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Nobel Perspectives: on a post COVID-19 world

Joseph Stiglitz

As part of the UBS Nobel Perspectives program we are pleased to bring you a webinar series that allows you to ask your questions directly to Nobel Laureates in Economic Sciences.

UBS Nobel Perspectives addresses the questions shaping our world, cutting through the noise, and holds the largest content library of Nobel Laureate interviews.

Joseph Stiglitz, Nobel Laureate was awarded the prize for Economic Sciences in 2001 for his pioneering work on asymmetric information which can provide the key to understanding many observed market phenomena, including unemployment and credit rationing. He has been the chief economist of the World Bank as well as chairman of the Council of Economic Advisors to former US President Bill Clinton. He joined Evan Brown, Head of Multi-Asset Strategy, in a webinar to discuss in detail the implications of the pandemic and what it means for investors.

Key webinar takeaways

- The pandemic has accelerated many structural trends including de-globalization and the need for investment in climate change.
- A more targeted and comprehensive fiscal stimulus approach is required.
- Financial assistance worked well when given to companies to retain their workforce.
- There will be onshoring and to some extent de-globalization but this will not solve the issue of longstanding inequality.
- Extremes in precautionary consumer behaviour is leading to weak aggregate demand.
- We need global cooperation for meaningful progress on health, economic and climate change.

Evan Brown, Head of Multi-Asset Strategy, UBS Asset Management

With much of Joseph's research focusing on financial crises, climate change and inequality, this webinar was a prime opportunity to tap into the mind of one of the world’s greatest thinkers amid such uncertain times.

Joseph Stiglitz’ prize winning research was based on markets operating with imperfect or asymmetric information where one party has better or more information than the other, a primary contributor to economic inequality.

To set the scene, the National Bureau of Economic Research (NBER) officially declared the US entered into a recession in February. We are already out of the labelled recession which means we could have possibly seen one of the shortest but deepest recessions of all time, as now we enter recovery.

"A combination of weakened balance sheets, increase in bankruptcies and extremes in precautionary behavior, is a recipe for a deficiency in aggregate demand."

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The world in the grasp of COVID-19

What kind of recovery can we expect in the US and the rest of the world?
A weak and difficult recovery, contingent on what kind of health and economic policies are deployed in various countries and if there is a second wave of infections. There are anxieties on both fronts.

The US Federal Reserve (Fed) expects unemployment levels to be down to ~6% by the end of 2021, which in my view is optimistic but achievable if the right policies are implemented.

Can you explain why a more robust, V-shaped recovery is unlikely, in your view?
I'm skeptical about a "V" shaped recovery. Many economic relief programs were designed to be over by the end of July at the latest—as of now, I don't think anyone believes the economy will be recovered by the end of July.

A combination of weakened balance sheets, increased bankruptcies, and extremes in precautionary behavior is a recipe for a deficiency in aggregate demand.

There has been a very powerful fiscal and monetary response from policymakers, there is a debate as to whether we need another fiscal stimulus package, what are your thoughts on this?
We really do need more stimulus. The Bureau of Labor Statistics noted that the unemployment rate understates how many people are out of work because of a misclassification error. Broader measures put underutilized labor at about 25%. That is a much weaker labor market and is going to take a while to repair.

The US added USD 3trn in stimulus and the Fed has scheduled liquidity operations of the same magnitude. These are big changes. At the same time, it was a fire-hose approach and not well-targeted. New Zealand, France, Denmark did a better job keeping workers linked to their jobs.

Additionally, the program wasn't comprehensive enough as it didn't include state and local government. The last jobs report showed a marked increase in unemployment among state and local employees. That's an area where you obviously have to do more. Also, if unemployed workers don't have good enough unemployment insurance because the states run out of money, that's going to add to the precautionary behavior that makes a robust recovery more difficult.

As congress reconvenes in July and works on its next stimulus plan, what should that look like?
This is an opportunity to say what kind of economy do we want emerging from this, as countries like France are doing. COVID-19 exposed pre-existing issues and we should address economic, racial, and health inequalities.

In terms of our PPP (paycheck protection program), there were problems in design and implementation, like relying on banks as an intermediary. The consequence was small businesses that were well-connected got the money, and others didn't. The second part is that many small businesses didn't trust the government, and thought the government would find a reason to prevent the loan from becoming a grant.

The current environment is presenting a divergence between the poor economic outlook and exuberant performance of the equity and credit markets. How do you reconcile this?
The divergence has never been greater than now. The stock market reflects views on future profitability, that is revenues minus salaries and wages. When wages are low and workers are suffering, stock markets can still go up.

Right now, interest rates are low on bonds and that means the discount rate used to value future profits is lower and valuations increase. Bonds can look relatively unattractive in comparison. But if the recovery is as weak as I expect, some of this equity advance is based on a false promise of a robust rebound, and may cause people to think it's an equity bubble when the recovery proves to be slower.

The unveiling of the next new normal

Do fiscal deficits matter?

Economics is about the science of scarcity and limited resources, so how you spend money matters. But we don't need to worry about deficits right now in the US. Economists worry about a deficit if it leads to inflation, which can have very adverse effects. Right now there are no inflationary pressures because there is no demand, in part because individuals are putting money aside as precautionary balances.

In the medium term, we may have to be concerned about people converting those precautionary balances into spending but not at the moment. It's more likely to show up in asset prices in the near-term.

You can expect to see a lot of debt crises in emerging markets in the coming months, which will weigh on the global recovery.

In the scenario that former Vice President Biden wins the US election, the Democrats win both Houses of Congress and Biden asks you to advise on the priorities for the first 100 days for the economy. What would your advice be?

We want to use this opportunity to think about the current issues and how to restructure to a new and improved economy and society. A top priority should be racial equality and social justice.

We were warned about the pandemic, when we had signals from previous pandemics such as SARS and Ebola. The first pillar is we want an economy with greater efficiency with an emphasis on competition. The lack of competition has undermined both productivity and innovation. Climate change is an existential threat, and we have to respond.

The second pillar is that we need more support and investment in the knowledge based industry. Science and education are necessary to boost our standard of living.

Finally, we will need to have explicit programs to address these problems, as we'll still have a weak economy in November 2020. Investments in green infrastructure will create jobs and help us move out of the pandemic-induced recession.

What are the feedback loops between the economy and inequality?

Inequality does undermine the overall performance of the economy in the US. When you transfer money from the bottom to the top, those at the top spend less.

COVID-19 has exposed inequality in America, access to healthcare is lower and disparities in health outcomes are wider. A very large fraction of the country living paycheck to paycheck without paid sick leave is a risk to public health. Meat-packing plants, for instance, became hot spots for the disease. People providing essential and front-line services are poorly paid, most exposed to the disease and disproportionately suffering.

> "A global recovery is a concern when many emerging markets do not have the same resources as advanced economies to respond effectively to the virus."
>
> Joseph Stiglitz

Audience Q&A

How do we find a middle ground here to make globalization work for everyone?

Firstly, I think the retreat from hyper-globalization was already underway pre-crisis, and this pandemic will accelerate that. There will be onshoring and to some extent de-globalization because of supply chain disruptions. Production will come back in the US but will be largely operated by robots, which may make us more resilient but it won't solve for inequality.

Secondly, the pandemic is a global health issue that we have to solve as an international community because as long as that disease is still spreading across some countries, the rest of the world will remain exposed. The scientific community has shown an unprecedented level of global cooperation in trying to solve this. More broadly,

cooperating on areas of common interest even as different nations disagree on politics and policy will be a challenge going forward.

COVID-19 is a particular risk to developing countries. How should the world address this?

The international community needs to come together to provide more assistance. The IMF has the power to distribute more funds to developing countries to fight COVID-19, but two countries stopped this initiative.

Unfortunately emerging markets were financially stretched even before the global pandemic. These countries have suffered decreasing exports and remittances as well as money flowing out of these countries. As we emerge from the crisis, these countries cannot print their own money unlike the US. We should expect a lot of debt crises across the emerging markets. Creditors need to accept sustainable debt restructuring.

What are you optimistic about for the future?

The recent anti-racism protests during a global pandemic show it is time for racial and social justice and a stark move to end racial inequality. Individuals supporting the movement at this time when people are worried about their own health and economic well-being, people all over the world came together to say we're more than just that, and show solidarity and common values. That reinforces my hope that when we emerge from this pandemic, we will have a moment of reflection that ushers in a new era of social solidarity. What's happened in the past couple of weeks has given me hope that we can work together with common purpose to make a more equal society with more racial and social justice, addressing problems like climate change and economic and health inequality.

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