EDITORIAL

SUPPLY-SIDE POLICY FOR A POST-COVID-19 WORLD

The Covid-19 pandemic will have profound longer-term consequences. Certain industries will benefit, directly or indirectly, whereas others will suffer. The idea of thriving industries full of new opportunities and others struggling to survive reminds us of Schumpeter's creative destruction. Such a process can entail huge costs in the short run. Research shows the key role played by active labour market programmes. More broadly, economic policy not only needs to focus on the demand side but also, and increasingly, on the supply side so as to avoid that the pandemic acts as a lasting drag on growth.

The analysis of the economic consequences of the Covid-19 pandemic has hitherto predominantly focused on the near term. This is understandable. First, there was the severe decline in activity in March-April related to lockdown. As restrictions were progressively lifted in May-June, activity rebounded. From July onwards, the recovery has been losing momentum partly as distancing rules have remained in place due to the presence of the virus and more recently the tightening of restrictions in many countries to stop the exponential increase in new infections.

However, there will also be profound longer-term consequences, such as higher debt burdens for governments and many companies and the risk that many people who have lost their jobs or are in furlough schemes will remain unemployed for a considerable time. The supply side of the economy will undergo change as value chains are modified to increase their resilience to shocks. The demand side will change as well. Certain changes to spending habits during lockdown –such as increased use of e-commerce- may become permanent, the demand for office space will evolve as well as more people work from home, even in a post-pandemic world, etc. The long-term growth outlook of certain industries may look very different today compared to one year ago. In addition, in order to reach the climate objectives of the Paris agreement, many countries aim at reaching carbon neutrality by 2050.

The pressure on many businesses is expected to remain high. *"Historically, there is a lag between declining GDP growth and rising bankruptcies and unemployment, which tend to peak a year after the initial shock and remain high for another two years."* [1] Moody's has calculated that, by February next year, the trailing 12-month global speculative-grade corporate default rate could reach a range of 9.7%-13.3% if a similar path were to be followed as in previous cycles[2]. This creates a challenge for governments on how to allocate scarce budgetary resources. This point was emphasized recently by the UK Chancellor of the Exchequer, Rishi Sunak when presenting his Winter Economy Plan to Parliament: *"We need to create new opportunities and allow the economy to move forward and that means supporting people to be in viable jobs which provide genuine security. As I've said throughout this crisis, I cannot save every business. I cannot save every job."*[3]

The idea of thriving industries full of new opportunities and others struggling to survive reminds us of Schumpeter's creative destruction. *"Creative destruction refers to the incessant product and process innovation mechanism by which new production units replace outdated ones."*[4] Such a process can entail huge costs in the short run, with people losing their jobs and the destruction of corporate value. This could lead to a defensive policy reaction. In particular, governments that face elections could be tempted to prolong the special programmes that were put in place during the lockdown for an extended period in order to preserve jobs and businesses. In many countries, insolvencies are currently well below the level registered a year ago. However,

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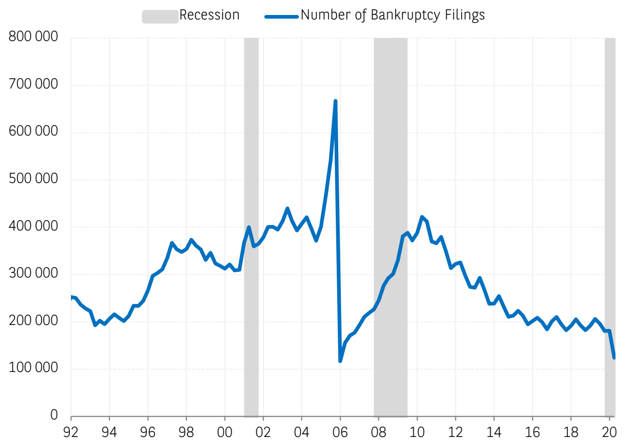

SOURCE: CIEC, BNP PARIBAS

1. Source: The Great Reallocation, Op-ed from Mr Agustín Carstens, General Manager of the BIS, for Project Syndicate, published 12 October 2020. According to the BIS, "bankruptcies among advanced-economy firms could rise by more than 20% *(from the 2019 baseline) next year."*
2. Source: www.moodys.com. The equivalent numbers were 3.6% in March and 6.1% in July this year.
3. Source: Winter Economy Plan speech as delivered by Chancellor Rishi Sunak, Published 24 September 2020, www.gov.uk.
4. Source: R. Caballero, economics.MIT.edu.

> In the longer run, the Covid-19 pandemic will entail structural change in many industries. Economic policy will increasingly need to focus on the supply side so as to avoid that the health crisis acts as a lasting drag on growth.

research shows that job security provisions slow down the adjustment process of the economy, lowers productivity growth and hence GDP growth.[5] This calls for a policy which, at a minimum, does not hamper structural adjustment but also finds ways to help those suffering from job displacement due to economic transformation.

The OECD has analysed this for 13 European countries over 1986-2008 and concluded that *"the probability that workers who lose their job due to plant closure find a job within the next year is positively related to spending on active labour market programmes."*[6] Such programmes include spending on job-search assistance, training, public sector job creation and subsidised employment in the private sector.[7] These policy questions are very much relevant at the current juncture. In the near term, Covid-19 is expected to cause a further increase in European unemployment and insolvencies. In the longer run, it will entail structural change in many industries with ensuing pressure on certain parts of the labour market. This means that economic policy will not only need to focus on the demand side but also, and increasingly, on the supply side so as to avoid that the pandemic acts as a lasting drag on growth.

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5. Quoting Caballero, "By impairing worker movements from less to more productive units, effective labour protection reduces aggregate output and slows down economic growth. We estimated that moving from the 20th to the 80th percentile of job security lowers annual productivity growth by as much as 1.7 per cent."
6. Source: OECD, *Coping with creative destruction: reducing the costs of firm exit*, Economics department working papers No. 1353, 2016.
7. Passive policies include spending on unemployment insurance and related welfare benefits (source: OECD).