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Fighting
COVID-19
Keeping Canada safe
during a global pandemic

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To avoid catastrophe, our leaders need to make hard choices based on what we know now

Brian Ferguson

When we first went into the COVID-19 downturn a lot of commentators were saying that while we'd experience a recession, and possibly a steep one, it would basically be V-shaped, with the initial deep drop followed by a very rapid upturn, bringing us back up to where we were at the end of 2019. While it's still not impossible that things will play out that way, the odds are increasingly against it. At the moment, the best we can hope for, and it's not necessarily the most likely outcome, is a U-shaped recession, probably with a fairly long, flat bottom to the U.

But if we heed those people who are saying that we'll have to keep the economy closed down for 18 to 24 months, or worse, for whatever undefined time it takes for someone to get a vaccine into widespread use, we're going to flatten the bottom of the U completely, turning the recession into a L-shape. We will, in fact, have moved from a recession into a state of depression equilibrium.

Prime Minister Justin Trudeau, on the advice of health policy experts, has persistently stuck with the mantra that Canadians will need to be locked down for as long as it takes, possibly months. But as important as they are at this time, and while they certainly should take the lead, the advice of public health experts is not the only advice our political leaders should be heeding. The Prime Minister and premiers are reportedly in talks to develop a plan for a staged re-opening but word is this will still be far off. Quebec Premier François Legault said recently that Quebec is preparing a plan to open up the economy once the spread of the virus stabilizes. Others should follow. Our political leaders need to announce their plans soon and avoid devastating economic consequences.

The people who were pushing the idea of a V-shape recession were thinking that we'd have a purely Keynesian recession, caused by a major drop in aggregate demand. Since the drop in demand would be almost a side effect of government putting restrictions on what we can buy and where we can buy it, when the restrictions were lifted there would be a mass of pent-up spending. A whole lot of celebratory and catch-up demand would pull aggregate income back up quickly. True, those people who had been laid off during the downturn wouldn't be in a position to splurge when it ended, but enhanced generosity of the social safety net and a burst of government stimulus would make up the difference.

But that assumed a very quick turn-around. It might have happened if the restraints had indeed been released by Easter, but the longer lockdown measures are in place, the less likely a sharp recovery becomes. Part of that is because as the recession drags on, we will start to move into a debt deflation situation, where people's incomes have fallen but the value of their debts hasn't. Government transfers can ease that for a while, and the financial system, backstopped by the Bank of Canada, can provide some support, but there's a distinct limit to how long that can be sustained, and even if we do provide wide-ranging mortgage and rent support, spending on a lot of other things will fall, producing a downward multiplier effect, and the recession will drag on.

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If it drags on long enough – a year, for example – then we move from a pure demand-side recession into a supply-side one. In a pure demand-side recession, national output falls because labour has been laid off but the capital equipment they'd been working with is still there, and when demand picks up again they can quickly return to using it, especially if they're still technically employed by the old firm. But if the recession drags on, then despite any assistance the government might provide, some firms are going to go bankrupt and that effectively removes their physical capital from the production process.

Think about a restaurant. If the downturn is going to be short-lived, it will shut down and lay off its staff but the kitchen equipment will still be there. But if the firm goes bankrupt, while it might appear as if the kitchen equipment is still there, ready to be used again, it's not going to be used until someone comes along who's willing to borrow the funds necessary to start the business up and who can find a lender willing to make those funds available. Both of those conditions will have to be satisfied if that kitchen is going to be put back into service, and the longer and deeper the recession is the harder it will be for both to be met.

That's the situation that a lot of small business is going to be facing. They'll have a certain amount of financial reserve, and if they and their banker can agree that the recovery's not going to be too far off they'll be able to survive longer than their own resources would permit, albeit at the cost of adding to their existing stock of debt. But there's going to be a limit to how long that can go on, and odds are that an 18 to 24 month shutdown is well beyond that limit. If they're faced with the idea that they'll have to hang on for whatever indefinite period of time it takes for someone to develop a vaccine, run it through Health Canada's approval process and get it into production, a lot of them will say it's just not worth the cost. The longer, and more uncertain, the duration of the shutdown, the more firms are going to close up for good, and the sooner they're going to do it.

We need to be planning now for how we're going to reopen the economy, and one of the most important parts of that policy is a clear target date, and a date which is survivable for small business and the very significant part of the labour force they employ. Even if everybody recognizes that plans might have to be changed and the date delayed, if the date is *a priori* reasonable and if the conditions under which it might have to be delayed are clearly set out, we will greatly have reduced our chances of winding up stuck in a depression equilibrium.

Of course, it's easy enough to say that we need to set a date for the grand reopening, but we know that we can't simply announce that all restrictions are off. We need to have some idea of what's likely to happen to the number of COVID-19 cases when we do lift the lid.

Quite a few people have proposed rules for recovery, but a lot of them share one major flaw. They assume that we can test for COVID-19 at a rate well beyond our present, or foreseeable, capacity. It would be ideal if we could test everybody, and keep on testing everybody (especially if, as some epidemiologists assume, recovered cases will not develop immunity, so we can expect to face annual epidemics, at least until we develop a vaccine) but we can't. It would be really nice to be able to delay lifting the lid until we have a solid handle on how many people were infected and what the true population mortality rate was, but if we make that a precondition for easing the restrictions, we might as well resign ourselves to settling into a depression equilibrium.

We're going to have to make policy in the face of massive uncertainty. It'll be a case of known unknowns, so we'll know what we need to collect data on, but they'll still be unknown. What can we do to at least ease the uncertainty?

One thing we can do is draw on the experience of countries which are further out along the epidemic curve than we are. There's evidence coming out of Germany and Austria that the proportion of their populations which has been infected is considerably larger than had previously been thought. That suggests that an even higher percentage of the infected than had been thought probably had very mild symptoms, to the point of being virtually asymptomatic, and also that the population mortality rate is probably smaller than had been thought. We can also draw on evidence from the public health systems in other developed countries to refine our view about patient-specific mortality. We should be looking at moving away from policies which assume that everyone is equally likely to be hit by a fatal episode and formulating hypotheses which can be used to shape the way we ease economic restrictions.

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For example, while there certainly have been tragic cases among children and younger adults, it is plausible to hypothesize that the greatest threat is to seniors. That's not surprising, since many seniors have lower general levels of health and compromised immune systems. And it's pretty clear that medical personnel are at elevated risk. That's hardly surprising – they work in places where the exposure to the coronavirus is significantly elevated.

Clearly, we should be prioritizing hospitals and seniors homes for protective equipment, but we can go beyond that. While we're recognizing that certain workplaces are high risk, why not extend our assessment process to all workplaces? We know that the virus has been found in some workplaces, but what we need to know – or to make a reasonable estimate of – is the likelihood of its spreading within the workplace. We're making some judgments about that now, when we limit the number of people who can go into supermarkets at a time, but we need to think about it more broadly.

We need to be thinking about risk trade-offs: we can prevent the spread of the virus in any workplace by shutting that workplace down completely, but that will also force its output to zero. We know we don't want to do that in essential workplaces, and by keeping them open but imposing safety requirements on them we're making a judgment about the risks and benefits of operating under those circumstances. We should extend that thinking to other places. If a non-essential workplace turns out to be low risk for transmission, why should it stay closed?

For example, at the moment we're shutting employers down completely and replacing at least part of the income lost by their workers. If the risk is primarily to older workers, should we be considering allowing those employers to re-open but paying their older workers not to work? Any such place would be operating below full capacity, but we need to think about whether that's better than not operating at all for months and possibly years.

We need to talk about immunity. Both the UK and Germany are looking at doing widespread testing for antibodies to COVID-19, and letting people who have the antibodies back into the workplace. Some epidemiologists are pretty dubious about this – we don't have solid evidence that having been attacked by the virus does create immunity, so there are epidemiological models which make their predictions on the assumption that someone who was susceptible, became infected and recovered, rather than entering the pool of the immune actually re-enter the pool of the susceptible. We could shut down until we have a solid answer to the immunity question, but that puts us back into a depression equilibrium. Governments need to be quite explicit about what assumptions they're making about immunity.

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And while we're thinking about testing, we should investigate group testing. The general idea that has been suggested here is that you take samples from a group of people – the employees of a workplace, for example – pool the individual samples and do one test on the pooled sample. If the pooled sample tests clear, nobody has the virus; if it doesn't you divide the group into smaller groups, take, pool and test new samples from each of those groups, and keep going until you've isolated the carrier or carriers. In principle this reduces the amount of testing which is needed, but we need to sort out how, and indeed whether, it could be worked in a real-world context.

We will have to use risk ranking to decide which bits of the lockdown should be eased first. Some conclusions are fairly obvious: sporting events and concerts are going to remain closed for a long time – it's pretty clear now that the prime vectors for both Italy and Spain were sporting crowds.

On the other hand, consider elementary schools. As long as they remain closed, not only are students losing education but a lot of young parents would be unable to go back to work even if their workplaces were opened. There is evidence coming out of other countries to the effect that adding elementary school closures on top of other lockdown items does not add much in protection but does add a lot of disruption. With a few tragic exceptions, kids seem to be coming through the epidemic pretty well. Maybe we should re-open the schools but ban kids from visiting their grandparents and make special arrangements for children whose health is compromised. We need to make a judgment about this and make it very clear what the basis is for that judgment.

Fiscal and monetary policy are going to be very weak reeds in this recovery. Interest rate cuts will not stimulate investment in a world as uncertain as we'll be facing immediately after the shutdown is lifted, and while fiscal policy in the form of infrastructure spending – building more hospital capacity, perhaps – will be more effective, there are long lags between the decision to fund infrastructure projects and the first shovel hitting the ground. Economists normally prefer government spending to tax cuts as fiscal policy instruments, but income tax cuts and cuts to the GST have the attraction that they would, in the first case, put money in consumers' pockets and in the second stretch the income consumers already have, almost immediately. Tax cuts wouldn't have enormous stimulus effects, but they'd have more effect than monetary policy would.

Any stimulus policy will require the federal government to run its deficit up, but the urge to find safe assets is so powerful at the moment that there's probably a large unsatisfied market for even very long-term federal government bonds. Still, we have to remember that ultimately our income isn't the number of dollars we receive, it's our share of the total amount of goods and services produced in a year, and with a projected 25 percent of the labour force on its way to being unemployed with a corresponding share of capital equipment sitting idle, total output's going to be down by about 25 percent. At the beginning of the crisis, experts were saying that our food supply chains were robust. We're not hearing that so much anymore, because commentators have realized that the food coming along those chains isn't coming out of nowhere, it's being produced by labour, and if the labour force is disrupted the supply chain breaks down.

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Early on in the crisis the mantra was "we're not determining the timeline, the virus is." That's medieval era thinking. The emergence of antibiotics made us think we were invulnerable to pandemic disease, but let's not forget that our societies, and economies, have come through bad episodes in the past. Coming through this one will require clear and realistic thinking: we have to recognize that we're not going to have the kind of data we'd really like to have for planning purposes until after the crisis has passed, so planners are going to have to be creative with the data we've got, and be open about the risks and trade-offs we're facing.

Governments can't simply say "well, at some point in the future we'll look at how we might reopen the economy," they need to be making explicit timelines now and those timelines have to take serious account of the damage that'll be done if we go past the cutoff dates for V- or U-shaped recoveries into the era of an L-shaped economy. We shouldn't fool ourselves into thinking that as long as the Bank of Canada can print lots of money, everything will be fine.

Reopening will clearly put some people at more elevated risk than they're at now – our plans can't involve forcing people to go back to work, especially in non-essential sectors. In those sectors, governments might permit firms to reopen under certain conditions, but leave the ultimate decision up to each employer and their workforce. But not reopening soon will also do a lot of harm to a lot of people, mostly those who are already the most vulnerable.

COVID-19 isn't the Black Death. But without a clearly articulated plan for emerging from this crisis we run the risk of turning it into our own Antonine Plague.

About the Author

Brian Ferguson is Professor of Economics at the Department of Economics and Finance at the University of Guelph. He is a Faculty Associate of the Canadian Centre for Health Economics. He received a B.A. in economics from Mount Allison University (1974), an M.A. from the University of Guelph (1977) and Ph.D. from Australian National University (1982). His teaching and research interests are in mathematical economics, health economics and social welfare. His work has been published in journals including *Health Economics*, *Journal of Population Economics*, *Substance Use and Misuse, Applied Economics*, and *Canadian Public Policy*.

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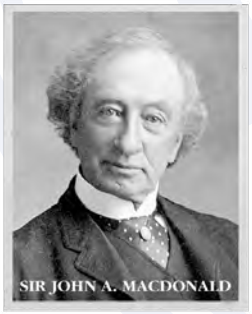

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