



Nobel Perspectives: On a post COVID-19 world

Professor Eric Maskin

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Professor Eric Maskin won the Nobel Prize in Economics Sciences in 2007 for laying the foundations of mechanism design theory. Maskin is the Adams University Professor and Professor of Economics and Mathematics at Harvard University. He is an expert in the field of microeconomics and has made contributions to game theory, contract theory, social choice theory and other areas of economics. He joined Evan Brown, Head of Multi-Asset Strategy in the Investment Solutions team at UBS Asset Management, in a webinar to discuss the implications of the COVID-19 pandemic on vaccine rollout, inequality, climate change and the broader global economy.

Key webinar takeaways

- Fiscal stimulus is essential for rebuilding the economy but it would be most effective if deployed after lockdown restrictions have been lifted
- Mechanism design is a powerful tool for creating a market where a shortage of products exist
- The key to reducing income inequality caused by the digital acceleration is to improve education and retrain less-skilled workers
- We can learn from the past where international coordination solved environmental and social issues
- To address climate change we need to design an international treaty where countries are required to reduce carbon emissions with the imposition of penalties and sanctions
- We are now in a better position to prevent a financial crisis because regulatory frameworks have limited bank leverage

The world in the grasp of COVID-19

Professor Maskin, you are recognized for your work in the field of economic theories such as 'mechanism design' – how to design a system or mechanism to achieve an economic or social objective. What role can mechanism design play when a government faces uncertainty such as the ongoing fight against COVID-19?

Mechanism design works well where markets do not function efficiently on their own. Suppliers may be reluctant to come to market where the price of goods is unknown. It allows governments to find out the costs of new goods such as PPE, testing equipment or vaccines where markets do not already exist. Governments then use the information to quickly create a market with known prices to encourage the number of suppliers participating in the market.

Mechanism design is a powerful tool for creating markets where a shortage of products exist such as virus testing equipment or vaccines

Expanding on that, how would you approach the problem of vaccine choice? In other words, the world is better if everyone gets vaccinated, but individuals may want to hold out for the most effective vaccines—how should we approach that?

“Mechanism design is a powerful tool for creating markets where a shortage of products exist such as virus testing equipment or vaccines.”

Professor Eric Maskin, Nobel Laureate

First, we would need to establish the amount of people who need a vaccine from the vaccines available. Then we could provide a financial incentive to encourage people to have the vaccine they may not have originally chosen or offer a family member the vaccine at the same time. Mechanism design uses incentives to reward citizens to make choices which benefit the broader society and not necessarily just themselves.

We are also busy combatting the economic effects of the virus and there is a lot of debate out there on the appropriate size and composition of President Biden's upcoming stimulus package. How can we use mechanism design theory to achieve the desired outcome from an economic perspective?

There is no doubt that stimulus is essential to not only provide financial relief to those in need, but also to stimulate the economy. In order to avoid low output for a long time, we need to stimulate consumer demand which leads producers to hire more employees and moves the economy closer to full employment. This crisis is different from the Global Financial Crisis (GFC) of 2008/9. Lockdown or partial lockdown is preventing consumers from purchasing goods and services such as travel and leisure. Stimulus needs to be deployed gradually over time, when restrictions have been relaxed to encourage more spending and move employment back to full capacity.

There is widespread concern over the large deficits and huge amounts of government spending that took place since the crisis started. What is your view on paying back the public debt?

When we are in a recession, it is perfectly appropriate to spend more in order to stimulate the economy. During the recovery phase, raise tax revenues in order to pay the debt back.

The pandemic has exacerbated social inequality across education, health and income segments, among others. In your opinion, which areas of society will look very different in the post vaccine world?

The pandemic has accelerated the inequality challenge. Huge advances in technology have changed the way producers operate by improving efficiency with automation and computer assisted production. While highly skilled workers' income has increased, those less skilled have seen incomes decline or have been displaced by technology. The key to reducing income inequality is to improve education and retrain workers to prepare them for a modern workforce. Governments could provide subsidies and tools to help workers find jobs.

The key themes of the century

Current policies suggest average temperatures will increase 3°C by the end of the century. What has to be done to limit this to only a 2°C warming of the planet? What else needs to be done by governments to reach this goal?

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Professor Erik Maskin, Nobel Laureate

Climate change is another issue that markets cannot solve on their own. Economists are in favor of a carbon tax because not only will it help to reduce carbon emissions but it will also incentivize companies to produce alternative energy sources with lower costs. Further, we need to design an international treaty where countries are required to reduce carbon emissions with the imposition of penalties and sanctions.

In the past, an international treaty successfully solved the depletion of the ozone layer but we need the political support to act now on climate change.

And are you optimistic that governments will act to solve huge social challenges such as global warming? Or does political short-termism hinder any real long term progress that can be made?

I am optimistic because of the success of forward-looking programs which were implemented in the past. After World War II, The US government enacted the Marshall Plan which was an enormous economic aid program to help rebuild Europe, which in the long run resulted in greater productivity as well as a stronger United States.

Another long-term investment initiative run by the US government that was very effective was the G.I. Bill: soldiers returning from war could receive a free university education. This had a huge effect on the diversity of workers entering the US labor force and helped to reduce exclusion of some segments of the workforce into certain professions. Leaders need to support long-term investment in education, climate change and infrastructure.

The ESG wave in finance is not just a function of regulation, but investor interest in achieving sustainable goals. Is it possible that the cumulative individual desire is enough to make a real impact, making regulation less necessary?

Relying on private initiatives is not enough to solve the climate change challenge. Public intervention is necessary for companies to feel encouraged by the fact that every other company is contributing to solve the issue too.

Audience Q&A

What is the fix for developed markets hoarding vaccines and emerging countries not getting the supply they need, when vaccinating everyone would clearly benefit the entire world?

An international body could coordinate a program to address this. In the past, a modified version of the pneumococcal vaccine produced in Europe and the US was needed for a new strain of the infection present in African countries. Pharmaceutical companies did not view the production as profitable. The World Bank initiated a consortium of donor countries who subsidized the production of a pneumococcal vaccine by the pharmaceutical companies. Companies received a bonus when supplying the vaccine to underserved countries. We could apply this incentive to help countries tackle COVID-19 that would otherwise be underserved.

Many market risk indicators appear as extreme now as they did in the 2008/9 GFC. Is additional regulation required?

We are now in a better position than previously to prevent a financial crisis because the regulatory system has improved, due to tightening of the US Dodd-Frank Act and European Basal regulatory frameworks around how much banks can leverage or lend.

On the Paris Agreement you mentioned a good way to respect the pact would be to apply international sanctions. Currently, is there anything that prevents the agreement from doing so?

Historically the rich countries became wealthy partly due to emitting as much carbon as they desired, while poorer countries emitted much less carbon. If sanctions are introduced then levying poor countries is viewed as unfair because it's harder for those countries to reduce emissions. However we can address this with provisions in the agreement which would allow financial relief to those countries.

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