

How to deal with the coronavirus recession: Social solidarity and state intervention

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Vladimir Popov



Wuhan Huoshenshan hospital on 30 January 2020. The hospital was scheduled to open six days later and was built in a matter of weeks. (Credit: Getty Images AsiaPac/Getty Images News)

ECONOMICS

The efficiency of the East Asian response to the coronavirus epidemic has been much praised by certain media outlets, particularly the response of China and South Korea. In Hong Kong, Japan, Singapore, and Taiwan, the number of infections has remained relatively low despite intensive contact with mainland China.

The media has praised ‘Asian values’, i.e., the primacy of society’s interests over those of the individual, which has enabled action against the spread of the disease.

“Ask not what your country can do for you – ask what you can do for your country”; these words of John F. Kennedy sounded novel in the US in the 1960s but were and are universal truth in China and East Asia. “We never

imagined there could be a different philosophy”, my Chinese friend remarked.

The internet is packed with photos of Chinese doctors and nurses working around the clock and [sleeping on the floor of their workplaces](#); of stadiums converted to hospitals in days; of [new hospitals](#) built in a couple of weeks; and of volunteers delivering food and taking care of the elderly. Military-style blockades of roads and even whole cities; prohibitions against leaving the house for all but the most important business; obligatory mask-wearing in public; household management committees organising quarantine, the delivery of essentials, and neighbourhood watch... Such measures have surprised the world twice over: first, upon their launch – “wow, how can this be done?!” – second, in their swift restraint on the spread of the epidemic. In South Korea, 250,000 people were tested by mid-March, 100 times more on a per capita basis than in the US (15,000 only). In China, hundreds of millions of people were confined to their houses for over a month.

Countries hit by the coronavirus in other parts of the world are now trying to replicate the East Asian response and it seems this strategy is yielding results.

However, there is a new danger today: the economic recession caused by the coronavirus. Here, the East Asian experience is no less precious than in the field of public health.

Why structural recessions happen

A structural recession is caused by the need to reallocate labour and capital from one industry/region to another. In this case, the need is to reallocate resources from all facilities affected by the epidemic and its related prohibitions – e.g., on travel, tourism, retail trade, sports events, restaurants, the entertainment industry, schools and universities, etc. – to public health, emergency services, and public-order activities. Economists call this a supply-side recession; in theory, it could be overcome by expansionary fiscal and monetary policy at the price of higher inflation. But a quicker and more efficient solution is the elimination of supply-side constraints through the facilitation of – and even mandatory – labour and capital reallocation.

One comparison can be made with the series of transitions that saw the production and circulation of music using vinyl records shift to the

widespread use of tape recorders, CDs, iPods, and eventually smartphones, following innovations in sound technology. Similarly, the conversion of energy-intensive industries into less energy-intensive industries has followed energy price increases. These kinds of structural shifts happen all the time and if they are gradual and small-scale, they do not cause recessions.

But when the necessity emerges for sudden, large-scale structural shifts, recessions can occur. The output drop from the outgoing industry is not quickly compensated by production increases in a newly emerging industry and the general level of output falls.

Recessions in Western countries associated with oil price increases in 1973, 1979, and 2007 are examples of poorly managed structural shifts. In market economies, adjustment occurred in these cases through rising unemployment: industries became unprofitable due to increased costs, they laid off workers, and unemployment contributed to falls in wages. Only later did cheaper labour costs make expanding production in other industries profitable.

Without government assistance in retraining laid-off workers and stimulating new investment, this can be a painful, lengthy, and costly process.

The transformational recession in post-communist economies in the 1990s is an example of even worse management of structural shifts. There were collapses in agriculture and industry and rises in services (trade and finance) and resource industries. In many countries, the reduction of the general level of output (GDP) during this transition was larger than during the Great Depression of the 1930s.

How to deal with a recession

More successful examples of managing structural shifts are to be found in East Asia, where collective interests are a high priority and governments are not afraid to resort to market intervention and direct investment-financing in times of crisis.

In China, the production of protective masks increased from 15 million a day in early February to over 100 million a day by the end of the same month! Over 3,000 enterprises that previously had nothing to do with the

supply of health products began producing masks, special protective suits, sanitizers, and hygiene goods. *China Petroleum and Chemical Corporation, China National Machinery Industry Corporation*, and several major car manufactures (*Shanghai GM Wuling, Guangzhou Automobile Group, BYD*) all organised the production of masks.

The South Korean company *Seegene* developed a test kit and began mass production in three weeks – all 395 employees dropped their other work and focused on making coronavirus test kits. Production of the company's 50-odd other products temporarily ceased for two weeks. Molecular biologists with PhDs stopped their research and development work and took places at the assembly line and senior scientists served in the packaging of the product.

In Western countries, similar examples can be found in the conversion of non-defence industries to defence production during World War Two. In most countries, this happened through state assistance in easing and speeding up the transition. Before and during the war, governments increased both taxes and borrowing and used the proceeds to purchase weapons. In the United States, an increase in defence procurement after the recession of 1937-38 caused a boom; economic growth accelerated from negative values in 1938 to 17-20% annually in 1941-43.

Even better results have been exhibited by centrally planned economies. They have clear advantages over market economies in mobilising and converting domestic savings into investment and in promoting structural shifts, both quickly and with full employment. In the 1930s-40s, on the eve of and during World War Two, the USSR transferred huge resources from agriculture to industry, from light to heavy industry, and from non-defence to defence industries. In 1940, Germany produced twice as much steel and more defence output than the Soviet Union, but by 1943, the USSR had already surpassed Germany in the production of tanks, aircrafts, and artillery guns. This was most crucial to the war's final change of course.

If the coronavirus continues to spread quickly, the ability of countries to move resources from non-health to health-related industries will be a crucial factor in fighting the epidemic and also in fighting the recession.

Betting only on market forces to ensure equilibrium is dangerous. The capacity to cope with the coming recession today depends to a large extent on how the governments assist markets in carrying out structural shifts.

During the 2008-09 Great Recession, China put into place a huge fiscal stimulus package so that the economy only slowed down marginally (from 14% in 2007 to 9% in 2009), whereas other countries experienced their deepest postwar recession. If the world economy goes into recession this year, which countries will react similarly?



Vladimir Popov

Vladimir Popov is a Principal Researcher in the Central Economics and Mathematics Institute of the Russian Academy of Sciences. He is also a professor emeritus at the New Economic School in Moscow, and an adjunct research professor at the Institute of European and Russian Studies at Carleton University in Ottawa. In 2009-15 he worked in DESA, UN, as a Senior Economic Affairs Officer and Inter-regional Adviser. He has published extensively on world economy and development issues (he is the editor of three books, and author of ten books and hundreds of articles, including in the Journal of Comparative Economics, World Development, Comparative Economic Studies, Cambridge Journal of Economics, New Left Review, as well as essays in the media). His books and articles have been published in Chinese, English, French, German, Italian, Japanese, Korean, Norwegian, Portuguese, Russian, Spanish, and Turkish. His most recent book is "Mixed Fortunes: An Economic History of China, Russia, and the West" (Oxford University Press, 2014). He graduated from the Economics Department of the Moscow State University in 1976, and holds PhDs (Candidate of Science, 1980; and Doctor of Science, 1990) from the Institute for US and Canadian Studies of the Academy of Sciences of the USSR. More info can be found at his website: <http://www.nes.ru/~vpopov>