

GDP: has it misguided the unconventional policy response to COVID-19?

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Purpose of presentation

Three issues

GDP is the sum of all spending in an economy.

Q1: Is it appropriate to define the economy (or even the business cycle) in terms of GDP?

Policymakers have attempted to “freeze” much of the economy so that once the virus has passed the economy can “thaw” and GDP can continue along its long run growth path.

Q2: Have policymakers successfully “put the economy on ice”?

Q3: Does this policy response reflect GDP bias by protecting pre-COVID market relationships?

Presentation Roadmap

How can GDP misguide policymaking?

The financial crisis comes back to haunt

The primacy of public health in response to COVID-19

Protecting the GDP future growth path from the public health policy response

Post-GDP alternative policy responses

GDP as a measure of Downturn and Recovery

Impact of COVID-19 on Overall GDP



ECONOMIC IMPACT OF COVID-19

Massive collapse in output – reflecting changes in both supply and demand. What changes are likely to be permanent?

Lockdown measures have been lifted and replaced with less stringent social distancing guidelines – allowing businesses to restart trading and furloughed workers return to work. **Recent increase in cases risks a second lockdown – increasing uncertainty.**

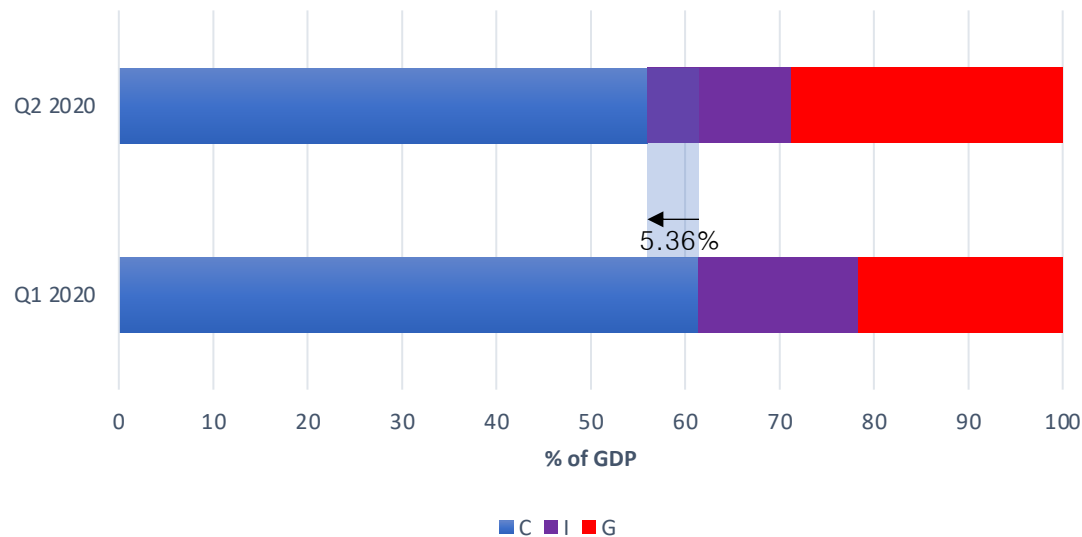
Governments should look to stymie hysteresis (economic "scarring") from pauses in children's education, loss of organizational capital, etc.

On the one hand, the fall in GDP reflects pauses to business as a result of government lockdown rather than private malinvestment. But, many 'zombie' firms were already close to insolvency.

GDP: the Statistic in more detail

Inside headline figure

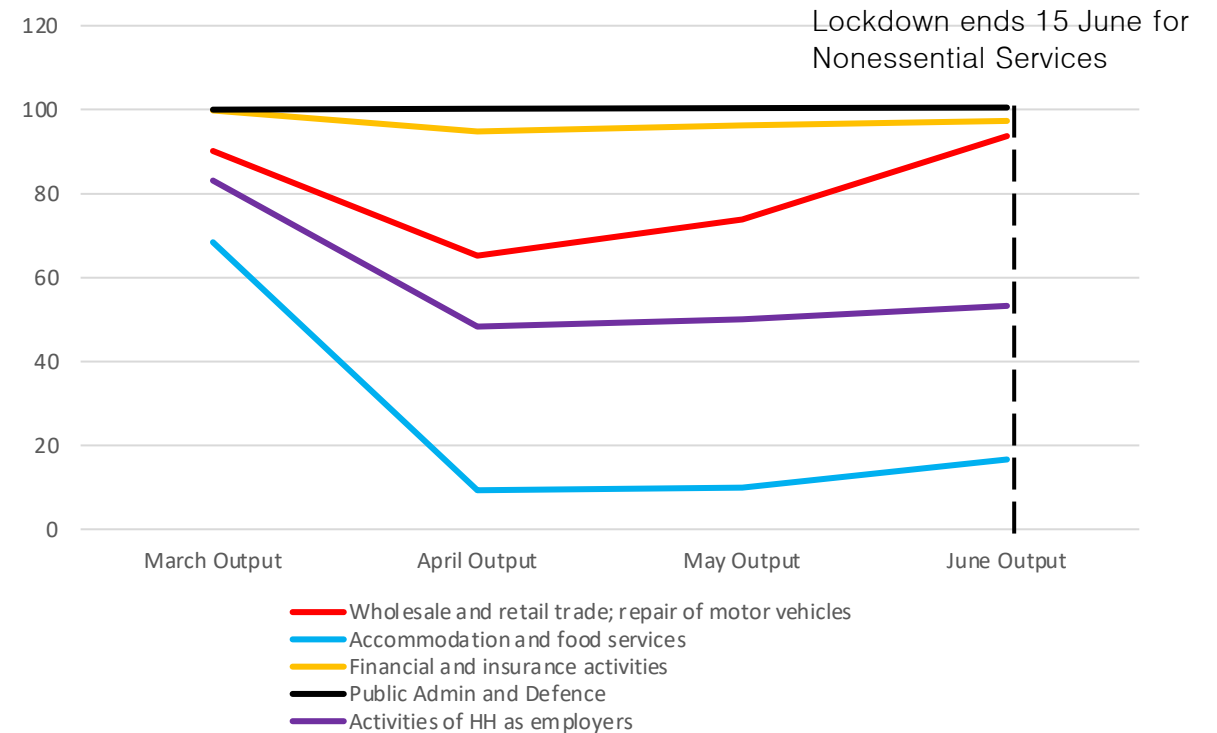
Private consumption is the largest expenditure component of UK GDP



The share of consumption in overall expenditure fell from 61% to 56% between Q1 and Q2 2020.

Source: theglobaleconomy.com

% Change in Output by Sector from February



Sectors disproportionately affected by lockdown and social distancing measures (i.e. accommodation and food services) have seen the largest decline in output since February.

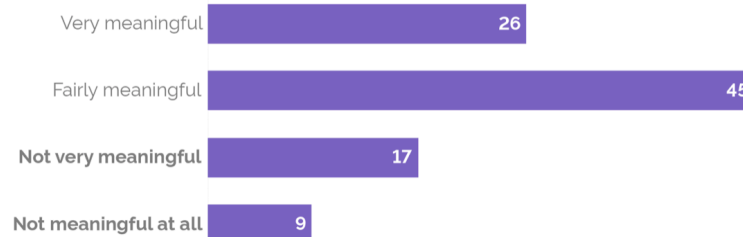
Source: OBR

GDP: the Statistic in more detail

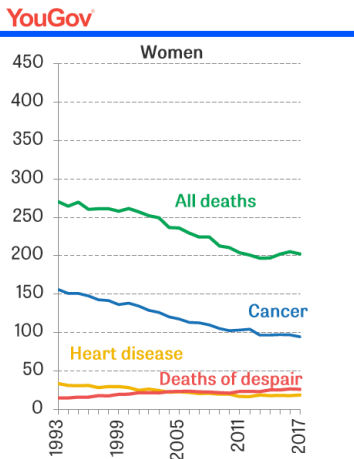
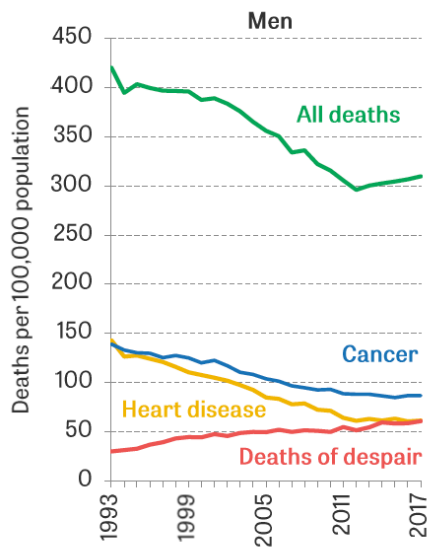
Beyond headline figure

A quarter of British workers don't find their job meaningful

In general, to what extent would you say you find your job meaningful? (% of 1,150 workers)

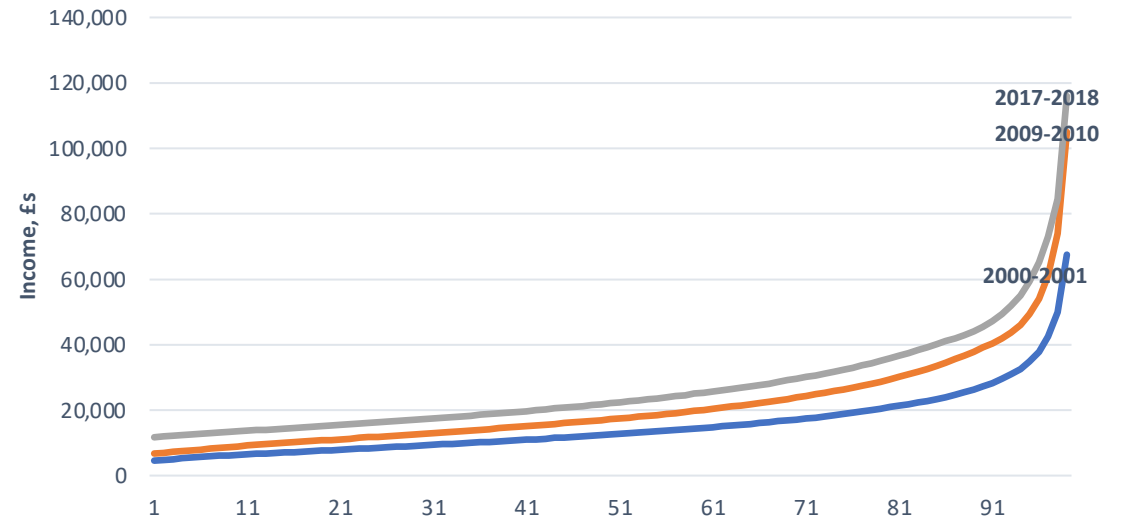


22-23 Jan 2020



Middle-age mortality (45–54) in England, 1993–2017

UK Individuals' Share of Income After Tax by Percentile



There were 29 deaths per 100,000 people in England and Wales in 2018 from “deaths of despair; these are suicide (10.5), drug poisoning (7.6), and alcohol abuse (11).

Most of the rise in GDP has gone to the upper half of the income distribution. Income is weighted most heavily towards the wealthiest 10 per cent of individuals.

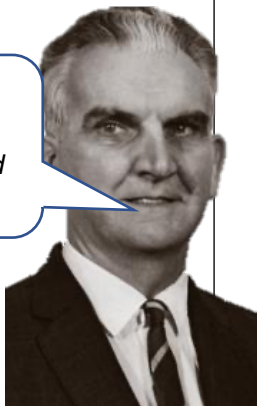
Capital Depletion: How is Output Produced?

A Balance Sheet for the Economy

Natural Endowment	Efficiency	What We Gain	What We Lose
Extraction (Land)	Capital Innovation	Intermediary and final goods	Waste, Pollution, Intertemporal trade-offs in consumption
Workers (Labour)	Education and training, capital equipment	Produce final goods and services (left idle)	Work is unpleasant, and a quarter "lack meaning"
Capital	Innovation, economies of scale	More output with less effort / resources, new ways to satisfy wants	Asset depreciation, lumpiness of large capex and "stranded assets"

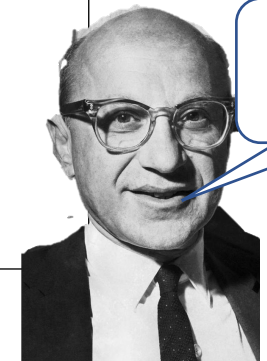
The GDP accounting methodology does not distinguish between gains and losses

The earth is a single spaceship, without unlimited resources



K.E. Boulding

How much (usable) oil was there before 1800?



M. Friedman

Presentation Roadmap

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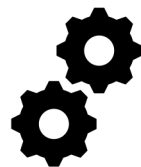
Post-GDP alternative policy responses

Legacy of the financial crisis

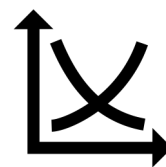
Unintended consequences of the policy response to the financial crisis



CB intervention to do “whatever it takes”



Financial engineering more profitable than investment in the real economy



Low growth (/low equilibrium interest rates)



High returns for holders of equity and homeowners.

How many “zombie” corporations have managed to survive purely due the forgiving environment created by central banks?

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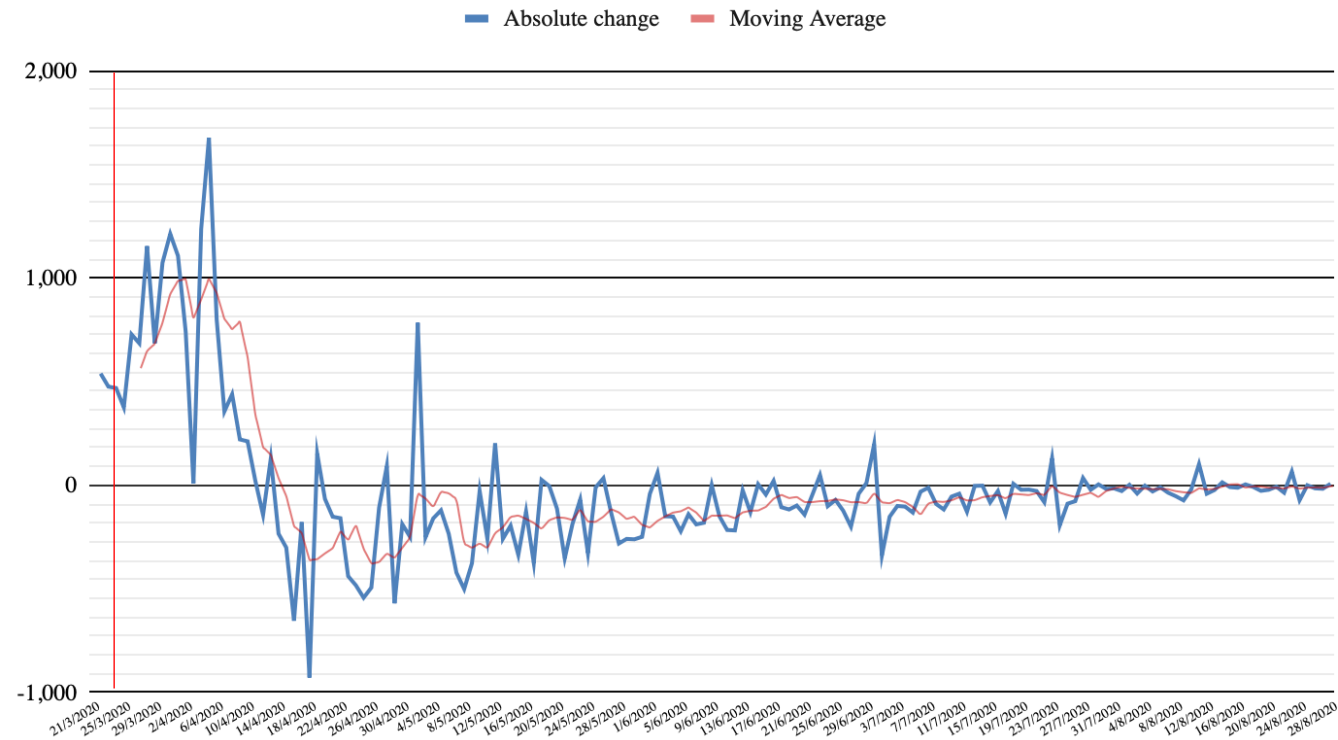
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Policy Response in the post-GDP economy

Primary Response: Lockdown

Daily Change in Admission to Hospitals in England



The policy choice to lockdown the economy was clearly a public health issue and shows a willingness to look beyond short run GDP as the primary component of welfare. Coming out of lockdown, restrictions have been lifted on business interactions fastest whilst meet ups between multiple households is still banned.

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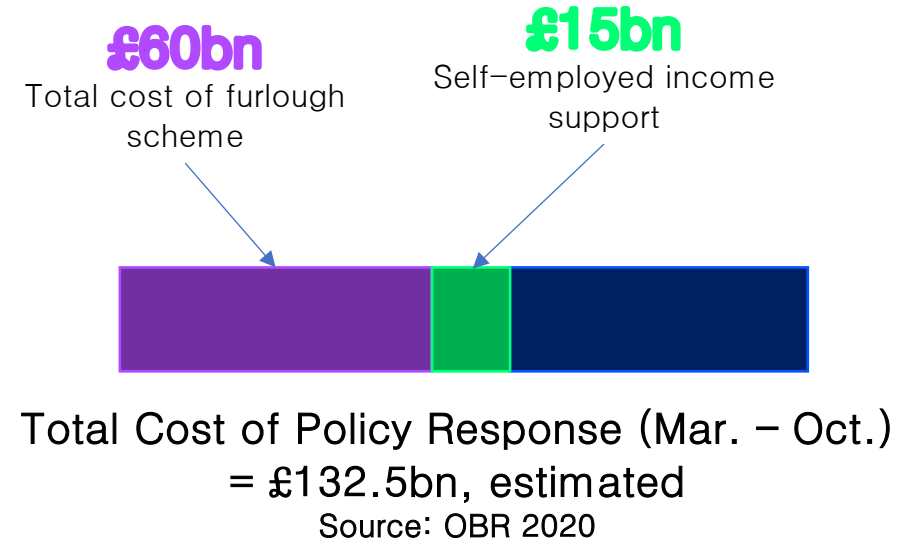
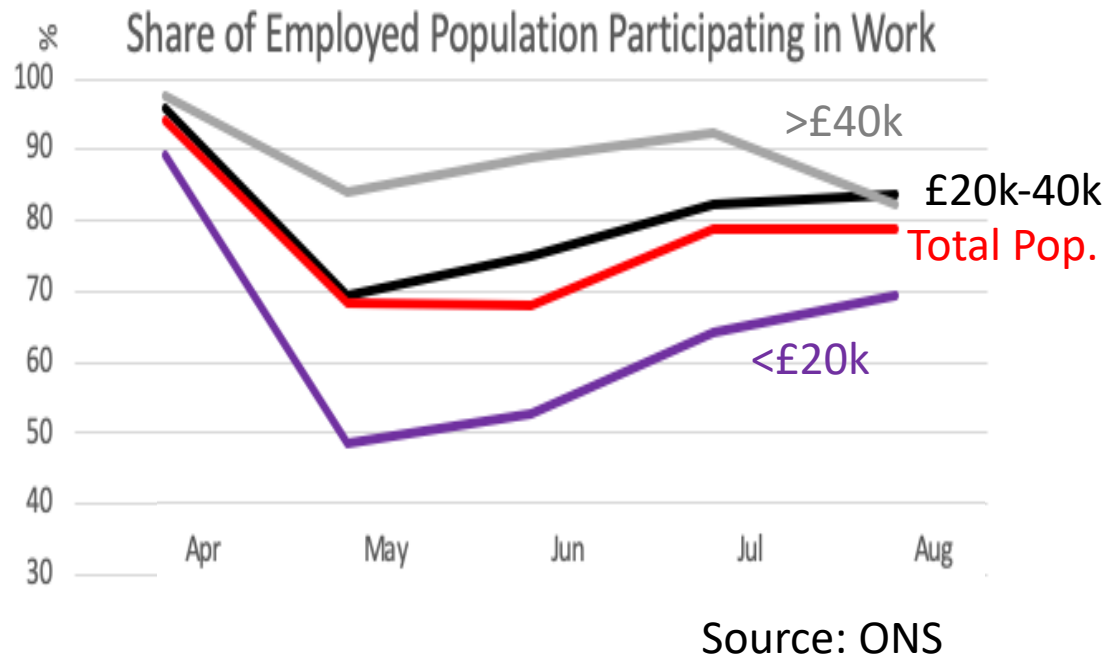
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GDP in the Policy Process: Mitigation of COVID-19

Income Replacement – the govt is prepared to spend massive amounts of money



Furlough replaces 80% of the monthly income of those earning £30k p.a. and below.

GDP in the Policy Process: Mitigation of COVID–19

Business loans

	“Bounce back” loan scheme	Business Interruption Loan Scheme	Future Fund scheme
Details	Allows small companies to borrow up to £50k with only light checks on ability to repay.	Offers loans up to £5m. [The coronavirus large business interruption scheme (CLBILS) — which part guarantees loans (80%) of up to £200m.]	Provides government debt that can convert into equity stakes.
Justification	Tension between SR and LR: the virus and its associated restrictions impose short–run costs on businesses that do not affect their long–term viability.		
Equity issues	Up to 40 per cent could default (FT/OBR 2020).	Moral hazard: banks may worry less about the consequences of their lending.	Conflicts with interests with some religious groups, etc.

A lesson from the financial crisis: these loans are an attempt to fix the lending channel for SMEs who lack access to capital markets.

GDP in the Policy Process: Economic Recovery from COVID-19

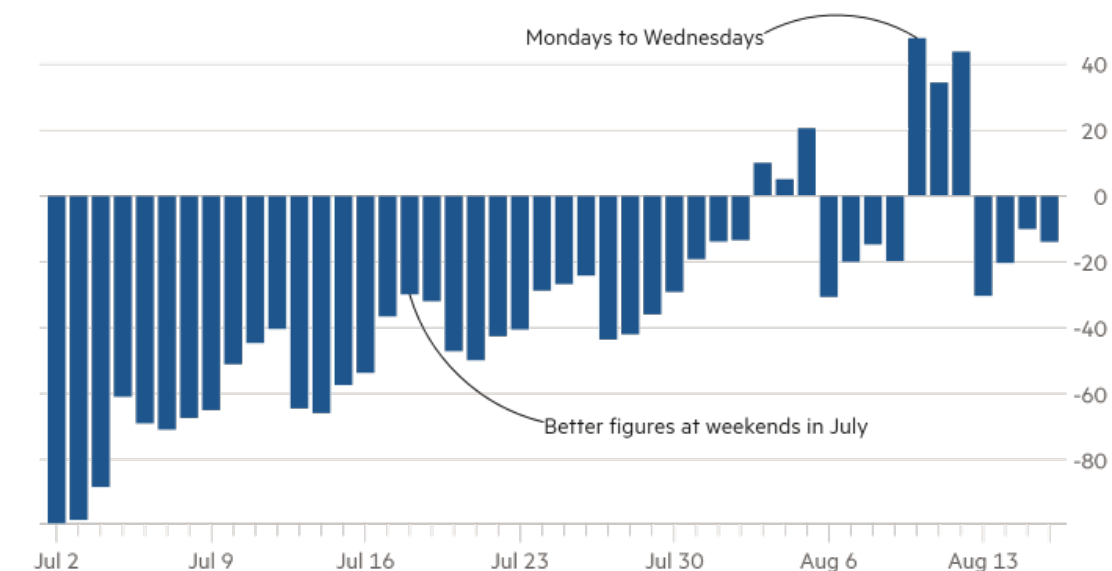
Eat Out to Help Out

Average weekly UK household expenditure on restaurant and cafe meals in 2019



Restaurant bookings surge on 'eat out to help out' days in August

Annual change (%)



Source: OpenTable
© FT

Households in the bottom half of the income distribution spend half as much eating out as those in the top half of the distribution*.

*Excluding tails of the distribution

Source: ONS

The scheme, costing £0.5bn, incentivized eating at restaurants Mond.–Wed. during August. Restaurants also benefited from a VAT cut set to cost £2.5bn.

Source: Financial Times

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Post-GDP Policies

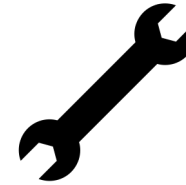
Non-GDP centric responses to COVID-19



Provide Universal Basic Income
(vs targeted intervention)



Price market failures



Fix lending channels



Refocus restrictions away from
personal life

Governments should be willing to bear more of the financial costs of their policies. They should also act to increase certainty by offering “fiscal forward guidance”.

Conclusion and Q&A

It's all in the assumptions!

The appropriate economic policy response to COVID-19 really depends on what you are doing with public health policy.

Given the health policy response, the government should have an answer to the following questions:

- **Preservation.** Are you sure that the economic structure you are trying to protect is efficient and fair?
- **Solvency.** Similarly, how can you be sure that the market would continue this pattern if not for the lockdown? What real changes need to occur as Brexit approaches?
- **Structural change.** What supply and demand changes – both short and long term – have occurred as a result of the virus, mortally affecting pre-COVID business plans?
- **Focus.** Is it right to focus restrictions on interactions which take place outside of the market?
- **Cost.** Are you considering the true opportunity cost of your policy? What are its unintended consequences?