The Federal Reserve is being sent on a mission to places it has never been before," according to Adam Tooze, the author of *Crashed: How a Decade of Financial Crises Changed the World*. He writes that central bank officials "are being sucked into a series of entanglements that they cannot control and that they normally will not touch with a long pole, but this time felt they had to go in, and go in hard".[18]

The fiscal spending approved by the US Congress far exceeds the spending programme during the Great Recession. It has reached over 4% of GDP in fiscal stimulus and another 5% in credit injections and government guarantees. That is twice the amount in the Great Recession, with some key countries ploughing in even more to compensate workers put out of work and small businesses closed down (see figure 6).

17 https://www.theguardian.com/business/2020/sep/30/banks-chief-economist-warns-against-chicken-licken-pessimism-uk

18 Tooze, 2020.

Fiscal packages as percentage of GDP, 2020
Source: IMF data, author's calculations.



Most of this largesse is to keep business, particularly big business, alive, rather than to help workers and small businesses. If we take the $2 trillion package agreed by the US Congress, two-thirds of it has gone in the form of outright cash injections and loans that may not be repaid, to big business (travel companies and so on) and to smaller businesses, but just one-third to helping the millions of workers and self-employed people to survive with cash handouts and tax deferrals. Indeed, those payments ended in October with little prospect of a new package, at least this side of the US presidential election.

It is the same picture in Europe: first, save big business; second, tide over working people. Moreover, the payments for workers laid off and the self-employed are now being phased out and so fall short of providing sufficient support for the millions that have already been locked down or have seen their companies lay them off. The reality is that the money being shifted towards working people compared to big business is minimal.

Moreover, the pandemic slump will not be ended by central bank largesse or the fiscal packages. Once a slump gets under way, incomes collapse and unemployment rises fast. This has a cascade or "multiplier" effect through the economy, particularly for non-financial companies. This will eventually lead to a sequence of bankruptcies and closures, deepening and prolonging the slump.

This scenario is denied not just by government officials and bankers who think that the economic damage from the pandemic and lockdowns will be short, if not so sweet. Many Keynesian economists in the US are making the same point. Larry Summers, who was treasury secretary under Bill Clinton, reckons the lockdown slump was akin to businesses in summer tourist destinations closing down for the winter. As soon as summer comes along, they all open up and are ready to go just as before: "The recovery can be faster than many people expect because it has the character of the recovery from the total depression that hits a Cape Cod economy every winter or the recovery in American GDP that takes place every Monday morning".[19] Leading Keynesian guru Paul Krugman believes that this slump is not an economic crisis but a "disaster relief" situation.[20] While there might have to be higher spending now, and an increase in the deficit, once this spending has worked, the economy will return to its previous state and the deficit will be repaid.

The reason for this optimism is that Keynesian theory starts with the view that slumps are the result of a collapse in "effective demand" that then leads to a fall in output and employment. But this slump is not the result of a collapse in "demand", but of a closure of production, both in manufacturing and particularly in services. It is a "supply shock", not a "demand shock".

The "financialisation" theorists of the Hyman Minsky school are also at a loss, because this slump is not the result of a credit crunch or financial crash—although that may yet come.[21] This pandemic hit the world economy through supply, not demand as the Keynesians want to claim.[22] It is production, trade, and investment that stops first when shops, schools, and businesses are locked down in order to contain the pandemic. Of course, if people cannot work and businesses cannot sell, then incomes drop and spending collapses, producing 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.

The Keynesians believe that as soon as people get back to work and start spending, "effective demand" (and even "pent-up" demand) will shoot up and the capitalist economy will return to normal. But if you approach the slump from the angle of supply or production, and in particular, the profitability of resuming output and employment, which is the Marxist approach, then both the cause of the slump and the likelihood of a slow and weak recovery become clear.

Indeed, UNCTAD reckons that a V-shaped recovery from the 2020 slump is not likely. But even a full V-shaped recovery with annual growth next year above 5% and the world economy returning to its 2019 level by end of 2021 would still leave a $12 trillion income shortfall in its wake and

19 Quoted in Cohan, 2020.

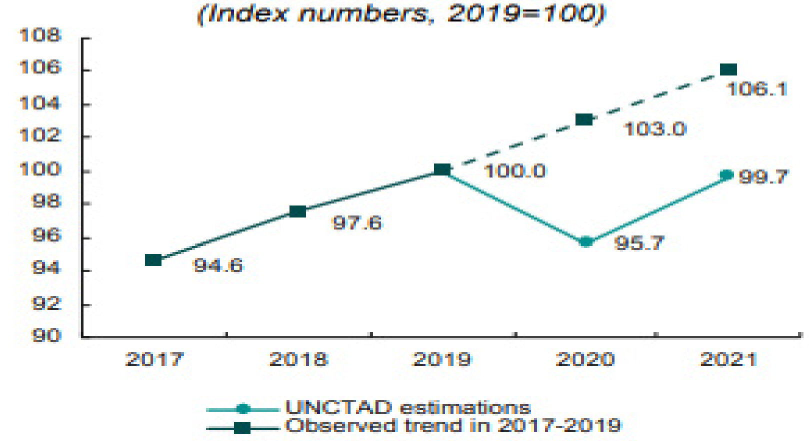
20 Krugman, 2020.

21 Hyman Minsky argued that financial systems would tend to move from stability to fragility, resulting in a sudden collapse of financial asset prices. His work has influenced many "post-Keynesian" economists. See Roberts, 2019a.

22 As Marx wrote in a letter to his friend Louis Kugelmann in 1868, "every child knows a nation which ceased to work, I will not say for a year, but even for a few weeks, would perish"—Marx, 1988, p68.

an engorged debt burden, particularly in the public sector. But even that is not going to happen, says UNCTAD: *"Our own assessment also sees the bounce continuing into next year albeit with stronger headwinds weakening the pace of global recovery which will, under the best scenario, struggle to climb above 4 per cent."*

FIGURE 1.1 World output level, 2017–2021
(Index numbers, 2019=100)



Source: UNCTAD secretariat calculations, based on United Nations Global Policy Model.

The tipping-point

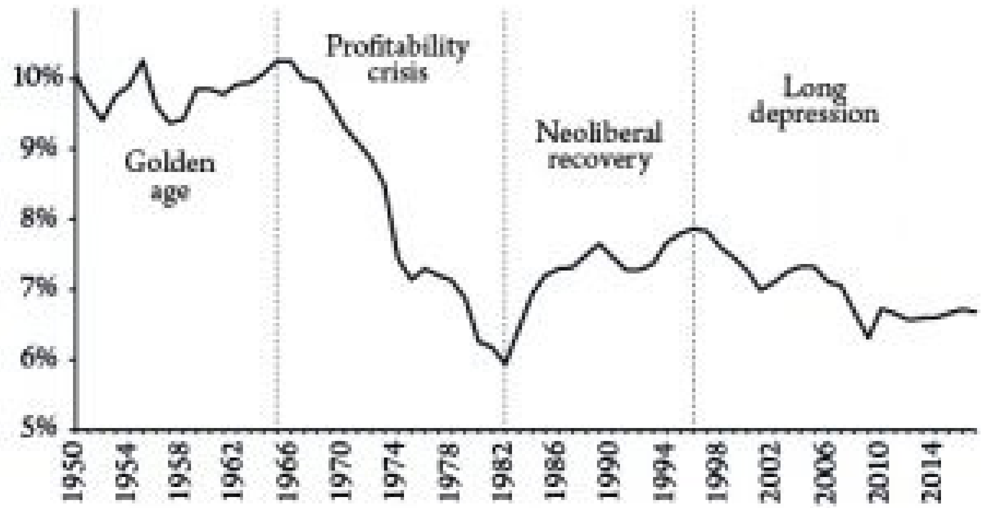
One reason not to expect a V-shaped recovery is that Covid-19 was the tipping-point for the world capitalist economy already in trouble. One analogy is to imagine a pile of sand building up to a peak. Grains of sand start to slip off—and then comes a certain point when, with one more sand particle added, the whole sand pile collapses. If you are a post-Keynesian you might prefer calling this a "Minsky moment", following Minsky's argument that capitalism appears to be stable until it isn't—because 'stability breeds instability'. A Marxist would agree that, yes, there is instability, but would add that instability turns into an avalanche periodically because of the underlying contradictions in the capitalist mode of production.

As the British Marxist economist Chris Dillow argues, the coronavirus epidemic is really just an *extra* factor keeping the major capitalist economies dysfunctional and stagnant. He lays the main cause of the stagnation on the long-term decline in the profitability of capital: "Basic theory (and common sense) tells us that there should be a link between yields on financial assets and those on real ones, so low yields on bonds should be a sign of low yields on physical capital. And they are." He identifies "three big facts": the slowdown in productivity growth; the vulnerability to crisis; and low-grade jobs. As he says, "Of course, all these trends have long been discussed by Marxists: a falling rate of profit;

monopoly leading to stagnation; proneness to crisis; and worse living conditions for many people. And there is plenty of evidence for them".[23]

The profitability of capital in the major economies has been on a downward trend. Moreover, the mass of global profits was also beginning to contract before COVID-19 exploded onto the scene. So even if the virus does not trigger a slump, the conditions for any significant recovery are just not there.

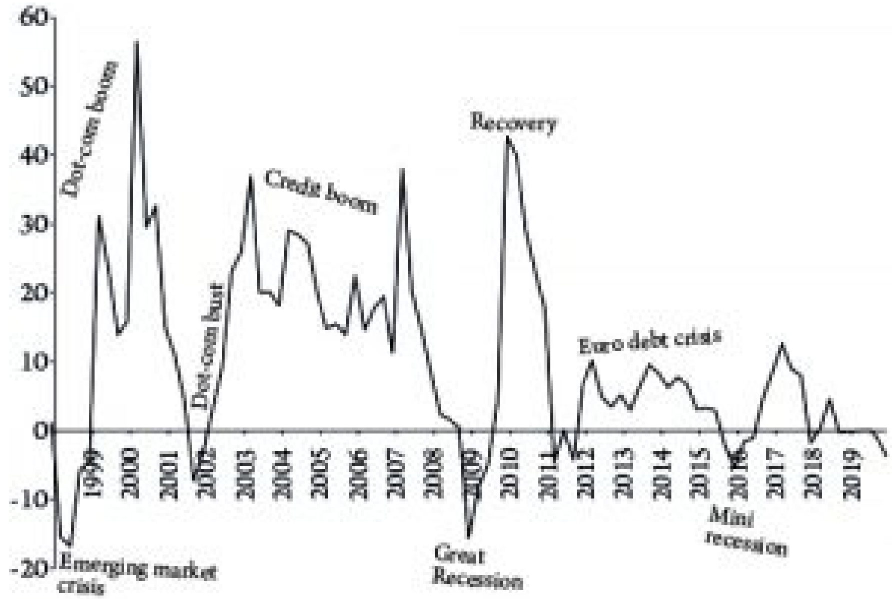
G7 internal rate of return on capital (weighted by GDP)
Source: Penn World Tables 9.1 IRR series, author's calculations.



23 Dillow, 2020

Global corporate profits from six major economies (weighted mean, percentage year on year, Q4 2019 partially estimated)

Source: National statistics, author's calculation

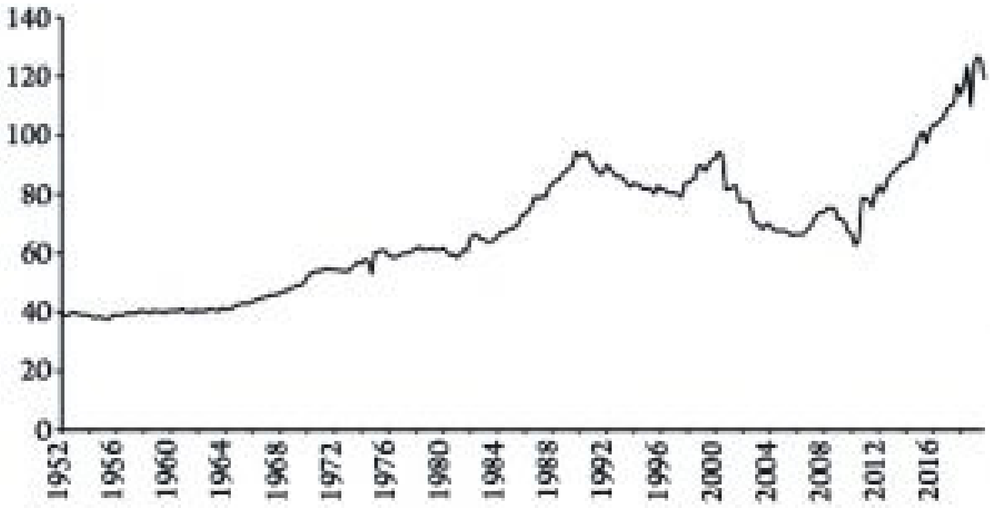


Then there is debt. Over the past decade, characterised by record low, or even negative, interest rates, companies have been on a borrowing binge. Everywhere corporate debt has soared during the long and weak "expansion" since 2009. Huge debt, particularly in the corporate sector, is a recipe for a serious crash if the profitability of capital drops sharply. According to the IIF, the ratio of global debt to gross domestic product hit an all-time high of over 322%, close to $253 trillion, in the third quarter of 2019. The rise in US non-financial corporate debt is particularly striking.

This has enabled large global tech companies to buy up their own shares and issue huge dividends to shareholders, while piling up cash abroad to avoid tax. It has also allowed small and medium-sized companies in the US, Europe, and Japan, which have not been making any profits worth speaking of for years, to survive in what has been called a "zombie state", making just enough to pay their workers, buy inputs and service their (rising) debt, but without having anything left over for new investment and expansion. A recent OECD report said that, by the end of December 2019, the global outstanding stock of non-financial corporate bonds had reached an all-time high of $13.5 trillion, double the level reached in real terms in December 2008. The rise is most striking in the US, where the Federal Reserve estimates that corporate debt had risen from $3.3 trillion before the financial crisis to $6.5 trillion last year. Given that Apple, Facebook, Microsoft, and Google parent Alphabet alone held net cash at the end of last year of $328 billion, this suggests that much of the debt is concentrated in old economic sectors where many companies are less cash generative than big tech. Debt servicing is thus more burdensome.[24]

US non-financial corporate debt to net worth (percentage)

Source: US Federal Reserve.



The IMF's latest Global Financial Stability report amplifies this point with a simulation showing that a recession half as severe as that in 2009 would result in companies with $19 trillion of outstanding debt having insufficient profits to service that debt.[25] So if sales should collapse, supply chains be disrupted and profitability fall further, these heavily indebted companies could keel over. That would hit credit markets and banks, triggering a financial collapse.

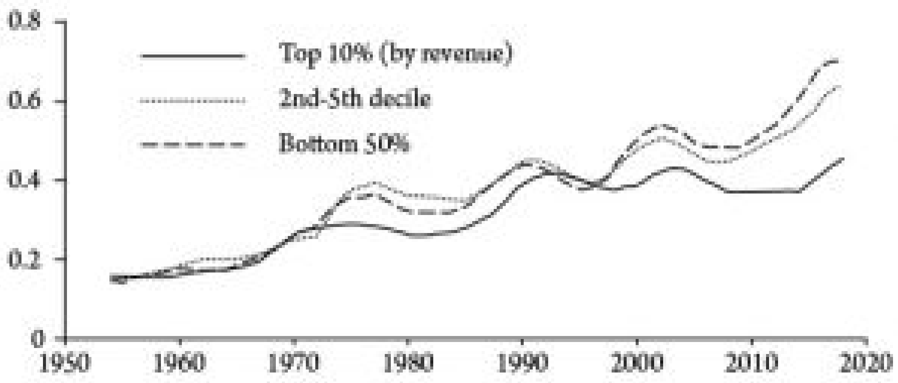
A recent paper by Joseph Baines and Sandy Brian Hager starkly reveals all. For decades, capitalists have been switching from investing in productive assets to investing in financial assets — "fictitious capital", as Marx called it. Stock buybacks and dividend payments to shareholders have been the order of the day rather than re-investing profits in new technology to boost labour productivity. This mainly applies to larger US companies. A vast swathe of small US firms were already in trouble. For them, profit margins have already been falling. As a result, the overall profitability of US capital has fallen, particularly since the late 1990s. Baines and Hager argue that "the dynamics of shareholder capitalism have pushed the firms in the lower echelons of the US corporate hierarchy into a state of financial distress." As a result, corporate debt has risen,

24 Plender, 2020

25 IMF, 2020.

not only in absolute dollar terms, but also relative to revenue, particularly for the smaller companies. Everything has been held together because the interest on corporate debt has fallen significantly, keeping debt servicing costs down. Even so, smaller companies are paying out interest at a much higher level than the large companies. Since the 1990s, their debt servicing costs have held more or less steady but they are nearly twice as high as for the top 10%. Now the days of cheap credit could be over, despite the Federal Reserve's desperate attempt to keep borrowing costs down. Corporate debt yields have rocketed during this pandemic crisis. A wave of debt defaults is now on the agenda. That could "send shockwaves through already-jittery financial markets, providing a catalyst for a wider meltdown".[26]

Debt to revenue ratio of US non-financial firms,
WRDS Compustat data



When the optimists talk about a quick V-shaped recovery, they are simply not recognising that COVID-19 is not generating a "normal" recession, and it is not hitting just a single region but the entire global economy. Many companies, particularly smaller ones, will not return after the pandemic. Before the lockdowns, there were anything between 10 to 20% of firms in the US and Europe that were barely making enough profit to cover running costs and debt servicing. These "zombie firms" may find the "Cape Cod winter" will be the final nail in their coffins. Several middling retail and leisure chains have already filed for bankruptcy, and airlines and travel agencies may follow. Large numbers of shale oil companies are also struggling. As financial analyst Mohamed El-Erian concludes: "Debt is already proving to be a dividing line for firms racing to adjust to the crisis, and a crucial factor in a competition of survival of the fittest. Companies that came into the crisis highly indebted will have a harder time continuing. If you emerge from this, you will emerge to a landscape where a lot of your competitors have disappeared."[27]

26 Baines and Hager, 2020.

27 El-Erian, 2020

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The mainstream policy reaction

Yet these cash packages are new. Straight cash handouts by the –government to households and firms are, in effect, what the infamous monetarist economist Milton Friedman called "helicopter money", i.e., dollars to be dropped from the sky. Forget the banks; get the money directly into the hands of those who need it and who will spend it. Post-Keynesian economists who have pushed for helicopter money, or "people's money" as they would prefer it, are thus apparently vindicated.[28]

In addition, an idea long excluded by mainstream policy has now become acceptable: fiscal spending financed not by the issue of more debt (government bonds) but by simply "printing money" (that is, by a central bank depositing money in the government's account). The policies of Modern Monetary Theory (MMT) have arrived. This "monetary financing" is supposed to be temporary and limited, but supporters of MMT are cock-a-hoop, hoping that it could become permanent, as they advocate. Under this approach governments simply create money and spend to take the economy towards full employment and keep it there. Capitalism will be saved by the state and by MMT.[29] The problem with this approach is that it ignores the crucial factor: the social structure of capitalism. Under capitalism, production and investment is for profit, not to meet the needs of people. Profit, in turn, depends on the ability to exploit the working class sufficiently compared to the costs of investment in technology and productive assets. It does not depend on whether the government has provided enough "effective demand".

Michael Pettis, a well-known "balance sheet" macro-economist based in Beijing, challenges the optimistic assumption that printing money for increased government spending can do the trick: "If the government can spend these additional funds in ways that make GDP grow faster than debt, politicians don't have to worry about runaway inflation or the piling up of debt. But if this money isn't used productively, the opposite is true." He adds: "creating or borrowing money does not increase a country's wealth unless doing so results directly or indirectly in an increase in productive investment… If US companies are reluctant to invest not because the cost of capital is high but rather because expected profitability is low, they are unlikely to respond to the trade-off between cheaper capital and lower demand by investing more".[30] You can lead a horse to water but you cannot make it drink.

The historical evidence shows that the so-called Keynesian multiplier has limited effect in restoring growth, mainly because it is not the consumer who matters in reviving the economy but capitalist companies.[31] There is little reason to believe that it will be more effective this time round. A recent study argues that a quick recovery from this pandemic is unlikely because

28 Coppola, 2020.

29 For a Marxist critique of MMT, see Roberts, 2019b.

30 Pettis, 2019

31 Roberts, 2012.

"demand is endogenous and affected by the supply shock and other features of the economy." This suggests that traditional fiscal stimulus is less effective in a recession caused by a supply shock. Demand may indeed overreact to the supply shock, leading to a demand-deficient recession, because of "low substitutability across sectors and incomplete markets, with liquidity constrained consumers." But this means that "various forms of fiscal policy, per dollar spent, may be less effective".[32]

But what else can governments do, and what else can mainstream economists recommend? If the social structure of capitalist economies is to remain untouched, then all you are left with is printing money and raising government spending.

A social economy

However, there is an alternative. Once the current lockdowns end, what is needed to revive output, investment, and employment is something like a "war economy" or, more accurately, a "social economy". The slump can only be reversed with massive government investment, public ownership of strategic sectors, and state direction of the productive sectors of the economy. Andrew Bossie and J W Mason outline the experience of the public sector role in the wartime US economy. They show that all sorts of loan guarantees, tax incentives, and other measures were initially offered by the Franklin Roosevelt administration to the capitalist sector. But it soon became clear that the capitalists could not do the job of delivering on the war effort because they would not invest or boost capacity without profit guarantees. Direct public investment took over and government-ordered direction was imposed. Bossie and Mason find that federal spending rose from about 8-10% of GDP during the 1930s to an average of around 40% of GDP from 1942 to 1945. Most significantly, contract spending on goods and services accounted for 23% of GDP on average during the war. Currently in most capitalist economies public sector investment is about 3% of GDP, while capitalist sector investment is 15% or more. In the war that ratio was reversed.[33]

What happened was a massive rise in government investment and spending. In 1940, private sector investment was still below the level of 1929 and actually fell further during the war. So the state sector took over nearly all investment, as resources (value) were diverted to the production of arms and other security measures in a war economy. John Maynard Keynes himself said that the war economy demonstrated that, "it is, it seems, politically impossible for a capitalistic democracy to organise expenditure on the scale necessary to make the grand experiments which would prove my case—except in war conditions".[34]

The war economy of 1941-5 did not stimulate the private sector; it replaced the "free market" and investment for profit. To organise the war

32 Guerrieri and others, 2020

33 Bossie and Mason, 2020.

34 Cited in Renshaw, 1999

economy and to ensure that it produced the goods needed for war, the Roosevelt government spawned an array of mobilisation agencies that not only often purchased goods but closely directed their manufacture and heavily influenced the operation of private companies and whole industries. Bossie and Mason conclude that: "The more—and faster—the economy needs to change, the more planning it needs. More than at any other period in US history, the wartime economy was a planned economy. The massive, rapid shift from civilian to military production required far more conscious direction than the normal process of economic growth. The national response to the coronavirus and the transition away from carbon will also require higher than normal degrees of economic planning by government."[35]

Another leg in the Long Depression

In the absence of this, far from a quick snap back in the world capitalist economy when the lockdowns end, the prospect is for another leg in the "Long Depression", characterised by low output, investment, and income growth. After the Great Recession when growth resumed, it was at a slower rate than before. Since 2009, US per capita GDP annual growth has averaged 1.6%. At the end of 2019, per capita GDP was 13% below trend growth prior to 2008. At the end of the 2008-9 recession, it was 9% below trend. So, in spite of a decade-long expansion, the US economy has fallen further below trend since the Great Recession ended. The gap is now equal to a permanent loss of income of $10,200 per person. In this pandemic slump, Goldman Sachs is forecasting a drop in per capita GDP that will wipe out all the "gains" of the past ten years. The massive spending by the US Congress and the huge Federal Reserve monetary stimulus won't stop this deep slump or even get the US economy back to its previous (low) trend.

An economic recession can lead to "scarring"—long-lasting damage to the economy. IMF economists have noted that after recessions there is not always a V-shaped recovery. Indeed, it has been often the case that the previous growth trend is never re-established. Using updated data from 1974 to 2012, they found that irreparable damage to output is not limited to financial and political crises. All types of recessions, on average, tend to lead to permanent output losses. That does not just apply to a single economy; it also affects the gap between rich and poor economies: "Poor countries suffer deeper and more frequent recessions and crises, each time suffering permanent output losses and losing ground."[36]

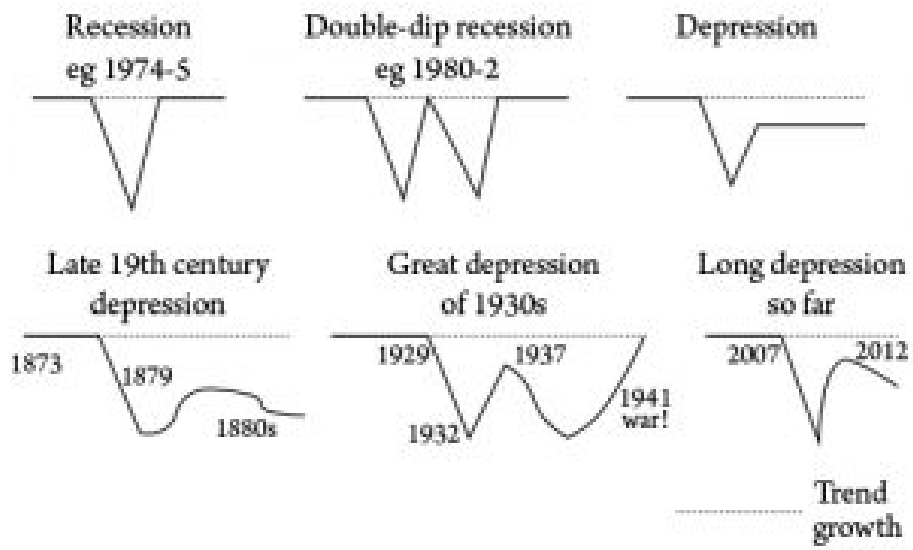
Their paper complements my view of the difference between "classic" recessions and depressions.[37] In depressions, the recovery after a slump takes the form, not of a V-shape, but more of a reversed square root shape, which sets an economy on a new and lower trajectory.

35 Bossie and Mason, op cit

36 Cerra and Saxena, 2018.

37 I discuss this in depth in Roberts, 2016

Schematic representation of the shape of various recessions



Perhaps the depth and reach of this pandemic slump will create conditions where capital values are so devalued by bankruptcies, closures, and layoffs that weaker capitalist companies will be liquidated and more successful, technologically advanced companies will take over in an environment of higher profitability. This would be the classic cycle of boom, slump, and boom that Marxist theory suggests. However, the past ten years have been more similar to the period of crisis in the late 19th century. Now it seems that any recovery from the pandemic slump will be drawn out and so deliver an expansion that is below the previous trend for years to come. It will be another leg in the long depression we have experienced for the past ten years.

The story of the Great Depression of the 1930s and the war that followed shows us that, once capitalism is in the grip of a long depression, there must be a grinding destruction of the capital accumulated in previous decades before a new era of expansion becomes possible. There is no policy that can avoid that and preserve the capitalist sector. If the required capital destruction does not happen this time, then the Long Depression that the world capitalist economy has suffered since the Great Recession could enter another decade. The major economies (let alone the so-called emerging economies) will struggle to come out of this slump unless the law of the market and of value is replaced by public ownership, investment, and planning, utilising all the skills and resources of working people. This pandemic has shown that.

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