

The economy under the pandemic and afterwards

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Abstract

The article deals with the peculiarities of the current global economic crisis and discusses whether the crisis can give an impetus to a new development model. The author emphasizes that as the crisis is caused by external shock (the pandemic), it is very different from other types of economic crises and can be followed by serious civilizational consequences. The pandemic is the price for globalization. During the crisis, governments face an unsolvable dilemma: saving lives or preserving the economy (that is, future lives), with a significant credit of trust of the population. In such a period, a society has a chance to improve the path of its development (get out of the path dependence). In particular, the author discusses institutional changes needed in contemporary Russia to make this happen, namely the tax system revision and the law enforcement agencies reform.

Keywords

COVID-19, globalization, pandemic, economic crisis, path dependence

JEL codes: B52, O43

Probably, I am not the only one who has the impression that the leap 2020 turned everything over and we are in some theater of absurd. In such conditions, it is extremely difficult to predict because the parametric uncertainty usual for the contemporary world, when prices, rates and proportions change, has been replaced by the structural uncertainty. We do not know what the world will be like after passing through the painful systemic crisis, it largely depends on how we will behave, what we will do, think, undertake, advise and implement in this difficult, harsh time.

How does this crisis work? Where did it come from? What are strategic opportunities within this crisis? What are the risks and opportunities associated with government actions in the aftermath of the crisis?

The pandemic is not an invasion of aliens, but it cannot be said that this invasion is not linked to our previous life. In history, the processes of economic rapprochement of countries

and formation of state unions and empires were always accompanied by pandemics. Rome, which united the territories which presented almost the entire world, was marked by the Antonine plague. The dawn of Byzantium is associated with the Justinian plague. Mongolian Empire, which was one of the largest states, maybe the largest in world history, faced “black death”, the plague of the 14th century. In this context, COVID-19 stands in this sad line, as well as the “Spanish flu” of the early 20th century.

What is the mechanism of the current crisis? Why does globalization, the interconnection of peoples and economies, bear such a danger? It is clear that the isolated existence of nations creates ecocenos, when the disease wanders for a long time around a certain part of the continent, the herd immunity gradually appears there, and people do not react to it as much. But when the plague is thrown from Asia into Europe, it turns out to be a disaster.

However, we should not blame the East or Asia here because there were situations when Europe was a source of infection for other countries. For example, Mongolia was dramatically affected when European travellers brought syphilis there, imported either from Africa or America. And the American Indians of Peru and Chile and the prosperous civilizations of Mexico, died largely not from the swords and guns of conquistadors, but from the fact that bacteria came together with the European conquerors, and they turned out to be much more malicious killers. There is a link between well-established transport networks, rapid communications and the risk of pandemics. Therefore, in a short time the current pandemic was transferred from China to Italy, and Italy became the European and world center of the pandemic.

Now let's pay attention to the second fact that many people consider surprising. Look how the governments of all affected countries reacted – up to the introduction of military regimes. In fact, there are no other topics in the media except the pandemic. What is the reason for this? Large potential human losses? I dare recall that the flu takes between 400,000 and 600,000 lives every year, and deaths from road traffic accidents claim 1,350,000 lives a year. Yes, of course, the pandemic is more dangerous than regular flu, but it is impossible to say that the government uses its forces against conventional flu, but 5 times less, it would not be true.

It seems to me that the strong response of governments in different countries is also due to the fact that the agenda that emerged in the world by 2020s is not very satisfying for many governments. There are two core problems in different parts of the world: social inequality and climate change. Both problems require actions from the governments to limit their elites or agreements with others elites. However, due to state of emergency the agenda has changed and governments have got the rights to dispose budgets and manage them, and this is also an important motive, although the responsibility of governments increases.

One more question. Is there a peculiarity in what happens when you look at it as an economic, social and systemic crisis? It is not similar to the crises of 1997-1998, 2008-2009, and especially 2014-2015, when there were fluctuations in exchange rates. It is something completely different. This crisis is caused by an external shock. Such cases occur in history, but they are not frequent. And the economic dynamics is also different. In an ordinary crisis, everything falls except the overnight rate, i.e. the price of money for one night. But in the current crisis, when there is an external shock, some assets and resources are falling, for example oil, shares of transport and travel companies, however, there is something that is growing strongly, like pharmaceuticals or digital services.

It is clear that the current crisis has a very strong impact on institutions and relations, in fact it is a crisis of competition. Companies are assigned to some tasks for the emergency.

And these powers are quite a common, albeit risky thing: these methods limit usual business activity. At the same time, demand changes dramatically. Remote delivery, remote technology, digital entertainment are growing 10 times more, and the world economic links are being reshaped. We finally realize where we had real dependencies, to what extent we depend, for example, on Chinese components and to what extent we can replace them. This applies not only to Russia, but to all countries.

Therefore, we face an unusual crisis, and some people think this is the end of globalization. No, it's not the end of globalization.

Let's look at things broader, not five, ten, twenty years, but centuries back. If we assess what happened in the last century by the basic parameters of freedom of trade, financial integration, international migration, it turns out that the highest level of integration was achieved not when it seemed to us – at the end of the 20th century, but in 1913, prior to the First World War (Broadberry and O'Rourke 2010). In fact, globalization is not a linear but an oscillating process, with its inflows and outflows. The outflow of globalization started not in January 2020, but after the crisis of 2008-2009. The share of international trade began to fall, trade wars began, a particularly strong one was the US-China trade war of 2018.

Therefore, I would say that we should not accept the false prediction, globalization will not end, it will return, the inflow will follow the outflow. By the way, I think that we are now on the lower extremum of this oscillating curve of globalization, and maybe, a new upward trend will start from here, if new pandemic-related methods of cooperation between countries appear. Despite the fact that now we isolate ourselves from each other and try not to continue previous ways of interaction.

Concerning the future, we are ultimately interested not even in whether globalization will go up or down, but where we will find ourselves in this curve, how will the ratio of the main actors, China and the United States change, and what the place of Russia will be. Here again, I suggest that we consider the case more broadly.

Considering the longer historical retrospective, we see that there are some kind of sustained paths, trajectories on which countries develop and their economic growth is in a certain manner determined within these trajectories. This was found out by Angus Maddison (Maddison 2007), a distinguished British researcher who summarized data on GDP per capita for all countries of the world since 1820 and up to the 21st century, and it turned out that in fact there are the first and the second cosmic speeds. Everything is developing in a certain way, but most of the countries, about 175 countries, are in low-Earth orbit, and 35 countries are far ahead. This is the second speed. And there are countries that in the 20th century shifted from the first to the second speed, for example, Japan.

These trajectories are often the result of such crises. For example, the famous “black death” plague of the 14th century, which came to Moscow in 1353, divided the Europe because in Western Europe prerequisites for rapid economic development appeared, while East German lands, Romania and Russia experienced the so-called second edition of serfdom. Russia has developed such institutions that have severely impeded its development, although sometimes they were instruments of leaps followed by declines. Not necessarily does an external shock create such conditions, there can be mistakes of institutional choice. For example, England and Spain have separated over the centuries, and this discrepancy in their paths has been projected to South and North Americas, to the competition of the United States of America with Argentina because, as studies have shown, Spain and England have made different decisions on taxation (North 1990). It turns out that it is fundamentally important

that a taxpayer could control the formation of his taxes, and then there will be investments, and if not, there will be waste of resources and focus on rent-seeking.

Therefore, the further paths of development are largely set now, and it depends not only on external shocks but on what decisions we make. In fact, development can arise from two sources. One is an external shock, such as a pandemic or significant climate change. A few years ago, at the Faculty of Economics of Lomonosov Moscow State University, we had a conference on the problems of economic development, held together with the Russian School of Economics and the University of Namur. Nathan Nunn, the Harvard University professor, made a report that showed the connection between the climate variability and the way development of certain countries goes on now. It turned out that the countries affected by the cold of Little Ice Age, developed the ability to change, adaptability, and innovativeness (Giuliano and Nunn 2017). I am glad that Russia in the 17th century was strongly affected by this cold, that is, we have good prerequisites to change something for the better.

Another scheme of institutional change, with a cumulative effect, is authored by Douglas North (1989). Let me remind you that the first scheme was offered to the academic community by Harold Demsetz (1974). According to North, people experience a change inside and then it changes social order. Sometimes it happens in a completely unexpected way. Robert Fogel, a distinguished historian who received the Nobel Prize along with Douglas North, has shown that this occurs via changing values, tastes and preferences (Fogel and Engerman 1974; Fogel and Engerman 1995). For example, American plantation slavery was abolished not because it had become economically inexpedient, but because people felt that slavery was an evil. This is how internal evolution, imperceptible, not directly related to the economy, leads to enormous changes in the economy, unexpected, for example, for European countries that actually sided with the South in the American Civil War.

Russian history also gives such examples when the internal cumulative process leads to big changes. For example, the advisers to Catherine II called for abolition of serfdom during the reforms, however, The Liberties of the Russian Nobility decree was signed, but liberties of peasantry were not. When did it happen? It happened when a broad understanding that serfdom was vile emerged in the society, when “Mumu” was written (1852), the great book by Ivan Turgenev, which shifted the views of many people. Therefore, the cumulative process is also going on. There are both an external shock and the internal process, which is related to accumulation of experience, the emergence of new understandings.

How does this work in the current situation? I would say there is a dramatic dilemma of public policy in the face of the pandemic. Governments look with horror at Scylla and Charybdis. The strict lockdown is needed to reduce mortality, but this lockdown kills the economy, and therefore undermines lives. In fact, this means that Governments have two limitations on making decisions. The first one is the necessity to stop the expanding of the epidemic in the short term of 1 to 2 months. It is necessary not to overload the capacities of healthcare, to fit in the resuscitation facilities, availability of necessary equipment and doctors. But there is a second limitation: in the short period of 6 to 12 months it is necessary to somehow support economic activity at the level that avoids erosion, destruction of economic and social infrastructure, because together with it the health infrastructure will also die. In this case, we will not stand the second blow of the epidemic, which is not bounden, but also not excluded (remember that the “Spanish flu” 100 years ago came and went three times), if we don’t choose longer goal-setting to support the economy.

The Russian solution to the issue, as I understood it from the President’s address on April 8, 2020, is to balance the situation by regions, to introduce a polycentric regional manage-

ment of the quarantine regime and economic activity, to allow economic activity wherever it is possible and to restrict it where epidemic outbursts exist. However, it's a policy of survival in this situation. And the goal is not just to survive.

Returning to the specifics of the shock crisis, I draw attention to the fact that there are three possible priorities, which it would be wrong to overlook.

First, we see that the government is hesitating to start spending the National Welfare Fund savings. I think that the escalation of the state financial assistance is necessary to maintain the falling demand, to social support of the population. What is really going on in April 2020 in Russia? The President announced a non-working month and its expenses are laid mainly on business and other operating organizations. Figuratively speaking it looks as an attempt to stop the enemy's army by poorly armed divisions of the national militia. OK, it is necessary in order to gain time and tighten up the Siberian divisions, but it is time already, I think, to move the Siberian divisions forward in battle, i.e. to use the possibilities of the National Welfare Fund.

Together with our colleagues at the Faculty of Economics in cooperation with the Institute of Economic Forecasting of the Russian Academy of Sciences we made a forecast: at least 2 trillion rubles a year will be required to compensate for falling demand. It's not an absurd sum, and it won't give prosperity to those who receive it, but that's what matters and is needed. I remind you that the current crisis stems from falling demand, like in the oil market – a catastrophic decline in demand, when the Chinese economy dropped out, and now the European and American as well. So, the problem is that without compensation of demand, it is impossible to ensure the work of the economy.

And without social support of the population too, because people count on this support. Everyone remembers the Presidential message made in January 2020, which, according to Alexei Kudrin, is one of the most expensive in history (social assistance was announced that could cost approximately from 3 to 4 trillion rubles for several years), and in these conditions promises are important because the level of trust is essential to pass through the crisis.

The inclusion of state support is absolutely necessary, it should not be postponed. Balancing the release of the economy and quarantine regimes, postponing certain payments is not enough, it is not a decision, state funds will have to be poured in.

We were saving a piggy bank for hard times, now we debate about whether the times can be even harder than today. The government, the national bank has about 8 trillion rubles in the National Welfare Fund, plus the balances in the accounts of the government, all the money of the budget, which the government manages, totally it is about 18 trillion rubles. And there are gold and foreign exchange reserves of the Bank of Russia, they slightly decreased because placement in the yuan reduced them and the price of gold decreased. But, note, there are several 'lines of defense': redistribution of the budget, the National Welfare Fund, and the possibility of using part of gold and foreign exchange reserves as they are already used to stabilize the exchange rate.

Why do I think it's time to turn on the oxygen bag? Because it is a mistake to think that money is only spent and not replenished. If the economy lives and works, it continues to replenish budget. That's why I think that it is a mistake to assume that in this game money is formed only from government funds, in fact money invested from government funds in improving the economic situation is returning from a growing economy.

How to inject? This is a serious question, and I would say that this is the second of the above mentioned priorities, perhaps even more important, because it concerns the choice of the path of development. What do we support? Are we patching holes and filling troubles with money? No. Let's return to the idea that in shock crises the wrong path can be chosen,

and then it is impossible to withdraw from it for decades, there is a path dependence effect, tightening into a certain trajectory. So, it's very important for us not just to choose a wrong path, but maybe to correct some extremely important things that we failed to correct before this pandemic-related crisis. The shock crisis is a blow that can push the country out of the path dependence.

It seems to me that the issues of taxes and technology are the most important.

Why am I talking about taxes? I recall that the wrong decision on taxes made Spain lose its competition with Britain. Now the question is how to help 22 falling industries – travel agencies, transport, hoteliers, etc. Does the state have to help? Yes, it does, but help can be provided in different ways. I actively support the idea that support to the industries and businesses should be provided at the expense of the taxes they paid in 2019. These were successful industries, they paid a lot to the budget. Russia has the world's best tax administration system organized by Mikhail Mishustin. We can surely separate sub-accounts of each company, how much it contributed, and according to the amount of a sub-account provide a loan for three years, i.e. a loan that is to be refunded later. It is about loans, not subsidies. Subsidies are appropriate when enterprises do not work but they have to pay salaries, and according to the decision of the authorities it is necessary to go for a subsidy. However, for former successful industries there should be loans from their own paid taxes. Why is this important? It is unreasonable now to give in to false idea that the situation is extreme, as we will just divide money, those who need will take. In this case those who didn't pay taxes, can get support, and those who did, may not receive. It is necessary to establish a common understanding that paying taxes is not only a duty, but a right to receive certain services from the state.

In addition, we can soon face a crisis in managing housing and public utilities because citizens are allowed not to pay at once, not to pay the entire sum, etc. And in this case, we can soon drown not only in financial problems.

Does the state have to support operators of housing and utility services in these conditions? It is definitely necessary, but which ones and on what terms? In my opinion, this is the right moment for investing in upgrading old infrastructure by using developing digital assets, for example, where digital doubles can be applied to modernization. What is the meaning of these priorities? We are not solving the urgent issue of today, we are resolving the question of what path the development of the country will take, and whether it is possible to correct now the mistakes that have been made. In my opinion, now is the time for a large-scale tax reform and for new technological policy because the shock crisis has actualized certain issues. If in these circumstances the State decides on serious tax reforms, it will be able both to support the falling industries and inspire the growing ones to move into the future, for example digital sectors, which can boom.

In the crisis, a desire arises to return to the previous state. Well let's return to the quiet, as it now turned out, and prosperous 2019... The same desire appeared during the 2008-2009 crisis, but economists insisted that it is impossible to return to the previous model, it is necessary to decide on reforms. But it didn't happen, so the country lost growth rate after recovery period and didn't shift to a new investment model.

I believe that the crisis is a time for turning, that is why I hope for serious institutional reforms in two spheres. The first is taxation because this sphere is now strange indeed. Thanks to the efforts of Mikhail Mishustin, we have good tax administration, but a bad tax system that chokes the economy. It would be hardly reasonable to destroy our best tax administration in the world because the tax system is bad. What is wrong with it? The pressure of indirect taxes, poor management, the wrong practices when individual's income tax is paid

by his employer, or when the person lives in the Moscow region but his taxes go to city of Moscow, or he lives in the Leningrad region but his taxes go to the city of Saint Petersburg. Therefore, I believe that now it is time for tax reform aimed to lower the tax price of labour. Social taxes have a bad effect as they encourage use of cheap labour, they create an incentive in the economy to dig a ditch, not to make new software products. Therefore, there is a need for radical reduction of social taxes not only for small businesses but for the entire business because after all, qualitative changes and achievements in global competitiveness are based not on microbusiness. Although small businesses can contribute as well.

When an individual can manage his income tax he has the ability to put pressure on the municipality, move with his income tax, practice selective taxes, he has the ability to vote by his tax ruble paid as an income tax on where to be invested. We have developed this idea in the Center for Strategic Research when working on the “Strategy of Development of Russia for 2018-2024” (Auzan et al. 2017).

The second sphere is the law enforcement system reform. It is often said that business needs more freedom. What is business to be liberated from? From unreasonable inspections, from urgent payments, etc. And what are the highest non-productive costs for business? It is the pressure of the law enforcement bodies. There is a need to reform the law enforcement system. In the world, there are two schemes of how elites control the instruments of violence. The first scheme, when the elites share instruments of violence, is unsuccessful in the vast majority of countries. “The Navy is to you, the Air Force is to me, the Investigative Committee is to you, the Prosecutor’s office is to me”. There is a competition for economic areas by means of the super-tool of law enforcement structures. On the other hand, there are countries with collective control over law enforcement institutions. This second scheme of collegial control existed in the USSR. There was such a saying: “Until the Central Committee allows the KGB is powerless”. The Political Bureau of the Central Committee of the Communist Party fully controlled the security services. The Great Marshal of Victory Konstantin Zhukov was removed not that from the army but totally from public life in order that no single military person would control the Armed Forces. Yuri Andropov, when he was elected General Secretary, was fully blocked from the KGB which he headed before. And that’s the right scheme. Therefore, I believe that now it is necessary to reform the Security Council, to introduce an economic bloc there, to look at what costs the law enforcement bodies generate. Strange as it may seem, but it is an anti-crisis measure. Moreover, I believe that the law enforcement institutes themselves do not need this exhausting economic battle.

Therefore, urgent institutional steps in these two spheres are of crucial importance. First, revision of tax system as it was wrongly constructed in the early 1990s, and second, reform of law enforcement institutions.

There is one more important issue. Does the State now have a credit of trust? Is the State wasting the credit of trust now by applying emergency measures that may not be popular among citizens? Or vice versa, these difficult times call for stronger state, not only in Russia, but throughout the world, people will rally around the State and trust in the state institutions will grow?

Debate on the topic of trust in State institutions was initiated by the Federation Council, but didn’t take place due to these very emergency measures.

In the last decade, trust in State institutions has been fading worldwide, i.e. the institutions of all countries faced the current crisis in conditions of rather low trust. What happens next? Well, that depends on what the authorities can do. The society gives a certain credit of trust to the authorities when people die and urgent responses are needed. Even critical, opposi-

tion-minded citizens tend to demand the introduction of the state of emergency in order to provide juridical clearness of how everything is going on, to shape clear reasons for compensations, to settle a force majeure situation for business contracts. Now, the authorities around the world have been given some credit of trust, although the other day the trust was low. If we talk about Russia, a fairly high level of trust in certain State institutions has not been kept after the spring of 2018, and there is a crisis of trust in Russia, like in some other countries.

Now, trust issued to the authorities is being tested. The Governments that will fail to cope with the pandemic, will exacerbate the crisis of trust. The Governments that will succeed in anti-pandemic measures, will restore trust in the institutions of executive and legislative power.

Why is the 2020 crisis unique? There are very important benchmarks for the future. We are hardly able to predict the industry structure in 2021 or asset prices because this crisis has plunged us into a situation of structural rather than parametric uncertainty. However, there are two important features which give rise to hope that shifts in the world economy depend on us to a certain extent.

Firstly, we are all forcedly digitalized. A significant part of the population and governments have entered the digital world not due to the presence of some special programs of digitalization, but by need. This carries new opportunities and new threats because the government is now quite ready to conduct digital identification of citizens, but this is a way to the totalitarian control. However, people can now transcend closed borders through virtual communication. Networking that exists now hardly ever existed before.

Secondly, perhaps for the first time there is a combination of both – cumulative and shock – schemes of institutional change. That's why I think that large-scale changes are on the way. Billions of people around the world in conditions of self-isolation and lockdown stay at home day after day, week after week and think, talk, correspondence, read, discuss, argue! About what? About themselves, the country, the world. I think in the nearest future we will face revolutions in tastes and preferences, which will generate unexpected new formats over the world. I don't want to say that the new world will be definitely better, I don't know in what it will be good and in what it will be bad. But I can imagine some schemes, for example firms without people or global networks, when people work in different countries through the global network, firms where there is an owner and no management, all while having staff – all this is possible. But the principle thing that I know about this future world, that it will be different. What it will be like, it depends on the results of our discussions and decisions in the course of this forced in-depth study of ourselves and the world.

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