Paying for Covid: what should policymakers do next?

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1. Agenda

- The economics of a pandemic
- ‘Omicronics’
- How do we pay for all this?
- What does this mean for monetary policy?

- Q&A

2. Market 'failures' that justify state intervention

- Protection from a deadly virus is a 'public good': total benefits, including social benefits, are larger than private firms can charge for
- Spreading a virus is a negative 'externality': little incentive to avoid putting strangers at risk
- Almost impossible to get private insurance against a national lockdown
- Large transactions costs involved in closing and restarting businesses, or firing and then rehiring

3. Should we put a price on a human life?

- Health economists often put a monetary value on people's lives based on the number of years they have left, and the quality of that life ('QALYs'). This is simply about using limited resources in the fairest way.

1. Suppose it would cost £1 *billion* to prevent just *one* premature death. Would this be worth it?

2. Imagine you are allocating the last seat on a lifeboat as the Titanic sinks, and have a choice between rescuing a healthy child or a sickly old man. Whom would you save, and why?

4. “Health vs. economy”

- There is some trade-off between preventing premature deaths and protecting the economy
- But if the virus is not controlled, people might choose to stay at home, and the economy would be hit anyway
- You cannot judge the value of lockdowns (as many do) by looking only at the number of deaths *while Covid restrictions are in place*. What’s the counter-factual?
- Locking down harder and sooner may increase the hit in the short term, but reduce it in the long term

5. Benefits of lockdowns

Most visible:

- the reduction in illnesses and deaths from Covid itself

But also

- The prevention of other deaths and harms (to young and old) if the NHS is overwhelmed with Covid patients
- Reduction in other communicable diseases, e.g. flu
- Fewer deaths from traffic accidents, pollution, and so on
- A stronger economic recovery in the longer term from getting on top of Covid more quickly

6. Costs of lockdowns

Most visible:

- The collapse in economic activity, including business closures, job losses and lost income
- The impact on the public finances

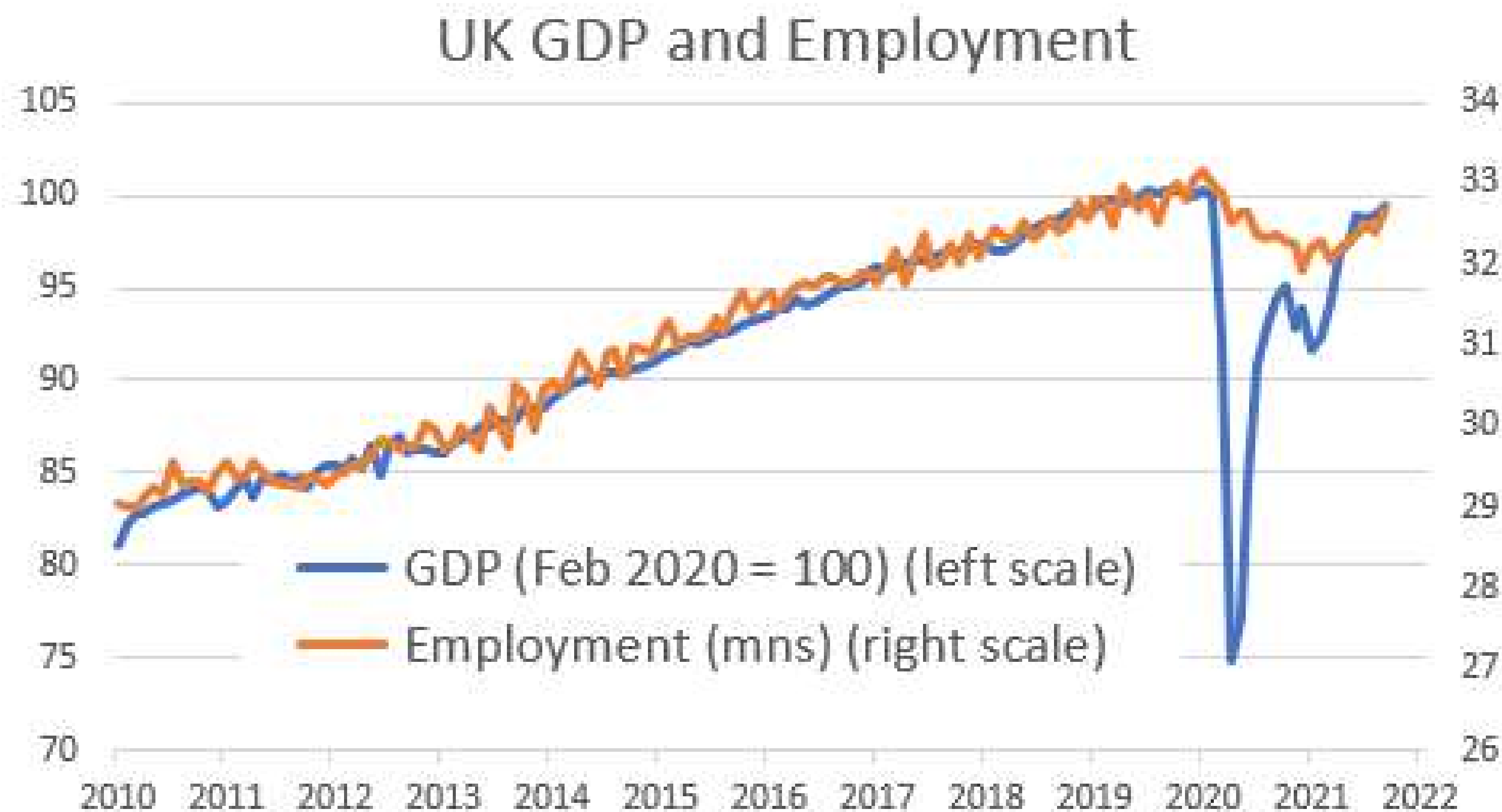
But also:

- Harms done to people with other conditions (e.g. cancer patients) not receiving the care they need
- Costs to mental health and wellbeing
- Harm to education and job opportunities
- Damage to civil liberties and confidence in government

7. Why this recession has been different

- The slump in GDP was inevitable and even *desirable*: we actually wanted people to stop doing what they would normally be doing, in order to save the lives of others
- Rather than stimulating growth, economic policy has focused on shielding the economy - while it is put in a state of temporary hibernation
- As long as the majority of businesses, jobs and incomes can be protected, normal economic activity should resume relatively quickly when the Covid threat fades…

8. …and that's pretty much what's happened



9. Long-term economic impact

- OBR has assumed that Covid will reduce the long-run productive potential of the UK economy by 2% (aka ‘economic scarring’)

- This is based on (pessimistic?) assumptions about:

1. labour supply (e.g. lower participation rates)

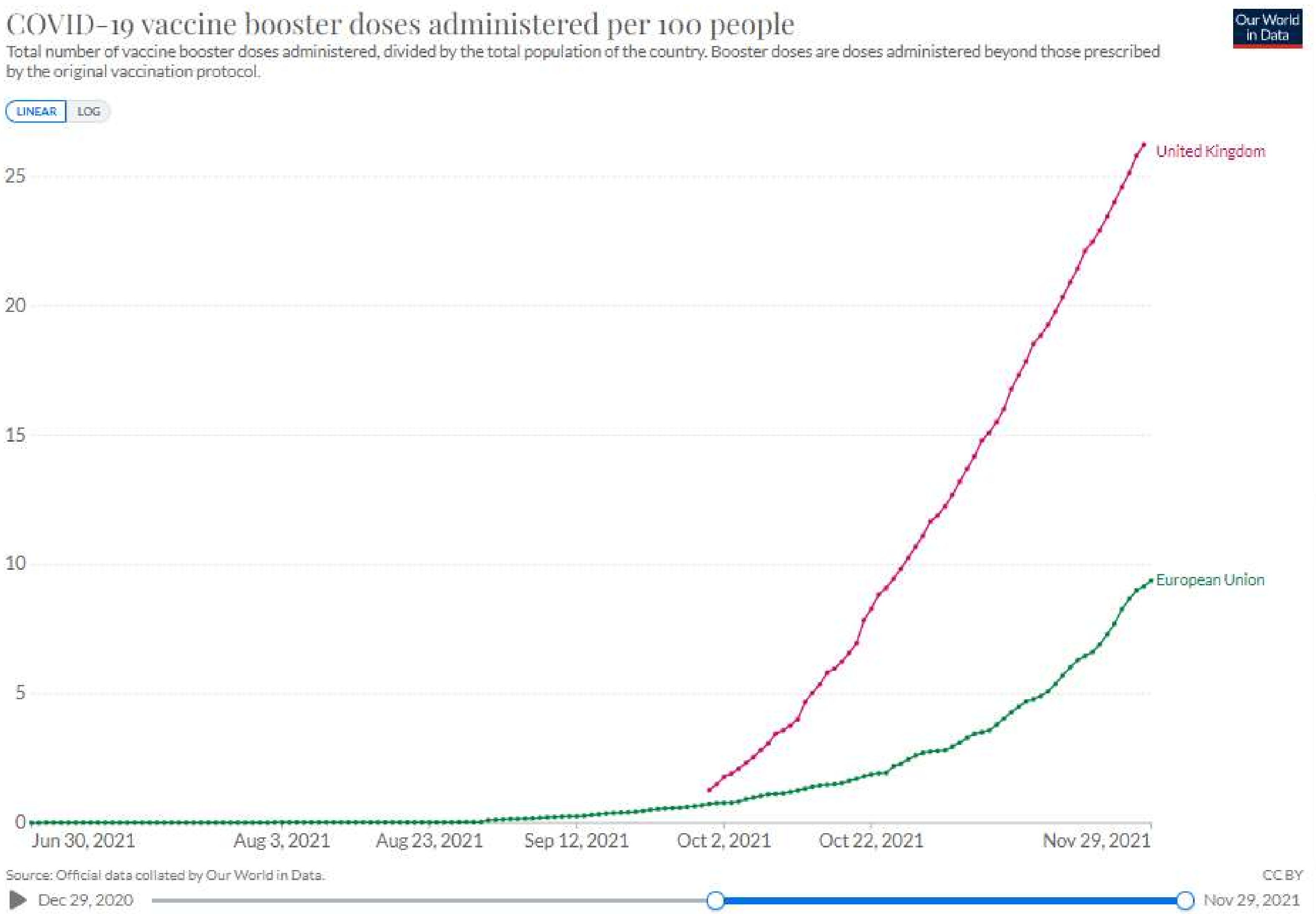
2. capital stock (lower investment, earlier write-offs)

3. total factor productivity (most debatable?)

10. 'Omicronomics'

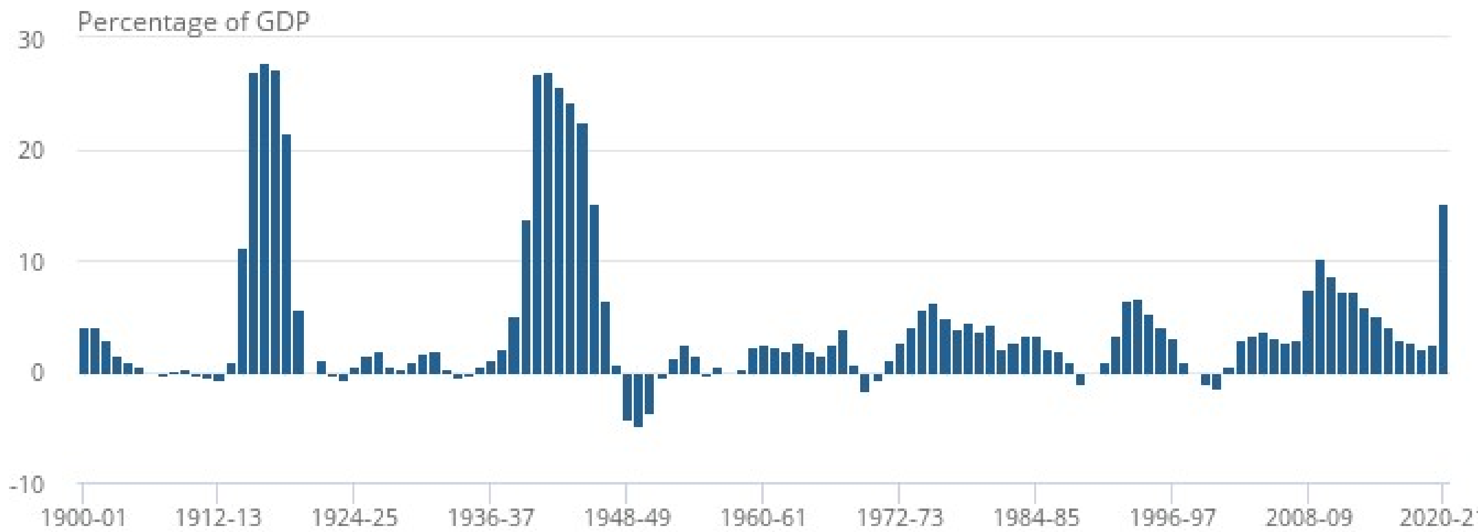
- Main short-term risks:
  1. another 'pingdemic' (shock to supply)
  2. voluntary changes in consumer behaviour (demand)
- Best things the UK government have done are:
  1. reopen the economy in the summer
  2. accelerate the vaccine booster programme…
- This has given the UK population a relatively high degree of (herd) immunity

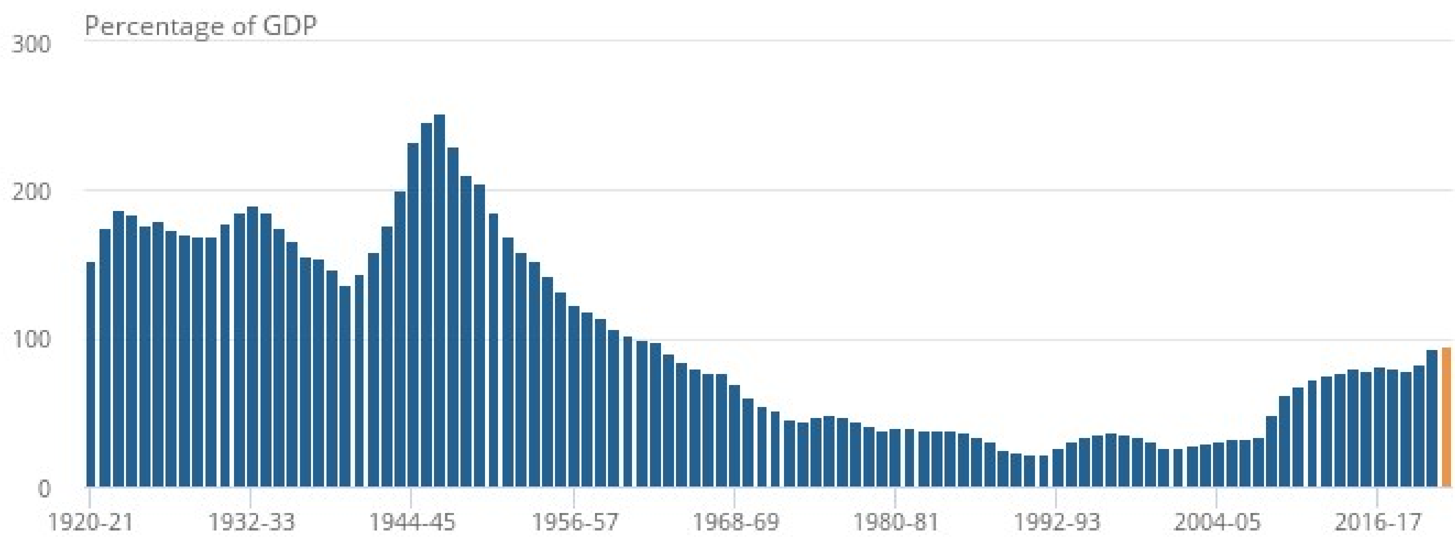
11. ‘Plan A’



COVID-19 vaccine booster doses administered per 100 people
Total number of vaccine booster doses administered, divided by the total population of the country. Booster doses are doses administered beyond those prescribed by the original vaccination protocol.
Our World in Data
LINEAR
LOG
United Kingdom
European Union
25
20
15
10
5
0
Jun 30, 2021
Aug 3, 2021
Aug 23, 2021
Sep 12, 2021
Oct 2, 2021
Oct 22, 2021
Nov 29, 2021
Source: Official data collated by Our World in Data.
CC BY
Dec 29, 2020
Nov 29, 2021

12. UK Public Sector Borrowing and Debt

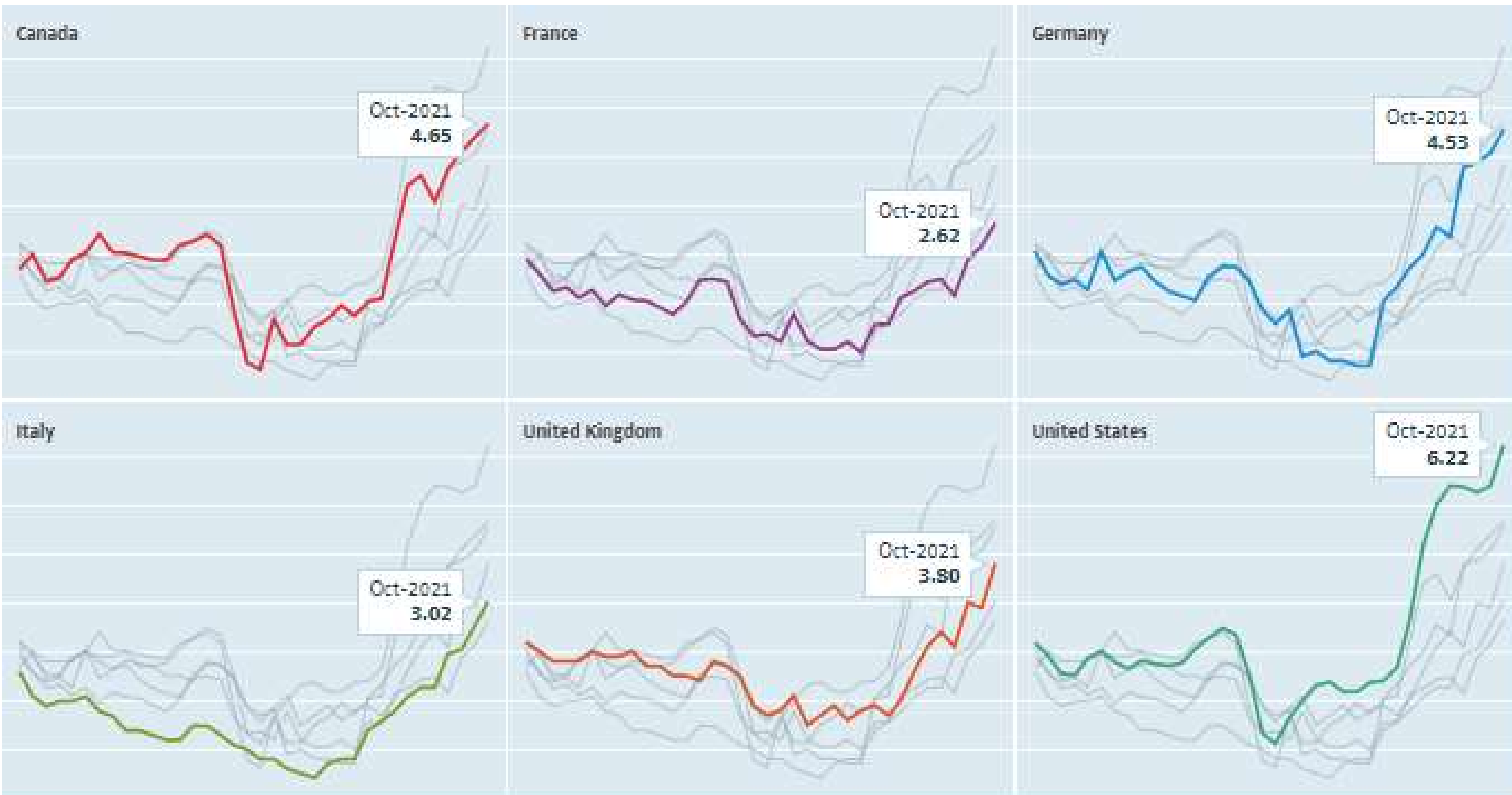




13. How will we pay for all this?

- There is no need to pay back debt: as long as the gov't can meet the interest payments, it can simply be rolled over
- The absolute size of the debt (£bns) matters much less than the size of debt relative to the size of the economy (% GDP)
- It helps when interest rates are lower than the growth rate of the economy (nominal GDP), and when a lot of the debt is held by the central bank
- There is no rush: the economic and fiscal outlook is still too uncertain, demand for government bonds is high, and tax rises (or spending cuts) could just slow the recovery
- Let growth (and inflation) reduce the debt burden instead

14. CPI Inflation (%, OECD measure)



15. Should we worry about 'stagflation'?

- 'Persistent high inflation combined with high unemployment and stagnant demand'

X Even at 5%, UK inflation would be much lower than in the 70s (more than 20%)

X Some good reasons to believe this jump in inflation will be temporary

X Caused by lack of supply, not weak demand

X Unemployment low, not high

16. But there are still risks

- Hardly any discussion of the monetary causes of inflation: too much cheap money chasing too few goods and services
- The ‘transitory’ prices pressures have been larger and longer-lasting than expected, and spreading
- ‘Wood for the trees’: if you strip out whichever prices happen to be rising the most, ‘underlying’ inflation will always appear to be low

17. What policy-makers should do about inflation

- Governments need to allow markets and price signals to do their job, e.g. end furlough to ease labour shortages, and don't cap energy prices!
- Ease burden on low-income households
- Not much that central banks can do in the short term, but can help to prevent a temporary increase in inflation from becoming permanent…

18. Issues for the Bank of England

- MPC has a narrower inflation mandate than the Fed, and the recovery in the UK economy has more momentum than in the euro area
- Current QE programme set to end shortly anyway
- Keeping inflation down over the longer term matters far more than the immediate impact of a small hike on borrowing or saving rates
- What is the MPC waiting for?

19. Some conclusions

- The furlough scheme was a great success, but it was right to end it
- There is no rush to tighten fiscal policy, but monetary policy is too loose
- Context and credibility are crucial in assessing impact of central bank decisions
- The other big debate is whether the state should shrink back again, or take a much bigger role in future too