HSBC Global Research

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After the pandemic

The long-term consequences of COVID-19

Economics
Global

- Whatever the near-term economic and financial losses…
- …there will also be important long-term consequences…
- …that may fundamentally reshape relations between nations

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Internal and external lockdowns

Even when “internal lockdowns” come to an end, it’s likely that “external lockdowns” will remain in place: nations states will likely distance themselves from one another, initially through fear of reinfection from elsewhere. There will also, however, be pressure to deliver new domestic “social contracts” that, in turn, may threaten the post-WW2 “rules-based” international system.

The return of “strategic industries” and “national champions”

There is likely to be a renewed focus on “strategic industries” and “national champions”, a throwback to the 1950s and 1960s. If political leaders wish to defend the interests of their citizens, they’re likely to reject their earlier dependence on global supply chains that, at times of maximum stress, can be a source of vulnerability.

Agreement on common health standards?

A global or regional agreement on common health standards would be a desirable post-pandemic outcome, but this could be a challenge given, for example, the recent US temporary withdrawal of funding from the World Health Organization. More broadly, the isolationist and protectionist rhetoric that emerged following the Global Financial Crisis may receive additional impetus.

Scarring

While there is a broad consensus amongst forecasters that economic activity will bounce back strongly later this year or in 2021, there is also broad acceptance that the level of economic activity will be permanently lower than it would have been in the absence of COVID-19. We examine some of the key long-term drivers of this permanent shortfall and consider the varied implications for debt sustainability.

Technology and supply chains

Technology is likely to be a wildcard. Already, we are learning to work from home and to engage remotely thanks to the internet: for many, the daily commute may become a thing of the past and we may never return to the skies in quite such numbers. Advances in robotics and AI, alongside the enhanced desire for national security, may lead to a further significant shortening of global supply chains and a renewed home bias in the distribution of capital, leaving some nations states languishing even as others regain a semblance of their former economic selves.

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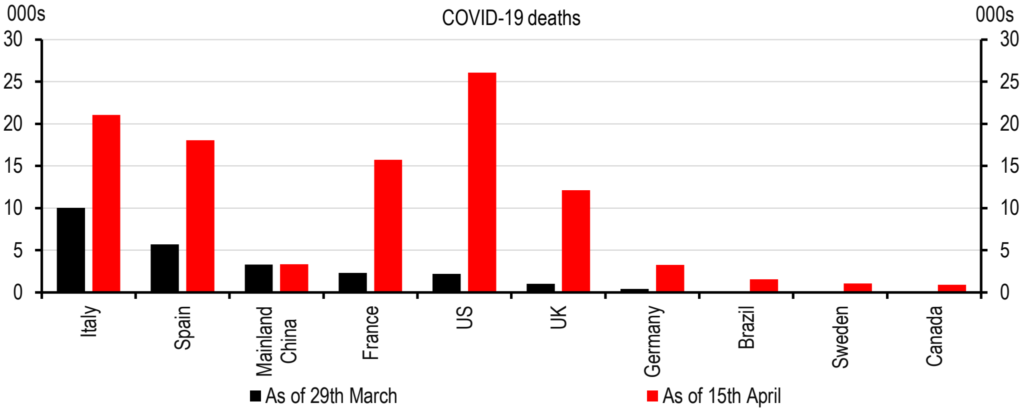
From Wuhan to the World

It started off as a problem for Wuhan, an enormous Chinese city with a population of 11 million that was barely known in the US and Europe. It's now spread around the world. COVID-19 was initially regarded as purely a Chinese problem that, at most, would knock maybe a tenth of one percent off global economic growth[1]. With the Wuhan lockdown being emulated – at least to a degree – across an increasing number of countries, the world economy now appears to be on the verge of output losses that, in some countries, may exceed those witnessed during the Great Depression.

1. COVID-19 deaths: mid-March and mid-April



Source: ECDC

Making predictions about the course of the crisis itself is hazardous. The virus itself is new. No one can be sure how it might subsequently mutate. We don't know whether COVID-19 will exhibit a seasonal pattern. An effective vaccine is currently a product of our imaginations, not reality (even if reported progress appears to be reassuringly rapid). We may be only in the foothills of discovering an effective antiviral drug. And, thanks to a shortage of testing – both for current sufferers and for the "recovered" who may have antibodies – we don't know what the true mortality rate is.

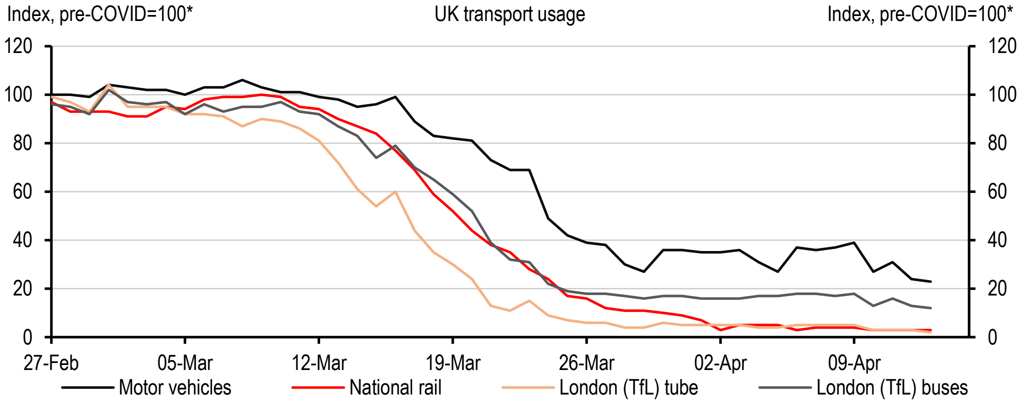
[1] See, for example, https://www.imf.org/en/News/Articles/2020/02/22/pr2061-remarks-by-kristalina-georgieva-to-g20-on-economic-impact-of-covid-19

Lockdown and herd immunity

We do know, however, how the majority of governments have reacted to COVID-19: the original lockdown in Hubei province is increasingly being emulated elsewhere. Most economists (although not all world leaders) agree that there is no near-term trade-off between a "social-distancing" lockdown and underlying economic performance: better to stop the initial rapid spread of the virus in a bid to "buy time" for increased health provision than to carry on "as normal", as if the unchecked spread of a potentially lethal disease has only negligible economic consequences. In this world (to quote from *Argo*, the Oscar-winning movie about American Embassy staff extracted from Iran during the 1979-1981 hostage crisis), "there are only bad options", but "it's about finding the best one". In the absence of a pharmaceutical solution, lockdowns and social distancing – with occasional lifting – are the "least bad" bad options.

There are, in truth, two versions of lockdown. The first takes places within nations. Its success varies depending on the quality of the housing stock – the more slums, the more difficult it is for the public to comply with social distancing guidance – and the availability of financial resources to allow businesses to go into hibernation and workers to be furloughed. Emerging markets often score poorly on both counts, one reason why financial outflows from emerging economies in the early months of 2020 were so enormous: investors fearful of financial chaos and capital controls have taken their money elsewhere.

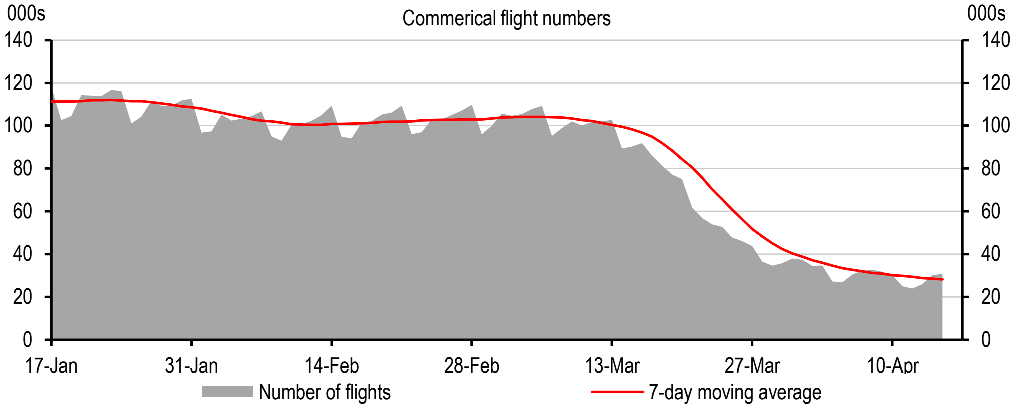
2. The UK lockdown: collapsing transport usage



Source: UK Government. Note: *For roads, the data is compared with an equivalent day from the first week of Feb 2020, for rail it is the equivalent week in 2019 and TfL tube and bus it is equivalent day in 2019.

The second version of lockdown – the one that has been so damaging for airlines – takes place between nations. China's internal lockdown – primarily affecting Hubei Province and, within it, Wuhan – may have come to an end in mid-April but its external lockdown remains: as of 27 March, China had banned all foreign entry (with very few exceptions) to the country. It is likely that other countries in the process of easing severe lockdown measures will take a similar view. One result is likely to be a persistently lower flow of people between nations (particularly between developed and emerging nations) with potentially huge implications for travel and tourism alongside migrant labour flows and their corresponding remittances (a story with notable resonance for migrant workers from the Indian subcontinent and the Philippines).

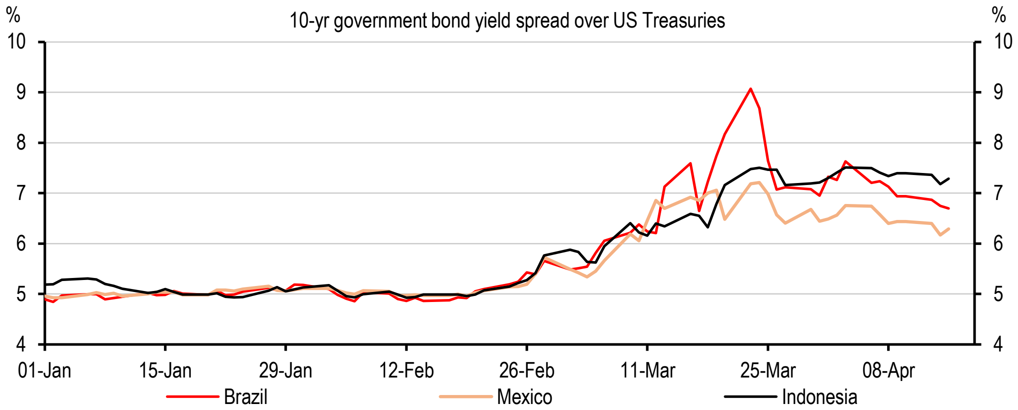
3. Commercial flight volumes worldwide have collapsed



Source: Flightrader24

The implication is that any recovery in the global economy will be, at best, patchy. Some countries will be easing restrictions even as others are in the middle of lockdown. Those countries unable to afford or impose a sustained lockdown may be left with no choice other than to accept a painful journey – in terms of mortality rates – towards herd immunity that will leave them for an extended period of time economically and financial marooned.

4. Emerging market funding costs have risen



Source: Refinitiv Datastream

These differing experiences, in turn, suggest that the global economy will be unable to fire on all cylinders for many months, if not years. The connections upon which globalisation depends – most obviously, the increasing freedom of movement of goods, services, people and capital across borders – will be stymied, necessarily restricting the rate of global growth. And, in the absence of a vaccine, all countries will be vulnerable to reinfection, suggesting that intermittent lockdowns may be a fact of life for a considerable period of time (unless, that is, the virus mutates into something much more benign).

Inner reflections

Debates are already taking place regarding how societies may have to change post COVID-19. A good example comes from writers at the Financial Times, invoking the spirit of institution building in the 1930s and 1940s to conjure up a post-virus world. In their words:

> *"Beyond defeating the disease, the great test all countries will soon face is whether current feelings of common purpose will shape society after the crisis. As western leaders learnt in the Great Depression, and after the second world war, to demand collective sacrifice you must offer a social contract that benefits everyone…*
>
> *…The victims of COVID-19 are overwhelmingly the old. But the biggest victims of the lockdowns are the young and active, who are asked to suspend their education and forgo precious income. Sacrifices are inevitable, but every society must demonstrate how it will offer restitution to those who bear the heaviest burden of national efforts.*
>
> *Radical reforms — reversing the prevailing policy direction of the last four decades — will need to be put on the table. Governments will have to accept a more active role in the economy. They must see public services as investments rather than liabilities, and look for ways to make labour markets less insecure. Redistribution will again be on the agenda; the privileges of the elderly and wealthy in question. Policies until recently considered eccentric, such as basic income and wealth taxes, will have to be in the mix…*
>
> *…The leaders who won the war did not wait for victory to plan for what would follow. Franklin D Roosevelt and Winston Churchill issued the Atlantic Charter, setting the course for the United Nations, in 1941. The UK published the Beveridge Report, its commitment to a universal welfare state, in 1942. In 1944, the Bretton Woods conference forged the post-war financial architecture. That same kind of foresight is needed today. Beyond the public health war, true leaders will mobilise now to win the peace."*[2]

This, however, presents a rather rose-tinted assessment of the challenges facing nations in a post-virus world. The leaders who won the Second World War did not fully win the peace. A world that was beginning to say goodbye to imperial power structures after the Great War fragmented into three separate groupings after the Second World War, namely the West, the Soviet Bloc and what became known as the non-aligned movement. The first two entered the Cold War, a struggle that often led to conflict and upheaval elsewhere in the world, including the Korean peninsula, Vietnam, Latin America and parts of sub-Saharan Africa. It was only with the reforms launched by Deng Xiaoping that opened China up to the rest of the world from the late-1970s onwards and the early-1990s collapse of the Soviet Union that a fully globalised world began to emerge (and, even then, dormant rivalries, often linked to religion or territorial claims, re-emerged).

[2] "*Virus lays bare the frailty of the social contract",* Financial Times, 3 April 2020, available at https://www.ft.com/content/7eff769a-74dd-11ea-95fe-fcd274e920ca

In the late-1940s, many governments understandably focused on domestic priorities. True, there were bold attempts to deal with protectionism via the tariff-busting General Agreement on Tariffs and Trade (GATT) and to prevent "beggar-thy-neighbour" currency devaluations via the Bretton Woods exchange rate system. The US Marshall Plan effectively bailed out western Europe at its moment of greatest need. Capital and exchange controls, however, remained firmly in place. Cross-border movement of people was severely limited, partly because of tight immigration controls.

The 1945-51 Labour Government in the UK may have constructed the welfare state but meat rationing endured until 1954 and citizens had to cope with persistent austerity, while the balance of payments was teetering on the brink, one reason why the 1956 Suez crisis proved to be at the very least a diplomatic embarrassment: Washington was unwilling to continue providing the UK with financial support until and unless it withdrew its troops from Egypt, a reversal that proved to be the final nail in the coffin for the UK's imperial ambitions.

It is not difficult to imagine the reinforcement of similar "home biases" regarding future policy choices. In the absence of globally- or regionally-agreed health standards, a new health "nationalism" may emerge in which movement of people (or 'virus incubators') across borders will be severely restricted. The degree of restriction may, in turn, be related to the emergence of home bias with regard to medical supplies. When, for example, a successful vaccine eventually materialises, it's easy enough to see how its distribution might be allocated in an acceptable fashion within countries: health workers first, other "essential" workers second, the rest of us third. Between countries, however, there is no "umpire": nations may be tempted to engage in 21st Century equivalents of piracy to jump to the front of the queue together with beggar-thy-neighbour policies to secure goods and services critical for safeguarding health provision.

This, in turn, may increase government support for so-called "national champions", strategic industries or companies that are deemed essential for the security of the state and its citizens. These "champions", in turn, would presumably receive the state's protection from hostile foreign takeover, by definition leading to a balkanisation of global capital markets and, in turn, undermining the interests of shareholders (unless, that is, the "champions" become profit-hungry monopolies, in which case customers would be poorly-served). In the process, the rules of international trade would be turned on their head: domestic security would trump international engagement.

The emergence of national champions would be consistent with a return to centralised "command-and-control" structures, more commonly associated with wartime. The free market revolution originally led by Margaret Thatcher in the UK and Ronald Reagan in the US is now under pressure thanks, in part, to companies being commandeered to produce goods not for their normal markets but, instead, for healthcare. There may be more to come. If, for example, the socialised European healthcare system proves to be more successful than the primarily private sector American equivalent in confronting COVID-19, there is likely to be greater political sympathy in the future for states to have a more enhanced role in allocating resources: the invisible hand potentially would be eclipsed by the very visible hand of government.

A new domestic "social contract" along the lines described in the *Financial Times* would have profound implications both for the distribution of income and wealth within nations and relations between nations. An effective universal basic income – designed to provide a guaranteed income "floor" for all citizens, whether rich or poor – would be affordable only with a sizeable increase in the tax burden on corporations, high earners and the wealthy: to raise such taxes may require worldwide income tax regimes for a country's citizens (in line with existing US tax policy) and significant restrictions on the mobility of wealth and capital. There would also have to be clearer rules on citizenship: those nations offering a universal basic income would presumably have to impose tough immigration rules to prevent "free riders" elsewhere in the world from taking advantage of such largesse. That, in turn, might restrict the free flow of labour across borders, increasing the disparity between "haves" in some nations and "have-nots" in others, potentially adding to existing economic migrant problems.

External consequences

As already noted, our modern globalised world did not fully emerge until the mid-1990s. To do so, however, we slowly moved away from the coercion of empire to a series of international "rules of the game". These, in turn, were policed by a collection of institutions mostly created in the 1940s and 1950s: the United Nations (and, within it, the World Health Organization); the International Monetary Fund, the World Bank, the Organization for Economic Cooperation and Development, the European Economic Community (later the European Union) and the aforementioned GATT (now the World Trade Organization). More recently, these have been augmented by the creation of the G20.

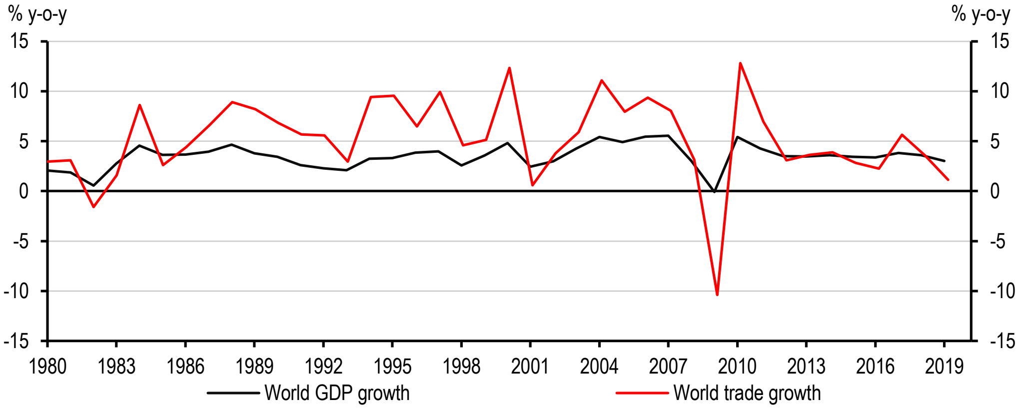
Yet even before the arrival of COVID-19, these institutions were under strain. The Global Financial Crisis had already created conditions for new brands of isolationism and protectionism. The emergence of "nationalist" politicians coincided with waning support for international institutions – including the UK's withdrawal from the European Union and Donald Trump's wavering support for NATO – even before the WHO was criticised in some quarters for its handling of the COVID-19 crisis. Alongside all this, China's re-emergence as a political and economic superpower threatened to provoke a return of global rivalries last witnessed during the Cold War.

COVID-19 may do more damage. In his address to the French nation on 13 April 2020, President Macron suggested that supply chains – from food to pharma – would have to become more "local". It was no longer possible for the French nation to rely on the vagaries of international markets in the midst of an international crisis which threatened shortages of basic essentials. In March, Germany and Italy almost fell out with regard to medical supplies at a time when Italy's need was particularly acute. Countries have cast doubt over the quality of imported medical supplies, hinting at cross-border inconsistencies regarding medical standards. Accusations of international "piracy" regarding the diversion of medical supplies from one country to another have emerged. Underneath all this – and contributing to criticism of the WHO – is mistrust over statistical reporting of COVID-19 cases and subsequent deaths.

Admittedly, we are seeing a coordinated response in some areas (echoing efforts made during the Global Financial Crisis). Scientific advances in the battle against COVID-19 are being widely shared and disseminated (with papers circulated often before peer review); the Federal Reserve quickly moved towards the establishment of international swap lines for US dollars, easing pressure on vulnerable currencies and capital markets elsewhere in the world; and the G20 has agreed a debt moratorium for some of the world's poorer countries to provide additional financial space with which to battle against a common enemy.

Co-ordination, however, can easily break down. Soon after the Global Financial Crisis, regional fault lines began to appear. Both the US and Germany were quick to reverse their earlier fiscal stimulus measures (even if, in the US case, some of the tightening occurred automatically at the state level thanks to the impact of balanced budget requirements). Regulatory barriers designed to protect the interests of local taxpayers were installed, leading to the creation of ring-fenced local banks. And, as already noted, the political mood in many countries turned away from globalisation towards isolationism and nationalism. One casualty was world trade which, since the Global Financial Crisis, has expanded much more slowly relative to GDP than in earlier decades.

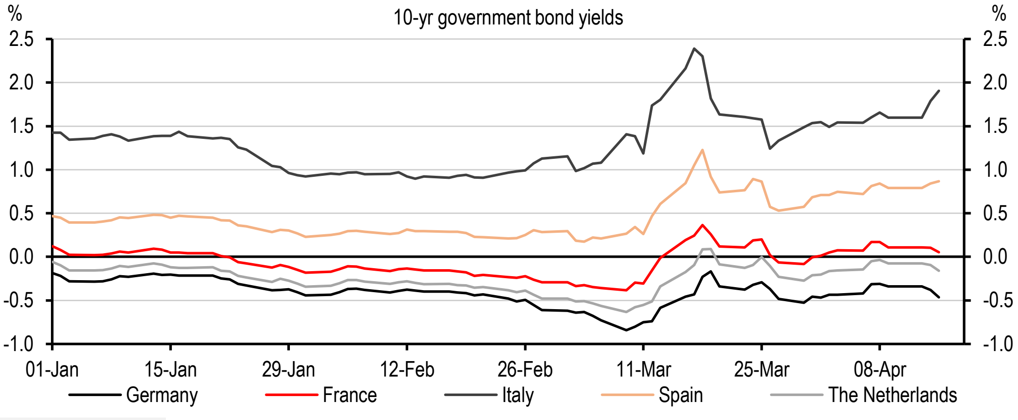
5. World trade growth has slowed relative to world GDP growth



Source: IMF WEO

Might we see the emergence of similar cross-border strains? It's difficult to tell. It might be tempting to believe that victory in November's US Presidential Election for Joe Biden might help "dial down" some of the rhetoric that has disturbed relations between the US and China but, with a relatively hostile Congress, this is hardly guaranteed. It is possible that the European Union agrees to common bond issuance in an attempt to "pool" virus-related financial risk across members of the Eurozone but, at the time of writing, Germany, the Netherlands, Austria and Finland were steadfastly resisting. It could be that, once COVID-19 is under control, the WHO's reputation will emerge unscathed (possibly leading to a series of newly agreed international health protocols) but, at this point, it's just as likely that the WHO will end up being a useful scapegoat for nations keen to disguise their own failings regarding COVID-19 (an increasingly common approach to a variety of equivalent international institutions). And, even as some countries emerge from their internal lockdowns, external lockdowns could remain in place for an indefinite period of time (including within the European Union's Schengen area, supposedly the *ne plus ultra* of frictionless movement of people across borders). In other words, the risk of dislocated nationalistic responses to a global pandemic remains high, particularly given emerging narratives regarding "national" struggle and "national" sacrifice. That, in turn, provides an unhelpful backdrop in assessing the longer term global economic outlook.

6. Within the Eurozone, Italy is under more pressure than others



Source: Refinitiv Datastream

After the fall: a possible economic trajectory

Knowing how far economies will fall in the near term is difficult enough. Assessing the extent to which they will recover thereafter is, in many ways, even more difficult. The long-term economic outlook is, thus, particularly uncertain. The degree of "scarring" – as the UK's Office for Budget Responsibility (OBR) described potential long-term economic damage in its April assessment of the impact of COVID-19 – is almost impossible to calculate at this early stage[3]. Estimates and assumptions vary enormously.

Based on a three-month lockdown followed by a partial reopening in the following three months, the OBR assumes that the level of economic activity in the UK will return to its pre-virus path by 2021 (which suggests a similarly sanguine view about activity elsewhere in the world). The International Monetary Fund, in contrast, accepts that global economic activity may end up permanently lower than it might otherwise have been, with a cumulative global output loss by the end of 2021 equivalent in scale to the Japanese and German economies added together[4]. Table 7 shows shortfalls in economic activity in 2021 according to April 2020 forecasts made by the IMF, the Peterson Institute for International Economics[5], HSBC and (for the UK) the OBR, benchmarked against HSBC's pre-COVID-19 projections made at the end of 2019 (the variance between the forecasts reflects both the huge uncertainty regarding COVID-19 and the timing of publication during a period in which forecasts were being cut on an almost daily basis). Most projections suggest the level of GDP in 2021 will still be considerably lower than it would have been in the absence of COVID-19, although the level of vulnerability is particularly large for the likes of Brazil.

In principle, the economic policy objective for any government facing COVID-19 is easy to state. Macroeconomic stimulus has to support otherwise-bankrupt companies and otherwise-unemployed workers during the period of lockdown, in the hope that they can emerge into a post-virus world in which business can return to normal. It is the equivalent of building a bridge over the economic and financial crevasse created by COVID-19[6]. Those countries with deep and liquid domestic capital markets and with credible institutions are likely to be best placed to engage in bridge building. Those lacking these advantages – mostly in the emerging world – will struggle to do the same, one reason why the G20 and others are trying to find ways to ease emerging economies' financial burdens.

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[3] See *https://obr.uk/coronavirus-reference-scenario/*

[4] See *https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/*

[5] See *https://www.piie.com/system/files/documents/dynan2020-04-10ppt.pdf*

7. How real GDP forecasts vary and what they imply about economic "scarring"

		2019 (% yr)	2020 (% yr)	2021 (% yr)	2019 (2019=100)	2020 (2019=100)	2021 (2019=100)	"Scarring" Shortfall (% points)
US	IMF	2.3	-5.9	4.7	100.0	94.1	98.5	-4.6
	PIIE	2.3	-8.0	10.2	100.0	92.0	101.4	-1.9
EZ	IMF	1.2	-7.5	4.7	100.0	92.5	96.8	-4.8
	PIIE	1.2	-12	12.0	100.0	88.0	98.6	-3.1
UK	IMF	1.4	-6.5	4.0	100.0	93.5	97.2	-5.1
	PIIE	1.3	-9.0	8.5	100.0	91.0	98.7	-3.7
	OBR	1.4	-12.8	17.9	100.0	87.2	102.8	0.3
Mainland	IMF	6.1	1.2	9.2	100.0	101.2	110.5	-1.3
China	PIIE	6.1	1.5	8.0	100.0	101.5	109.6	-2.1
India	IMF	4.2	1.9	7.4	100.0	101.9	109.4	-2.8
	PIIE	4.8	-0.5	8.0	100.0	99.5	107.5	-4.5
Japan	IMF	0.7	-5.2	3.0	100.0	94.8	97.6	-3.4
	PIIE	1.0	-8.0	3.8	100.0	92.0	95.5	-5.5
Brazil	IMF	1.1	-5.3	2.9	100.0	94.7	97.4	-6.7
	PIIE	1.2	-6.0	0.5	100.0	94.0	94.5	-9.6

Source: IMF, PIIE, OBR, HSBC

Building bridges is a much better option than doing nothing but, nevertheless, there will be consequences:

- Levels of public debt will soar relative to GDP, in particular during the period of lockdown. Thereafter – and consistent with wartime experience – public debt will likely end up permanently higher than it would have been in the absence of COVID-19.
- Bridge building will be more effective within nations than across nations. As China is discovering, ending a local lockdown does not imply that a country can re-engage with prosperous and dynamic world economy: whatever policymakers achieve domestically, they cannot fully offset the impact on a country's exports (and, hence, its overall GDP) of collapsing demand elsewhere.
- Some companies – primarily small and medium-sized enterprises – may opt to go out of business. Their owners will not wish to be saddled with additional debt and nor will they want to take on the personal liabilities associated with such debt. As a result, of the millions of workers now losing their jobs, some will struggle to find gainful employment when lockdowns end.
- Within the financial system, the ratings agencies risk adding an unhelpful pro-cyclical risk. As revenues shrink, so ratings downgrades become more likely, increasing the cost of, and lowering the availability of, credit for a wide range of companies (and their numerous suppliers), notwithstanding additional support from governments and central banks. Ratings agencies may struggle to see the other side of the bridge.
- The logistics of loan guarantees and outright "gifts" are not straightforward. Even if the ultimate credit risk rests with governments, it may prove tricky to persuade loan officers at banks to lend to companies that, in the short term, are severely loss-making. Some countries have already moved to "gifting" money to companies, their policymakers concluding that funding is unlikely to materialise with sufficient speed if banks have "skin in the game".

- The uncertainties associated with COVID-19 lockdowns threaten both physical and human capital. At the very least, some physical investment will be postponed and, in the event that companies fail, other investment will simply not happen. The consequence is likely to be a smaller capital stock than might otherwise have occurred. Meanwhile, school and university shutdowns may undermine both the volume of education and the reliability of qualifications. Unemployment for school leavers and recent university graduates may be particularly high: without being employed in the first place, there is no possibility of being furloughed. As such, human capital will be underutilised, effectively reducing the "return" on education. Productivity gains may, as a result, be lower.
- "Insurance" against future pandemics (and, in the absence of an effective vaccine, the return of the current virus) will inevitably be in high demand. In the same way that Homeland Security was boosted in the US after 9/11 or banks were told to hold more capital after the Global Financial Crisis, such insurance will, in the near term, divert resources to what might loosely be described as "non-productive" areas: attempting to limit "fat tail" downside risks is, in the short term, a potentially expensive business. And to the extent that governments take the view that a much wider range of economic activities should now fall under the "strategic industries" banner, global supply chains are likely to be attenuated with home bias becoming a much bigger influence, marking a part-reversal of the efficiencies gained over the last half century.

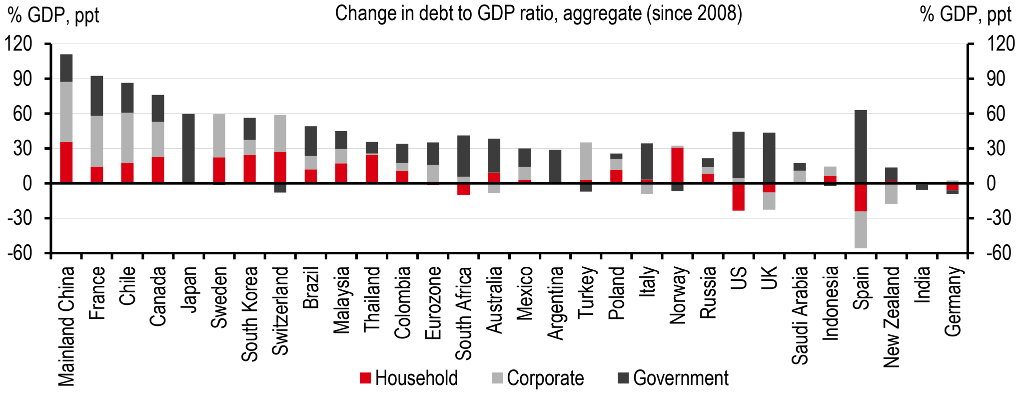
In sum, the likelihood is that, even after a strong rebound in economic growth later in 2020 or in 2021, there will be no return to business as usual. Political and social priorities will likely shift, with a greater emphasis on health security and a reduced weight on near-term economic gains (in much the same way that, following the Global Financial Crisis, financial stability was prioritised over economic growth). Supply chains will be shorter than before – reinforcing a trend that was already underway prior to COVID-19 − particularly in the increasing number of areas in which national security is emphasised, with a loss of near-term economic efficiency. Companies may be less "international" than they once were, fearing both the return of cross border lockdowns and sudden shortfalls of available labour in key offshore centres.

Overall, the likelihood is that the level of economic activity and its growth rate will be persistently lower than would have been the case had COVID-19 never appeared, suggesting that higher levels of public debt – an inevitable consequence of dealing with COVID-19 – may not always be easily digestible.

The burden of debt

Even before the arrival of COVID-19, the level of global debt (public and private in combination) was exceptionally high relative to the level of global income. Admittedly, a limited number of European countries had reduced their debt/GDP ratios but, for the majority of nations, higher levels of debt were a lasting legacy of the Global Financial Crisis. Typically, these higher levels reflected additional borrowing from both governments and companies: in some cases, households had managed to reduce their debt burdens, partly in response to a temporary softening of house prices.

8. Most governments borrowed their way out of the Global Financial Crisis



Source: BIS, HSBC

Given already-high debt levels, the arrival of COVID-19 – and the implications that it carries for both government borrowing and the level of GDP – arguably couldn't have come at a worse time. Fortunately, persistently-low interest rates have kept the debt-interest burden at a relatively low level, suggesting that there is plenty of room for government debt to rise a lot further in the months ahead, particularly in those countries in which central banks stand ready to "underwrite" additional debt issuance. After all, by the end of the Second World War, UK government debt had risen to over 200 per cent of GDP, more than double today's ratio.

What happens, however, when the virus is finally in retreat and economic growth has stabilised? How will nations cope with higher levels of government debt? One way to consider these questions is to recognise that we are collectively borrowing from our future selves. The more successful that borrowing proves to be in safeguarding economic activity on the other side of the bridge, the more easily digestible will be the higher future debt burden: the denominator in the debt/GDP ratio will rise quickly. If, on the other hand, the additional borrowing is unable to prevent wholesale 'scarring', the greater the future political challenge will be in deciding who ultimately has to repay the extra debt.

That debate was particularly active after the Great War (1914-18), partly because countries emerged from the conflict (and the Spanish flu which followed shortly thereafter) in differing states of financial health. For Germany and Austria, burdened with reparation payments in addition to the costs of the war itself, inflation became the inevitable escape mechanism. The value of government debt issued during wartime was swiftly destroyed, effectively reducing financial wealth to virtually nothing. For the UK, a desire to stick to the pre-war "rules of the game" persuaded policymakers to rejoin the Gold Standard at the 1914 exchange rate, a decision that imposed a huge internal devaluation on the UK economy, achieved only through persistent austerity and wage cuts (in that sense, the UK's experience matched southern Europe's during the recent Eurozone sovereign debt crisis). Other countries eventually ended up defaulting, although those defaults may have had more to do with the consequences of the Great Depression at the beginning of the 1930s than with the First World War itself.

Put another way, the "scarring" after the Great War turned out to be far worse than after the Second World War. As a result, debt was a lot less digestible in the 1920s than it was in the late-1940s and the 1950s. One reason for the difference was the willingness after the Second World War to put differences to one side – most obviously through the Marshall Plan – in a bid to build a future in which both victor and vanquished could flourish. Recognising the importance of mutual interdependence was of fundamental importance. Even then, however, there was no free lunch: as already noted, rationing in the UK persisted until 1954 while, in the US, the continued operation of regulation Q – banning banks from offering interest payments on current accounts – in effect allowed the Treasury to finance government borrowing at below-market interest rates.

The technology wildcard

Wartime may be deeply unpleasant but it can also be a catalyst for remarkable technical progress. Ten years after the end of the Great War, the US economy was booming thanks to the impact of mass production (particularly cars), mass consumption (thanks to rapid growth of consumer credit) and mass entertainment (radio and, in 1927, the emergence of the "talkies"). Biplanes were still a common fixture following the outbreak of the Second World War in 1939 but, by 1945, the jet engine – a harbinger of mass international travel – was in the ascendant.

It may be that the war against COVID-19 will also lead to significant technological change that, in time, will trigger major shifts in how societies operate.

One obvious change is the likely proliferation of home working, an outcome that may significantly reduce time spent on travelling to places of work. In turn, this might lead to a reduction in office space and an increased supply of property for residential purposes. A second, related, change is a likely proliferation of "virtual" meetings and "virtual" conferences: audio-visual quality will doubtless improve at a rapid rate in coming quarters and, as it does so, the need for physical meetings will decline. This will both reduce costs for companies and limit the business risk associated with heightened restrictions on the cross-border movement of people. In both cases, there is likely to be a significant and lasting climate "dividend".

A third change – already happening before the COVID-19 lockdowns – is the use of technology to shorten global supply chains and encourage 'reshoring", suggesting a growing income gap between already-industrialised economies and those in danger of being left behind (a process that may, in time, only be accentuated through the economic consequences of COVID-19). My article for *Bloomberg Business* published in late-January made the following observations:

> " *Instead of dispersing opportunities, skills, and knowledge to workers around the world, capital could stay home. Wealthy countries would invest in robot technology. Those who owned capital—or the ability to tax capital—would prosper. Those who supplied only labour—particularly for jobs that are easily automated—would suffer. Big chunks of Asia, much of sub-Saharan Africa, and large parts of Latin America might be left behind as the richer countries, in effect, build gated communities.*
>
> *Arguments for free trade depend on the idea that economic and financial links between countries create win-win outcomes. If the rise of the robots removes the need for global supply chains—or at least shortens them—it becomes easier to support isolationist policies. The institutions that helped set the international rules of the game since the end of World War II would dissolve or be supplanted. Regionalism and nationalism would become more likely default outcomes."*[7]

Put another way, technology may have been a driving force behind late-20th Century globalisation but, particularly in the light of COVID-19 and the enhanced desire for national "security", technology can equally be used to enforce separation. By doing so, we may end up in a world in which some countries bounce back from COVID-19 with heightened levels of domestic protection while others are left economically and financially stranded.

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[7] See King, S.D., Robots Pose Biggest Risk to the Poorest Countries, Bloomberg Business, January 2020, available at https://www.bloomberg.com/news/articles/2020-01-29/robots-pose-biggest-risk-to-the-poorest-countries

Conclusions

Inevitably, any assessment of the long-term economic and political consequences of COVID-19 has to be highly speculative. At the time of writing, many economies were in the middle of their lockdown "plunge" with considerable uncertainties remaining over both the length of lockdown and the pace of subsequent lockdown withdrawal. Forecasters, meanwhile, differ in their assessments regarding the degree of long-term "scarring" associated with COVID-19.

Nevertheless, it is possible to set out some key parameters that ultimately will determine our post-pandemic futures. Those countries unable successfully to impose lockdowns – whether through financial or social-distancing constraints – will probably end up with more in the way of economic "scarring": emerging markets are particularly vulnerable. Those countries that demand a new internal social contract may choose to distance themselves from the globalised world – and, within Europe, from the EU's strictures – that shaped so many lives in the pre-virus era. Those countries able to keep their businesses on life support for longer may build more effective "bridges" to the future than others. And those countries that can agree on common medical standards in our post-virus future may discover that they can more easily engage with each other than with countries that cannot – or will not – accept common standards applied by an international adjudicator.

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