Paris, 17 April 2020

# The global economy is in unchartered waters, but governments must also learn from the Great Recession

John Evans

## An Economic Crisis like no other

Economic commentators have cautioned in recent weeks against drawing parallels between the economic impact of the C19 pandemic and that of the financial crisis of 2008-2009 and the ensuing Great Recession.[1] There are clear differences. The shock to the global economy in the first quarter of 2020 has come from a sudden reduction in the supply of goods and services, the reduction itself being due to deliberate policies to isolate workers in all but essential goods and services, driven by the need to slow the spread of the virus and "flatten the curve" of infection. The International Labour Organisation estimated that at the beginning of April almost 2.7 billion workers, representing over 80% of the world's workforce were in full or partial lockdown. For the second quarter of 2020, they estimate that total working hours will decline by the equivalent of 195 million full time workers[2]. The OECD estimated at the end of March 2020[3] that the initial direct impact of these measures would be a decline in output of up to 25% for each month the containment measures stay in place. The IMF[4] estimated in mid-April that the industrialised economies will contract by more than 6% this year on the assumption that lockdown measures would not continue beyond the second quarter. This decline will "dwarf" that during the global financial crisis in 2008-2009".

The near meltdown of the financial sector and ensuing reduction in global demand in 2008 and 2009 led to an increase in the output gaps. Unemployment globally jumped by 34 million between 2009 and 2010. In the short-term, governments responded with a global stimulus plan co-ordinated by the G20 that tempered the rise in unemployment in 2009 and 2010. These measures were estimated by the ILO to have saved 21 million jobs. As the C19 pandemic mutates into a global economic crisis, the goal of economic policy in the short term must be firstly to transfer resources to the health sector to fight the pandemic and secondly to preserve productive capacity, firms and workforces, so that, when the health situation improves, production can be increased as quickly as possible to minimise the damage. At the moment, there is no point in stimulating demand for which there is no supply, but as the pandemic recedes and containment measures are lifted co-ordinated recovery policies will be necessary. Both the emergency response and the subsequent recovery programmes will have a large financial cost in the short term, but the much greater risk would be to allow much of the economy to collapse and jobs to be permanently and unnecessarily destroyed.

[1] Jon Danielsson, Robert Macrae, Dimitri Vayanos, Jean-Pierre Zigrand, (2020) "We shouldn't be comparing the coronavirus crisis to 2008 – this is why" VoxEU.org, 1 April.

[2] ILO (2020) ILO Monitor 2nd edition: Covid 19 and the World of Work

[3] OECD (2020) Evaluating_the_initial_impact_of_COVID-19_containment_measures_on_economic_activity

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

A closer economic parallel to the current situation would be the mobilisation of populations at the beginning of the Second World War. Health workers and those providing essential goods and services now play analogous roles to troops and ancillary staff in the War. Global supply chains have been broken. Sectors such as travel, tourism and entertainment were effectively shut down for civil purposes in a matter of days. Borders have been closed to movement of people and States have assumed powers over both the economy and civil populations unimaginable in any previous peacetime period. It is unavoidable that public deficits will rise to levels comparable to the aftermath of wars.

Getting the economic policy response right is as crucial to the welfare and health of citizens in the medium term as the immediate medical response now. Despite the different nature of the crisis from 2008-2009, there are lessons that can be drawn from the successes and failures of public policy and especially international co-operation during and after the financial crisis and Great Recession:-

- Countries which preserve jobs and value workers will be the most resilient to this and future shocks
- Policies and their financing must be socially fair and seen to be fair
- Developing countries are particularly at risk and failing to aid them now will risk a boomerang effect of the pandemic returning
- Support for the financial sector and beyond should not be unconditional
- International co-operation must complement national action

## Preserving jobs, valuing and protecting workers

For the two decades prior to the Great Recession, “labour market flexibility” – which in practice meant the freedom of firms to fire workers and unilaterally fix wages without constraints – became the mantra of employment policy for many governments and most international economic organisations[5]. When the financial crisis hit in late 2008 and the first half of 2009, firms operating in “flexible” labour markets such as the United States laid off their workforces and unemployment soared. Unions and businesses in what had become known as “corporatist” labour markets, most notable Germany, came together to negotiate agreements to keep workers employed in firms faced by falling demand, in exchange for short-time working schemes subsidised by the government. When the stimulus measures had their effect and recovery occurred, employment picked up rapidly in these economies. The lesson from the crisis is that it pays to value workers and not treat them as disposable for both economic and social reasons.

In the C19 crisis, many European governments have realised the importance of keeping workforces together through job attachment, social pacts and short – time working and “furlough” schemes. The OECD has noted that majority of European countries have applied schemes, which, together with social pacts it notes, increases the resilience of economies. By contrast the unemployment figures have again exploded in the United States – in a single week at the end of March, unemployment enrolments jumped by 6.6 million to an estimated national unemployment rate of approaching 20 %[6]compared to 3.5% in

[5] OECD (1994) Jobs Study
[6] The Century Foundation (2020) https://tcf.org/content/commentary/new-data-show-true-march-jobless-rate-near-20-percent/?agreed=1

February. A poll at the end of March found that 73 % of Americans had seen their income fall significantly as result of the crisis.[7]

The lessons of costs of hire-and-fire labour markets go further – the growth of non-standard work, the gig economy and platform work became fashionable prior to the C19 crisis as the new flexible labour market. Economic risk for many of these workers was shifted onto their shoulders from employers or the state. They have found themselves without income or employment as customers for their services dried up overnight. Little was done in the aftermath of the Great Recession to protect non-standard work in the industrialised countries and to expand an effective social protection system in developing countries. Indeed after 2010, as stimulus gave way to austerity policies, social protection was cut back. Lip service was paid by G20 to developing social protection at the Los Cabos G20 Summit in 2012 and afterwards, but there was little implementation of programmes at national level. The result is that the massive US unemployment rate is now a significant underestimate, as many irregular workers would not register as unemployed – these groups of workers will face severe hardship as containment measures continue.

The appreciation of the high-risk work of health workers and their protection – has justifiably become a central issue in the debates over responses to the Pandemic. The crisis has also shown the essential nature of other public sector workers – cleaners, refuse collectors and the private sector workers in retailing, food production. These are generally low-pay sectors, where workers are now being required to work in exposed and dangerous conditions. The pandemic has shown the importance of health and safety at work from a communal point of view, not just in terms of the welfare of the individual worker – if essential workers fall sick the health, economic and social response to the crisis will break down. Following the pandemic, a significant part of a new social contract must be to ensure decent pay, working conditions and safety for groups of workers so far forgotten.

## Fairness

The pandemic has brought into sharp focus the broader importance of social justice against a background of growing income inequality within countries. The rise in inequality in most industrialised countries during the three decades prior to the 2008 financial crisis was dubbed by the ILO in 2009 as “the crisis before the crisis.” Until the early 2000s, the conventional view of much of the economics’ profession and the international institutions was that income inequality was a normative issue about which economists could say little. This shifted with realisation that rising income inequality was a contributory factor to the financial crisis and had more far reaching economic, as well as social, costs. A series of studies from the IMF research department, as well as the OECD went further in identifying the negative economic impact of rising income inequality[8]. However, despite the shift in narrative by the OECD and other international organisations towards inclusive growth, the opportunity to set this process in reverse was missed following the crisis. Indeed, the premature pivot to fiscal austerity worsened inequality. As a result, income inequality has lessened the impact of the social response to the pandemic.

Condemning what he called “rigged capitalism” in the months before the pandemic, Martin Wolf of the Financial Times concluded “we need a dynamic capitalist economy that gives everybody a justified belief that they can share in the benefits. What we increasingly seem to have instead is an unstable rentier

[7] Financial Times Peterson poll, “Income of 73% in US hit by outbreak” April 7
[8] OECD xxxx

capitalism, weakened competition, feeble productivity growth, high inequality and, not coincidentally, an increasingly degraded democracy."[9]

Social justice or "fairness" will prove to be the defining determinant of how successful the virus will be brought under control in the coming months. Already it is clear that the pandemic is disproportionately hitting low income and disadvantaged groups. The hardship of confinement measures and hence the social tolerance of them also varies according to the living conditions and family situation of those affected. The health risks of those forced to work in the current crisis in exposed situations compared with those who can work from home can also increases the sense of injustice. The countries and communities weathering these measures most effectively will be those with greater social cohesion where containment policies are both designed and seen to be fair. The need to build social justice must also apply to the design and implementation of the exit strategies and recovery measures that will be put in place as the health crisis begins to recede.

The growth in public deficits which will emerge from the combined effects of: (a) the collapse of GDP and hence (b) tax revenue in the short term, (c) the emergency packages of disaster relief, as well as (d) the subsequent recovery measures that will require financing, will require the development of a consensus on taxation and borrowing. In the short-term, governments and international institutions have jettisoned deficit limits. The rise of public deficits and hence the ratio of debt to GDP will depend on the length of the lockdown, the cost of the emergency measures, the cost of the recovery packages and the speed of the recovery of productive potential. The current ratios of public debt to GDP vary significantly in OECD countries, with the median being between 80 and 120 % [10]. It is impossible to know exactly what the changes will be over the next two years. But a back-of-the-envelope calculation of Olivier Blanchard, the former chief economist of the IMF suggests an increase of 30 % of GDP[11]. Immediately after the Second World War, UK government debt had risen to nearly 250 per cent of GDP. For the industrialised countries as a whole, provided that the pandemic is brought under control in the next six months, the financing of debt at current, historically low, interest rates appears feasible. As Blanchard says "In the advanced countries, short of a defeat in the fight against the virus, the debt will remain sustainable. (And if we lose that battle, debt sustainability will be the least of our problems.)"

Within countries and currency unions, the financing of measures in the short term will require monetary financing by central banks and in the medium term the ultimate stabilisation of debt through the recovery of GDP growth and fair taxation. The risk of inflation or "moral hazard" are not the real problems in the current situation. John Maynard Keynes published "How to pay for the war"[12] in 1940, in which he proposed compulsory saving as a method of avoiding the inflationary consequences of a war economy. The British government chose to opt for rationing instead of Keynes' proposal, however he recognised the central importance of social justice in the measures being implemented, and proposed a series of radical measures on tax and spending to continue beyond the war, writing "I have endeavoured to snatch from the exigency of war positive social improvements, including universal family allowances in cash, the accumulation of working class wealth under working class control, a cheap ration of necessaries and a

[9] Martin Wolf, "How to reform today's rigged capitalism", Financial Times, 04/12/2019

[10] OECD (2020), General government debt (indicator). doi: 10.1787/a0528cc2-en (Accessed on 10 April 2020)

[11] Peterson Institute (2020), Olivier Blanchard "Whatever it takes" Getting into the specifics of fiscal policy to fight COVID-19

[12] Keynes J.M. (2010) How to Pay for the War. In: Essays in Persuasion. Palgrave Macmillan, London

capital levy (or tax) after the war, (it) embodies an advance towards economic equality greater than any which we have made in recent times."[13]

In the current situation, even if the overall rise in debt may be sustainable in industrialised countries, there is a risk of capital flight from individual countries hit hard by the pandemic, with already high borrowing requirements. This has led many economists[14] to call for mutualisation of debt through the joint issuing of pandemic or corona bonds. At the level of the eurozone, the ESM could issue common bonds for the specific purposes of financing necessary health expenditures and preventing economic dislocation in the affected countries. At the time of writing, it appears yet again that agreement on co-ordinated fiscal measures to show solidarity through the collectivisation of debt at European level is proving politically difficult to achieve with the finance ministers of the northern countries of the eurozone resisting the needs of those countries which up to now have been most devastatingly hit by the scale of the spread of C19 and the resulting economic impact. In 2010, fear of the sovereign debt crisis led many governments to push prematurely for the reduction of public debt. This prolonged far longer than necessary the recovery from crisis and increased social inequality.

The same mistakes must not now be repeated.

## Developing countries need emergency support

Although increases in industrialised counties' public debt may prove to be sustainable, and their central banks have not been slow to inject liquidity into the economy, and in several cases to provide "helicopter money" through monetary financing of debt, few developing countries have this luxury. During the first weeks of the crisis up to March 23, developing countries were hit by capital flight outflows of 83 billion[15] even before the effects of the pandemic on health and their economies were felt. 52 billion $ of these outflows was in the form of equity finance. International investors have sought "safe havens" in industrialised countries.

In the 2008-2009 financial crisis, developing and emerging economies were less hit at first than OECD countries, due to their more limited exposure to the banking system and the toxic assets in the private financial sector in general. However, the economic effects of the pandemic are hitting developing countries with devastating speed. On top of the capital flight, the sudden closure of international transport has disrupted supply chains and closed service sectors such as tourism. The commodity price collapses have hit commodity-exporting countries – most spectacularly low-income oil exporters. The effects on employment have been immediate, as the majority of the estimated 2 billion informal workers in the global economy are in developing and emerging countries. The ILO [16]has pointed out there are few social safety nets for informal workers who have lost their jobs overnight together with their livelihoods. Oxfam[17] has pointed out that the economic fallout from the pandemic could plunge an additional half a billion people, between 6% and 8% of the world's population, into extreme poverty.

[13] For an account of Keynes discussions with the TUC and Labour Party on his proposals see Richard Toye, (1999) - Keynes, the Labour Movement, and 'How to Pay for the War' JO - Twentieth Century British History

[14] See Social Europe xxx Baldwin et al xxx

[15] International Institute of Finance, April 2020

[16] ILO Employment Monitor(2020) op. cit.

[17] Oxfam (2020) xx April 2020

If the pandemic reaches major proportions in developing countries, the risks to health could be truly catastrophic. Social distancing measures and confinement are nearly impossible in most developing countries' urban areas. The fragile health systems in most developing countries would be stretched beyond their capabilities very rapidly. The risk is that developing country governments will be forced into an impossible choice between supporting the health of their populations and default or allowing economic collapse. The humanitarian suffering that this situation could bring about must be countered by intelligent action by industrialised countries, even from the limited perspective of self-interest. ~~If~~ the pandemic spreads in developing countries, there will be second and third waves of infection in countries coming out of lockdown.

The international trade union, business and civil society organisations (ITUC, ICC and Global Citizen) have called on governments participating in the IFI Spring meetings to provide emergency debt relief to enable developing countries to combat the Pandemic[18]. In addition to this and longer-term maintenance of development finance, there should be a rapid issuing of Special Drawing Rights by the IMF to support liquidity in developing countries. As part of the 2009 response to the financial crisis, the G20 London Summit agreed that the IMF should issue an extra 250 billion dollars in Special Drawing Rights. Given the scale of the current crisis an issue of at least 500 billion dollars is now required to support liquidity for developing countries[19].

## Support for the financial sector and beyond should be conditional

The majority of G20 countries have entered the crisis with their finance and banking sectors in better shape than in 2008 and 2009, however the longer the lockdown measures persist and the deeper the fall in GDP, the greater will be the risk bankruptcies and, as a consequence, nonperforming loans.[20] This may disproportionately affect insurance sector pension funds and other institutional investors who, since 2012, have sought to increase the yields on their investments by investing in financial products that package risk. This reinforces the importance of measures to stop the vicious cycle of redundancies, unemployment and falling demand, which simultaneously reduce productive capacity in the medium term. It also requires continuing government support both for financial sector and non-financial firms. For some, notably airline companies, this may result in nationalisation soon. In the rail sectors in the UK, effective nationalisation has already taken place, with the government taking over the obligations and the income of private rail companies.

One lesson from 2010 is that exit strategies pushed governments to withdraw responsibility and influence over firms and sectors too rapidly, which led to a return to "business as usual." The "pivot to austerity" in 2010 was a mistake.

The global trade union movement, working civil society groups and international organisations published in 2011 a blueprint for exit strategies[21] which sought to draw lessons from the crisis and put forward proposals aimed at moving towards more equitable and sustainable growth. These proposals were largely ignored as austerity programmes pushed many groups of workers into poverty and suppressed living

---

[18] https://www.ituc-csi.org/ituc-icc-global-citizen-letter-en

[19] For a forceful advocacy for an SDR issue see Gallager, Ocampo and Voltz, Financial Times 20 MLarch 2020

[20] See OECD https://read.oecd-ilibrary.org/view/?ref=127_127003-tvl9kqbfy9&title=Global-Financial-Markets-Policy-Responses-to-COVID-19

[21] European Trade Union Institute (2020) "Exiting from the crisis: towards a model of more equitable and sustainable growth" David Coats ed.

standards for a decade. Banks and businesses returned to business as usual - the result was the growth and continuation of "rigged capitalism" as Martin Wolf has called it.

This cannot be allowed to happen as economies emerge from the pandemic. Taxpayers' money must require conditionality, both in avoiding excessive executive pay, in ensuring companies play the social roles expected of them in the crisis and in the longer-term ensuring tax evasion and avoidance by the corporate sector does not undermine tax bases. The Responsible Business Conduct agenda now has to be given real teeth by governments insisting on commitments by firms to observe good practice standards such as OECD Guidelines for Multinational Enterprises, as well as ensuring that effective enforcement mechanisms are put in place. The TUAC launched a call[22] on 10 April for action to enforce the Guidelines along supply chains as part of the response to the pandemic.

The aftermath of the crisis will give an opportunity for governments to change company law to broaden the application of stakeholder capitalism. Workforces have to be given rights to co-determination, information and negotiation, in exchange for the social sacrifices made during the pandemic. There is an opportunity now to expand real industrial democracy.

This should also be the occasion to learn from some of the unintended environmental consequences of the confinement measures, so as to move to a recovery that is both equitable and environmentally sustainable. The requirements of moving to low carbon solutions due to climate change require that countries don't return to the old high-carbon model of development but rather introduce environmental conditionality into recovery programmes

## Missing in Action: international cooperation

The trade union and business organisations at the OECD, TUAC and BIAC, noted in March in a joint communiqué[23] that, whilst there were some similarities with the financial crisis, there is a noticeable difference this time – there is now "far less appetite" for international co-operation and for multilateral solutions.

In 2009, international cooperation halted an escalating crisis. The 2009 G20 London and Pittsburgh summits agreed measures which both avoided the Great Recession becoming a great depression on the scale of the 1930s. The error was that they retreated from this commitment prematurely. So far, the President of the United States – the world's most influential multilateral power – has rejected international co-operation and denigrated international organisations and efforts. Beyond this crisis the reconstruction of supply chains and a more socially and environmentally sustainable form of globalisation, will require stronger international cooperation, and a more effective G20. Unless there is an approach of enlightened self-interest from governments in the international sphere and increased support for the multilateral system, governments will repeat the mistakes of the past.

(An abridged version of this article will appear in Social Europe)

[22] TUAC 10 April
[23] OECD https://read.oecd-ilibrary.org/view/?ref=126_126661-pw76xp4r7v&title=TUAC-and-BIAC-joint-statement