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To V or not to V

by John Springford

The debate over the shape of the economic recovery continues. But recent medical advances should tilt governments towards continued support for workers and companies, because the pandemic may be over sooner than they had feared.

In a much-discussed – and much-criticised – speech on June 30th, Bank of England chief economist Andy Haldane argued that Britain's post-pandemic recovery had been V-shaped so far. Quoting data from Google, the Open Table restaurant bookings platform and online payments, he argued that the recovery in spending had been faster than the Bank had previously forecast. Haldane had been the only member of the UK's Monetary Policy Committee to vote against further quantitative easing in its June meeting.

Yet data from other countries, such as South Korea and New Zealand, which are further along into their recovery than the UK, suggest that spending on bars, restaurants and public transport has not bounced back completely, even with the virus largely under control. If governments withdraw support for workers and firms too quickly, a wave of bankruptcies and unemployment will follow.

The shape of the recovery will be largely determined by medical and epidemiological progress, so it is difficult for economists to forecast it. Improved testing and contact tracing, alongside social distancing measures, have allowed European countries to ease lockdown measures without significant increases in coronavirus cases. But to achieve a complete recovery, airlines, shops, theatres, cinemas, bars and restaurants will need to reopen fully, which will require a vaccine and improved treatment for the disease.

There are some hopeful signs that vaccines will be available next year, with candidates in China, Germany, the UK and US all generating antibodies in the first stages of human trials (though they have not yet been shown to prevent infection). New treatments have been discovered: an anti-viral drug, remdesivir, has been shown to speed recovery; interferon beta inhalers have been found to reduce the need for hospitalised patients to be ventilated; and dexamethosone, a steroid, cuts the share of patients on ventilators who die by a third. Yet these treatments do not stop COVID-19 from being a highly contagious and potentially deadly disease. Social distancing measures will have to continue until a vaccine is developed and administered to the majority of the population. With luck, that might happen next year, at least in richer countries.

Even those countries that have successfully contained the virus have not seen a full recovery in hospitality and retail. According to Google mobility data, which tracks people going to outlets in these sectors using their mobile phones, footfall is around 5 per cent lower in South Korea than it was a year ago, and 10 per cent lower in Japan and Australia. The numbers using public transport are much worse: footfall in bus terminals and railway stations is down 20 per cent in Japan and 40 per cent in Australia and New Zealand. People are walking, cycling and driving instead, but that does not prevent cafes, shops and bars near railway stations from struggling with depressed revenues. The hospitality, leisure and tourism industries are big employers across Europe, and unemployment will rise very rapidly if government support is withdrawn, as social distancing measures and people's fear of contagion weigh on consumption in these sectors.

Governments have two potentially competing objectives now that the first wave has passed. First, they must continue to support firms that will be viable with a vaccine, but insolvent without one, and keep workers attached to them so that firm-specific skills are not lost. Second, they must seek to reduce support for companies that are able to operate under social distancing conditions, in order to reduce the cost to the taxpayer of supporting the economy and to start the process of redeploying capital and labour. The problem is that it is very difficult to identify which companies fall into which category.

As British journalists Stephen Bush and Ben Kelly have pointed out, the good news on the vaccines and treatment front should, on balance, encourage policy-makers to continue to provide furlough schemes. If the pandemic is over in 2021, they can afford it. Britain's finance minister, Rishi Sunak, announced in July that he would reduce the amount of wage support paid by the government to 60 per cent per worker in September, and that the scheme would end on October 31st. Sunak said that he "will never accept unemployment as an unavoidable outcome", and he may have to revisit his decision to end the furlough scheme in October, especially if the infections start to rise again in the autumn. Under Germany's *Kurzarbeit* scheme, wage top-ups will continue until the end of 2020. And the French government has also been reducing support, to 70 per cent now and to 60 per cent in October, but its scheme will continue into 2021.

To support contact-heavy areas of the economy, sector- and area-specific furlough and loan guarantee schemes may be a solution. Hospitality and leisure outlets could continue to receive support, while it is reduced in sectors that are able to return to normal. Local lockdowns will probably be needed to deal with outbreaks, and their economies will need emergency aid.

It will not be possible, or desirable, for governments to rescue all companies – especially those that were already failing before the pandemic. Some will be unwilling to take on further debt, even if it is largely guaranteed by the state. Germany – and to a lesser extent, the UK – have tried to boost consumption through VAT cuts, to ensure that the economy returns to capacity (within the limit set by continued social distancing). Germany has reduced VAT to 16 per cent (from 19 per cent). The rationale appears to be that this will hasten the recovery in spending, thereby helping unemployed people find work in jobs that are less affected by the virus. Both Germany and the UK have reduced VAT for the hospitality sector to 5 per cent, which may boost bookings, but people may continue to fear infection in restaurants and bars.

Rather than trying to boost consumption, however, governments would do better to target the unemployment problem by giving more support for training and helping people find jobs. That is especially true of the UK, which spends only 0.3 per cent of GDP on such measures, according to the OECD. France spends 1 per cent of GDP, and its spending is far more cyclical than Britain's: it rises more in periods of high unemployment. Governments could also expand funding for care for the elderly and children. The pandemic has exposed the dire state of care homes in many countries, especially for poorer people. Better working conditions and pay would make it easier for homes to find staff. Greater childcare provision would allow more parents to work. Care is labour-intensive, and demand is rising as society ages.

European countries have eased lockdowns without a big rise in infections, but that should not make anyone complacent about the speed of the recovery and the ability of governments to end support for the economy without a sharp rise in unemployment. The virus has not been beaten yet, but governments can be more confident that it will be: that should encourage them to err on the side of activism.

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