
**ECON-19: Inside the Corona Crash**

*Season 1: Episode 1*

*The Big Picture*

James Whitmore:

My name is James Whitmore and welcome to ECON-19, a brand new podcast from the University of Melbourne where we go inside the Corona crash. Over the coming season, we'll be investigating the economic impact of the COVID-19 pandemic. We'll look at the mechanics of the economy, how we got to this point, and where we go from here. Like many of you, I've been working from home for the past several months due to the pandemic so this podcast is recorded in a makeshift studio. So, please excuse any unusual sounds you hear in the background. Today we're starting with the big picture. We're joined by a University of Melbourne academic who's been one of the leading commentators since the pandemic began.

Chris Edmond:

My name is Chris Edmond. I'm a professor of economics at the University of Melbourne.

James Whitmore:

So, I wanted to ask you, Chris, how does a virus cause the recession?

Chris Edmond:

Well, a virus need not, right, but here the issue it is a particularly virulent virus in the sense that it's very contagious and the health consequences are significantly pronounced. So, the common cold doesn't cause a recession because although it was very virulent, the health consequences are not particularly serious most of the time. Influenza is something in between where it's also quite virulent and it is more serious, and here we're talking about a virus that is even more easy to transmit and where the health consequences are considerably larger. And so because of those consequences, you then have sort of two kinds of economic reaction. You have what we might call a private economic reaction of individual households and families deciding to do less of the kinds of activities that might expose them to the virus, so being less willing to go to a bar, less willing to go to a restaurant, less willing to go to a concert, less willing to go to a movie. So, even absent any kind of policy decisions, people would be cutting back on their economic activity.

Chris Edmond:

And then we have a second thing, which is that people may be cutting back on their economic activity because they fear being exposed to the virus, but they may not fear it enough. Right. In economics, we talk about externalities, positive and negative externalities. So, these are situations where an individual doesn't take into account enough their effects on people nearby them. So, the classic example of a negative externality is pollution. So, a factory that emits pollution is doing so partly because it doesn't take into account the social consequences of the pollution it emits. In the virus situation, I may be less willing to go to a bar or a restaurant, but the amount by which I'm reducing my going to a bar or a restaurant is perhaps not as much as I should be if I was thinking about the social need.

Chris Edmond:

There's probably going to be too much transmission going on relative to what would be ideal. And so that's where government policy comes in to say, "Look, we can't rely on individuals in a kind of laissez-faire way just voluntarily deciding on their own risk assessments and deciding to stay home because they fear the virus. We need more than that because individuals aren't taking into account enough the consequences of their individual risk-taking actions on people nearby them. We also need regulation here to tamp down on the kinds of economic activity that are most conducive to spreading the virus."

Chris Edmond:

So, we have two interacting features. So, one is like the individual, the decisions that people will be making anyway to reduce their economic activity, and then there're extra reductions in economic activity that come about because of the policy response. So, those two things combining to create a kind of a big reduction in economic activity.

James Whitmore:

So, Chris, can you tell us what a recession is and why is it bad?

Chris Edmond:

A recession is bad because that's a situation where the labor market really, really deteriorates, but unemployment increases a lot. So, lots of people lose their jobs. People who are currently unemployed or out of the labor market find it much more difficult to find jobs, the situation where wages will grow or will grow more slowly than normal. And so, we usually think of a recession as being the kind of situation where across the board, many, many households are suffering. If you're an undergraduate and you graduate in a recession, as I say, you're kind of looking for your first real job in a recession, we know from economic research that the negative consequences of having to take that first job in the midst of a downturn linger for a long, long time. People who are older in life who become retrenched in a recession may find it much, much more difficult to get back into the labor market than they would have in kind of normal times.

Chris Edmond:

So, it's much more likely that somebody who is say, 55 or 60 and loses their job in the middle of the recession, maybe kind of in some sense involuntarily retired, becoming much, much more difficult to find comparable work again. So, for both for the young and for the old, recessions are bad news.

Chris Edmond:

Now, what do we mean by a recession? So, there's a kind of a technical definition, but basically, the idea is a recession is a time of pronounced contraction in economic activity. So, the economy normally grows around about 2% per year in a kind of ordinary year. Right. Each year because of population, because of technical progress, because of other things, the economy to get a bit bigger from about 2% or so bigger year on year. So, if that growth slows down, that's one thing. That's a situation where the economy overall is getting bigger, but at a slower rate. So, living standards may be going up, but not as much as before. And so we were experiencing a growth slowdown in the last couple of years, in 2017, 2018, it was clearly the case that growth was slower than usual, wages were growing slower than usual, but still, it was the case that the economy was getting bigger, just at a slower rate.

Chris Edmond:

A recession is something more than that. It's where the economy is not just getting bigger at a slower rate, it's actively shrinking. And we normally to avoid issues of false positives say when economy's been shrinking for about half a year or more, so we say two quarters or more, then we say, officially, you're in a recession.

James Whitmore:

How does this recession compare to ones we've seen previously? I mean, is this as bad as the Great Depression?

Chris Edmond:

Not yet. Probably not. So, let me back that up a bit. So, we're still in the midst of it. We won't really be able to answer that question until we're clearly out of it. So far, it looks like this recession will be, for the Australian economy at least, the worst since the Second World War, since in the postwar period, but probably not as severe as the Great Depression, so far. I mean, based on what we can see at the moment. It's a very unusual kind of recession in various ways. So, one is that the severity of the onset of the recession was particularly pronounced. We basically had what is sometimes referred to as a sudden stop. The economy was kind of ticking along fairly normally in February, early March, even though we already had rumbling of the coronavirus situation.

Chris Edmond:

And then in March, we had a real crunch and that is very, very much borne out by the labor market data that we've seen and by everybody's common awareness of the lockdown situation in March and April and May. So, the decline in economic activity that we've experienced over those months is likely to be an extremely sharp decline compared to previous recessions. The most important question for us is when we find the trough, when we find the bottom and things start to turn around, how quickly will it turn around? Will it turn around as quickly as it fell? Probably not. But will it turn around and recover quickly or slowly? That's the huge question ahead of us. And that's where economic policy, macroeconomic policy has a huge role to play in trying to ensure that the economy recovers as much as possible, consistent with not undermining the public health goals of keeping the virus under check.

James Whitmore:

The economic effects continue long after we get the virus under control. Why is that? Why doesn't the economy just recover as soon as we lift restrictions?

Chris Edmond:

There are two things there. So, one is just on the kind of the unusual sort of viral aspects of this recession, and the other is why do we always take a long time to recover from all recessions? So, on the first one, it kind of comes back to what I was saying a few minutes ago that even absent the lockdown, even absent any kind of official policy, people were beginning to stop going to bars and restaurants to the same extent as they previously would, not going to events with large crowds.

Chris Edmond:

Now, that won't be uniformly true across all people. Some people are more risk-tolerant than others, and some people will find that their economic circumstances are such that they have to engage in activity that might be seen as being sort of risky. But, overall, people will be doing less economic activity than they would have in the pre-virus world. And the other thing is that the mere fact of the recession, this is true for all recessions, it leaves a kind of scar tissue on the economy. Right? You have businesses going insolvent, shutting down. Even those that don't shut down, they maybe let a lot of people off and it takes time for businesses to feel that their economic circumstances have improved enough for them to go through the trouble of hiring and expanding again.

James Whitmore:

Back in April, Chris and three of his colleagues wrote an open letter to Prime Minister, Scott Morrison, about social distancing restrictions. Back then, quite a few people were calling for physical distancing restrictions to be lifted, and they were arguing that the lives saved were not worth the damage to the economy. Chris and his colleagues argued the best we can do is to limit the spread of the virus, and we have to address the public health crisis before we can fix the economic crisis. Today that's been signed by 289 Australian economists. So, I want to ask you about trade-offs. Throughout this pandemic, there's been a lot of talk about the trade-off between health on the one hand, and the economic cost of restrictions on our activity that are designed to keep us healthy, and you've played a fairly large role in this debate. Can you just tell us about what you've been doing? I mean, you led an open letter and what your take on this trade-off is.

Chris Edmond:

In our open letter, we wanted to make two points. So, one is that we were going to get a recession anyway, right, that what we might call the individual level response to the situation was such that there was going to be a large reduction in economic activity whether the government had locked down sectors of the economy or not. Right. And then, so the question was not, could we avoid a recession versus not avoid a recession, it was, could we avoid a recession plus a public health meltdown and just have the recession? And that's kind of the situation we're basically in.

Chris Edmond:

And then a second thing that I was involved in was sort of saying, "Well, but that's all well and good, except that the consequences of the recession are not felt evenly." Right. Some people, some segments of society disproportionately bear the brunt of an economic downturn, in particular, the poorest. You have low-income households and individuals bear the brunt of the recession to a much greater extent than others. And that can be both because they have less income, but also typically because the kind of jobs that they're doing are some of the ones that were most affected by the shutdowns.

James Whitmore:

What kind of economic considerations go into these decisions about how much, how far the restrictions should go? One thing we've spoken about is this value of a human life, the economic value of a human life. Can you just tell us about that and explain how it's used?

Chris Edmond:

Yes. All kinds of government decision makings involve what is referred to as cost-benefit analysis. So, basically, there's some budgetary cost of some program and that program brings some benefits. Now, sometimes those benefits are strictly monetary, or sort of easy to think about in monetary terms. So, let's put those ones aside. But often the benefits of some government program are measured in terms of lives saved or illness reduced, so other kinds of non-monetary benefits. And so there's always a question of how do you translate, how do you kind of assess which programs to spend money on? Say you have like $10 million to allocate and you say, "I want to allocate it to the ones that have the highest bang for my buck," but what does bang for the buck mean when you have all of these different programs with different, say, different health benefits. So, it's then standard to try and convert various notions of health benefits into a monetary figure. And every country does this. Every government around the world does this with slightly different methodologies and assigns a value to a "statistical life." So, that's to say an average life. And where does this number... So, that number is in Australia is about $4.9 million, just under 5 million. And you might say, "Well, where does that number come from?"

Chris Edmond:

It basically comes from looking at the willingness of people to do riskier jobs for more income. So, imagine I said, "Look, here is a job working in this very dangerous occupation." And I look at somebody else... I look at two people who have very, very similar skills, very, very similar demographic characteristics. And I see sometimes people will take the risky job with high compensation and sometimes they take the less risky job for lower compensation, and then I look at that so-called compensating differential. I look at that extra income that people seem to be willing to accept as compensation for the extra risk that they're taking on in that risky job. So, that compensation is an input to these kinds of value of a statistical life calculations, it's kind of like a blown-up version. I think it's notable that Australia has a relatively low value of a statistical life compared to some other countries that we would normally benchmark ourselves against.

Chris Edmond:

This is always done to some extent. Now, I don't think that these numbers were actually really used in the government's policy response. I think there was more of a kind of like flying by the seat of its pants, gut reaction kind of decision-making going on in March. Nobody was sitting down doing formal, numerical cost-benefit analysis, using those kinds of numbers, that still, they get invoked as a way of conceptually thinking about these kinds of problems. Like how much money would you be willing to spend? How much job loss might you be willing to entertain in order to reduce your mortality risk or other kinds of health risks to people?

James Whitmore:

So, the government immediately splashed billions of dollars on welfare and wage subsidies. Why was this the first thing it did?

Chris Edmond:

Okay. So, because the recession was an unusual kind or at least a large part of it was of an unusual kind, which is that the government was asking people to voluntarily... Not voluntarily. It was asking people to shut down economic activity, which was essentially mandating that businesses that would, in some sense, have been viable not go ahead, they're not operate as usual.

Chris Edmond:

That's very different to an ordinary recession where maybe there's been some financial market shock. The market has kind of messed up. Businesses made some bad decisions and they go under. This is a situation where perfectly viable, perfectly ordinary businesses are just being told you cannot operate as normal. Because you can't operate as normal, many of those businesses, absent some other kind of policy response would say, "We've got to let tons of people go. If we can't operate, we can't operate. We don't have a job for you anymore." And so, that would have led to kind of like an across the board meltdown of the Australian economy, if all of these businesses that are being told you can't operate as usual, were making a kind of ordinary business calculation to let people go.

Chris Edmond:

And so, instead, what we had was programs like JobKeeper to try and encourage businesses that were not able to operate as normal to nonetheless not let workers go, to keep them on the books with the hope that when the economy was able to restart closer to normal, that people would be able to be brought back into economic activity quite quickly, and that businesses would be able to get back to something approximately like normal economic activity more readily than they would have if they'd let a whole bunch of people go and then need to rehire, or you needed new businesses to spring up.

Chris Edmond:

Now, JobKeeper's not the only thing that was going on. There were also these large increases in what was the Newstart allowance, now the JobSeeker allowance because, of course, even with the JobKeeper programs in place and the other kinds of stimulus in place, there are still, of course, many businesses going under and so many people becoming unemployed. And so, you also need that extra degree of safety net present but the nature of the game here is trying to maintain as much income in place as possible so that the economy doesn't cascade out of control. An important way to think about this is that, of course, while many businesses were directly locked down, and so there were direct effects... Well, locked down and/or in very face-to-face kinds of activities where they were suffering from reduced activity, in general. There are many kinds of other kinds of businesses where that isn't so much a consideration, but as people begin to feel poorer as the recession takes hold, they're going to not get people spending in the same way.

Chris Edmond:

And so, other kinds of sectors of the economy that maybe sort of less directly exposed, were still kind of falling into recession as well. And so, what the wage subsidy schemes do is to try and arrest that, trying to say, "Let's not have a spiral of people not spending, therefore incomes falling, therefore other people not spending, therefore other people's incomes falling, and the whole thing kind of running off the rails." But because the crisis was so quick to hit and so comprehensive in affecting so much of the economy so quickly, the size of the intervention had to be truly dramatic compared to sort of historical fiscal policy measures.

James Whitmore:

I mean, that raises the question of... And it always comes up in Australian politics, this question of balancing the budget, which we always talk about when we talk about government spending, and now we've just lashed out billions of dollars. Is it actually important to have a balanced budget?

Chris Edmond:

I think it depends on what horizon you're talking about. So, right now is this time when we should not be worried about that. The whole point of a government and the possibility of a government borrowing is in order to get through unprecedented situations that cannot be tackled at the level of individual households or businesses, right, where you need a truly social collective response. And so, right now is a time when exactly the government should be using all of its fiscal capacity to support the economy and get us through to the other side.

Chris Edmond:

The flip side of that is in order to have the capacity to borrow in crisis times like now, you need to have relatively prudent fiscal policy, prudent budgetary policy in more ordinary times. You shouldn't be running huge deficits, building up a huge amounts of government debt in tranquil times. Because if you do, when you get to a crisis time like now, you won't be able to use fiscal policy as much as you should be. And that's a very, very consistent finding in the economic research literature, that countries that follow relatively prudent fiscal policies in tranquil times, in normal times then have the greatest capacity to deploy fiscal policy correctly, that is to say in a very, very stimulatory way in a crisis. To kind of come back to your question, budget surpluses or balanced budgets, they're not a goal in their own rights. They're an instrument. Right? Budgetary policy is an instrument that we use to achieve certain social outcomes that we want. And sometimes the correct instrument setting is that we should be running a surplus. Right now, the correct instrument setting is we should be running big, big deficits.

James Whitmore:

That was Professor of Economics, Chris Edmond. As we've heard, the virus would have caused a recession with or without restrictions because people were already decreasing their activity. We've heard that recessions are bad because they increase unemployment, which causes people to spend less, which causes people to lose more work, which causes people to spend less, and that's why the government's first response to the pandemic was to increase support for jobs. And, as Chris has told us, this is not the time to worry about government spending and big blowouts in the budget. It's the time to spend as much as we need to, to fix the economic crisis.

James Whitmore:

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