COVID 19 Economics Lesson
Towards a Resilient Society

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Based on
New Booklet

Based on webinars + beyond
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Thank you for your questions and for being part of it!
COVID as **Naked Swimmer Moment** and **Trend Accelerator**

- **Health externalities**
  - No universal health care
  - No sick leave
  - Higher death rate across minorities

- **Trend accelerator**
  - Optimal speed – growth vs. disruption (human capital)
Resilience

- **Risk** management - squeezed between concrete wall
  - Variance
  - *Tail Risk Analysis*

- **Resilience** management - squeezed between rubber wall
  - Mean-reversion
    - bounce back
  - roly-poly toy

- *Trap Avoidance Analysis*
Resilience: Diversity, Flexibility, Growth

- Diversity vs. Monoculture
  - Shocks are more idiosyncratic than symmetric
  - Reduced willingness to insure each other (Alesina)

- Flexibility

- Growth
  - Bicycle analogy

“A social contract that boosts inclusive growth stabilizes the social contract.”
Social contract

- Thomas Hobbes, (*Leviathan, 1651*), John Locke, Jean-Jacques Rousseau
  - An externality interpretation

- Social contract to limit/make us resilient to
  - Externality from others
  - Shocks (externalities from mother nature)
    - John Rawls and the “veil of ignorance”
    - Not insure, but provide resilience
      - Ladder to get out of the hole – not universal basic income
      - Dignity and limits moral hazard
Will we return to the pre-COVID social order?

Temporary or permanent shift?

Better externality internalization
Incentives: stick
Authoritarian

Better information aggregation by markets
Incentives: carrot
Open society

Health externalities

- Surveillance
- Privacy

Role of Social Norms (Japan, ...)

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Overview: Resilient Society

- Social contract
- COVID Health Resilience management
- Long-run effects: Innovation and Scarring
- Macro, Money and Finance
  - Financial Whipsaw (IPO boom)
  - Public Debt challenge
  - Inflation Whipsaw: Deflation/inflation traps
  - Inequality
- Global Resilience
What changes people’s behavior (social distancing)?

1. **Wave:** COVID Fear
   - Sweden vs. Denmark
   - Wisconsin vs. Minnesota

2. **Wave:** COVID Fatigue/Denial
   - Endowment effects
   - Optimal Expectations (Brunnermeier & Parker, 2005)
     - Optimistic beliefs if it doesn’t distort behavior
     - Government limits choice
     - Externality

Chetty et al. (2020)
Testing/Vaccine production

- Cost of testing is tiny
- Vaccine costs are tiny compared to lockdown
  - Develop 14 in parallel – redundancy
  - Develop vaccines with low correlation - portfolio approach

Sources: FT, Deutsche Bank, Airfinity
Innovation boost: trend accelerator or QWERTY jump

- **Innovation**
  - Overcoming cannibalization, QWERTY problem, and regulatory shackles
    - Tele medicine
    - Home office and real estate donut effect
    - Online learning/conferencing
    - Digital Money
    - Virtual world
Scarring → slow recovery

- **Belief scarring**
  - Less risk taking, more savings

- **Labor market scarring**
  - Women > men (unlike previous recessions)

- **Firm scarring**
  - Debt overhang problem
  - SME (chapter 7) vs. large firms (Chapter 11)
“Financial Markets Whipsaw”

- March 2020 shivers followed by strong recovery
  - **Stock market** record heights – IPOs like during NASDAQ bubble
  - **Gov. bond market** shivers   CB: Market maker of last resort
  - **Corporate bond market**    CB: Tail risk removal

Source: WSJ
Global Financial Crisis – averted in March 2020

- Flight to safety in the US dollar

- Fed interest rate cut and repo facility
High Public Debt Levels, but low interest rates

- Debt/GDP vs. Value at Risk (Debt servicing cost | ⋅ )

- Asset pricing formula with second term

  Asset Price = E[PV(cash flows)] + E[PV(service flows)]
  \hspace{1cm} \text{dividends/interest \hspace{1cm} convenience yield}

- Safe asset service flow:
  Precautionary savings + retrading (to partially insure idio risk $\tilde{\sigma}_c^2$)

  ⇒ low real interest rate $r^* = \rho + \gamma g - \frac{1}{2} \gamma (\gamma + 1) \sigma_c^2 - \Delta i$

- Safe asset status of gov. bonds – bubble feature that can pop
  - Fiscal space to “defend bubble”
Tail/Trap Risk: “Inflation whipsaw”

- **2 traps** ("resilience killers")
  - Deflation trap
  - Inflation trap (fiscal + financial dominance)

- **Independence** central bank + MacroPru
  - Accelerator and breaks

Brunnermeier, Merkel, Parker, Sannikov (2020)
Inequality of Resilience

- Households’ savings too small to be resilient
- Regional inequality: Poor in affluent neighborhoods

**Low-Income Employment Down in Affluent Areas**

Declines in high-income spending led to significant employment losses among low-income individuals working in the most affluent ZIP codes in the country, as shown in the map below of employment declines in early June in New York City.

- Racial gap
- Online education gap
- Income vs. wealth: valuation effects
Global Resilience

- EMDE: Visible vs. invisible Health, Life vs. livelihoods
- Limited policy space: crisis and recovery phase
  - Fiscal response: 20%, 6%, 2%
- Debt restructuring
- “Slowbalization” only (in trade)
  but deglobalization (in services, technology transfers)
- Global value chains
- From cost minimization to Resilience
  - Just-in-Time
  - Just-in-Case, dual sourcing
THANK YOU
&
HAPPY HOLIDAYS
see you in 2021!