Nine policy taboos overturned by COVID-19

*With less ideology and greater freedom in macroeconomic management, we can shape a more inclusive economic system, writes **Lutfey Siddiqi (LSE)**.*

An economy is defined as a "circular flow of income". One person's spending is another person's income. National income is the sum of everyone's spending and loosely speaking, growth comes from increased velocity of that spending.


The Chancellor, Rishi Sunak, briefs journalists in April 2020. Photo: HM Treasury via a CC-BY-NC-ND 2.0 licence

Social distancing or lockdown is a deliberate interruption in that flow of income. A circuit-breaker for the virus is necessarily a circuit-breaker for the economy. The pandemic-driven slowdown of 2020 is not an ordinary recession represented by a slower pace of spending; it is a proactive attempt to freeze large parts of the economy into standstill. To that extent, policy responses could not come from any ordinary toolkit; they had to be focused on immediate pragmatism, not philosophical tribalism.

It is encouraging to see that when it came to the crunch, pragmatism ruled in countries across continents irrespective of the affiliation of the ruling party.

At least nine taboos are confronted in the policy response to COVID-19 so far:

1. Rise above left and right

Who could have guessed that less than three months after a landslide victory over the Labour party, the Conservative chancellor and former Goldman Sachs executive Rishi Sunak would announce, "For the first time in history, our government is going to pay people's wages", earning praise from the head of Britain's trade union movement, Frances O'Grady. As the economic response shifts from relief to re-shaping the future economy, there is perhaps hope for constructive cross-party engagement to prevail. There's an opportunity, as Singapore's Tharman Shanmugaratnam has consistently argued, to rise above false binaries and build a new social contract from the political centre.

2. Print money, not debt

Relative to their counterparts in the Treasury, both the Federal Reserve in the US and the Bank of England were first off the blocks with overwhelming policy support. Interest rates have been slashed and the central banks stand ready to provide unlimited liquidity, against virtually any asset. The European Central Bank and Bank of Japan have also expanded the quantity and range of instruments that they are buying. Where have the critics of Modern Monetary Theory (MMT) and debt monetisation gone? It is as though inflation no longer matters or that any risk of future inflation is seen to be manageable. Even the pretence of prudence around quantitative easing ("it is only temporary and reversible") is now gone. Tellingly, the Financial Times' editorial board led with the headline "Printing money is valid response to coronavirus crisis". A similar case for printing money or versions of "QE infinity" is also being made in emerging economies even though supply-side constraints are arguably more inflationary over there.

Overturning the taboo around unlimited monetary easing will exacerbate fundamental dysfunction in the architecture of finance, capital markets and investment management. This month, the Bank of Japan – dubbed by the Wall Street Journal as "the central bank that ate Japan" – will end up owning half of the country's commercial paper and a sixth of its corporate bonds. We also saw the price of oil go negative for a specific delivery date. The challenge of underfunded pensions or financial repression in general will only get worse forcing us to confront additional taboos further down the line. However, a positive side-effect might be an increased flow of funds towards sustainable and impact investing.

3. Universal basic income (by any other name)

Countries such as the US, Canada, Japan and Singapore are giving cash, directly and quickly, to citizens with fairly liberal conditions or generous thresholds of eligibility. The terms and conditions for state-guaranteed business loans and payroll assistance are similarly designed to catch wide swathes of small businesses. The British approach (now changed) of guaranteeing only 80% of small loans had slowed their disbursement compared to places like Switzerland where the guarantee is 100%. Arguably, some of these measures amount to universal basic income (UBI) albeit for finite periods. As job insecurity in the gig economy comes sharply into focus, will some form of unconditional basic benefits remain in the policy toolkit?

4. Stakeholders, not shareholder primacy

On 31 March 2020, the Bank of England asked seven major banks to withhold dividends and cash bonuses, giving them until 8pm to take that decision failing which "we will consider use of our supervisory powers". The European central bank and the Swiss National bank (SNB) also took a similar stance. It is also clear that any company receiving bailout loans will have to refrain from paying dividends or buying back shares until the loans have been repaid. While some in the US may still be off-key on this issue (as highlighted here by CFA Institute's Kurt Schacht), we are seeing inspiring leadership from several firms around the world stepping up to take care of employees, suppliers and communities. (Some of those businesses are showcased on this LSE platform). Will the scale and breadth of this crisis sufficiently demonstrate the relative resilience of stakeholder capitalism and tip it further into the mainstream?

5. Inequality costs everyone

Inequality has also been thrown into sharper relief by the virility of this tragic pandemic. Social distancing is effectively a regressive tax. At the same time, the absence of widespread healthcare has widespread consequences, irrespective of individual wealth or income. "No-one is safe until everyone is safe", is now a common refrain. On this backdrop, many might reassess the cost-benefit of higher tax rates and a wider tax net. The very concept of financial wealth as a store of value rests on an implicit social contract which is not unalterable.

6. Globalisation with local characteristics

In the words of a G7 foreign minister, "This crisis has realigned food diplomacy, health diplomacy and supply-chain diplomacy". Embassies around the world have been working on repatriating citizens and ensuring that certain hubs remain open for key cargo. New partnerships are emerging, and old institutions are re-tested for fitness. On 22 April 2020, Singapore's foreign minister personally went to the airport to receive a shipment of essential supplies from New Zealand. This follows the two countries signing a declaration on supply-chain connectivity (along with seven others including Chile and Canada). In South Asia, India is engaged in a bit of "Covid diplomacy" sending in-demand medicines to neighbouring countries and allowing exports to the West only upon heavy requests. Over in the West, members of the European Union are debating the extent to which they would pool fiscal capacities to support a joint fund for post-Covid recovery. Every country everywhere is having to reassess where they wish to sit on the global-local spectrum.

7. Value of inefficiency

It is also clear that over-optimised, hyper-efficient supply chains can be costly in terms of diminished resilience against shocks. Agility, modularity, optionality and even some duplication will need to be factored into the design of supply chains. In this new calculus, technologies such as vertical farms might be seen as more viable. "National interest" may be invoked more readily for decisions around the deployment of 5G technology or bail-out of American energy firms for example.

8. Emerging markets and debt relief

The outright taboo around capital controls was already dented in 2012 when the IMF reversed its earlier stance and supported their use "as a last resort, imposed selectively on capital inflows, and on a temporary basis". In practice, the experience of Malaysia and Iceland, and administrative controls in large economies such as India and China have made capital flow restrictions more acceptable. At the same time, academic work (by Helene Rey and Hyun Shin, for example) has highlighted that floating exchange rates may neither insulate against western monetary policy nor self-correct in the presence of global factors.

In the current crisis, the IIF reports record outflows of capital from emerging markets along with weakening currencies. A record 102 countries have applied to the IMF for emergency funding. The G20 countries have agreed to temporarily freeze bilateral government loan repayments for low-income countries and have urged private creditors to participate in the plan. The response from private creditors so far is to treat each debtor on a case by case basis. Overall, coordinated international assistance for emerging economies have not yet demonstrated the requisite imagination, especially when compared to the taboo-breaking decisive action taken in the domestic arena.

9. National chief risk officer in the cabinet

Having served on the World Economic Forum's risk response network for several years, I sometimes go back in time to see how risks were perceived and framed in the annual risk report. The 2007 report makes the case for a chief risk officer (CRO) at a national cabinet level, to mirror the equivalent role of enterprise CRO in the private sector. This minister would have her own budget and remit to cut across departmental silos. This would allow for better assessment of trade-offs and use of systems thinking in the design of resilience strategies. At an international level, national CROs could formally meet to coordinate risk mitigation efforts. The 2013 report goes on to detail a framework for national resilience that could be used by the country CRO, based on the five pillars of robustness, redundancy, resourcefulness, response, and recovery.

Over the years, such an approach has been applied to specific subsystems (for example, the financial system or natural disaster management) but appointing a national-level "risk tsar" has not been entertained. As allegations now emerge of table-top simulations of pandemic risks being conducted and subsequently ignored, perhaps governments will revisit the benefits of a senior accountable person in charge of cross-cutting risks.

All in, with fewer ideological constraints and greater degrees of freedom in macroeconomic management, it should be possible to shape a more inclusive economic system in the post COVID-19 world. However, it would require active shaping.

It is imperative that governments take a proactive, intentional and an “industrial strategy” approach to the recovery effort. The task is not just to protect existing jobs in existing businesses but to foster economic sectors of the future and assist with skills transition into the jobs of the future.

This post represents the views of the author and not those of the COVID-19 blog, nor LSE. It first appeared at LSE Business Review.