

The Coronavirus Pandemic and Structural Changes in the Global Economy

We are facing a possible recession that is similar in magnitude to the depression of the 1930s. The coronavirus crisis is changing lives around the world. What are the implications for the global economy? Which new behaviors will become permanent and in what respect might we return to our previous 'normal'? A group of researchers coordinated by the ASA has been analyzing the development of the crisis in weekly sessions since mid-March.

As part of this foresight driven analysis, the group conducted a systems analysis that identified four main dimensions of uncertainty that are developing as a consequence of the unknowns surrounding the length and degree of the lockdowns due to the Coronavirus pandemic. They are: (i) the economic stability of states, (ii) governance of states, (iii) development of global governance, and (iv) stability of the global financial system. It is obvious that the structure of the global economy will change, however, in what ways and to what extent?

The group identified potential structural changes in five areas. The Coronavirus pandemic and the economic recession it has caused will change the structure of the global markets, structure of production factors, the distribution of wealth, structure of global governance of trade, and geopolitical coalitions.

1. Structural changes in the global markets

The total freezing of domestic demand has heavily hit small and medium-sized companies, especially in the service sector. These companies are the main employer in most countries. Their ability to survive the recession is a key factor affecting short and long-term unemployment. Large, strong companies are also being affected but their survival rate will be higher than small and medium-sized companies because they typically have access to additional capital and better government support. National economies where a larger portion of small enterprises are family-run companies may prove to be more resilient.

It is obvious that digitalization, and the use of digital platforms, made a major leap forward during the lockdown. To avoid the virus, many business people are now working remotely and conducting meetings in virtual meeting spaces. Children are attending online classes. Friends and family are meeting online. Even the most conservative businesses have been pushed to rapidly implement digitalized work processes.

The results can be seen in the stock market performance and usage statistics from the largest technology companies. Microsoft reports a 775% increase in usage of their cloud products. Amazon is desperately trying to recruit new warehouse and delivery staff in most western countries. The fast-rising market value of Netflix (entertainment) and Slack (virtual workspaces) indicate that investors believe in the bright future of digitalized service production.

The implementation of the Internet of Things (IoT) and robotics has been increasing slowly over the past 20 years. Now, companies are planning to rapidly accelerate their adoption of these technologies. IoT is the basis of many technologies that are being considered to screen and track individuals to ensure public spaces and workplaces are safe. Examples

include thermal cameras, biometric sensors, and smart health passports. The use of robotics and IoT in manufacturing, food production, and service delivery is a way to reduce the cost of goods produced locally, allow for safe distancing in workplaces, and reduce the reliance on migrant labour.

The long global supply chains that currently underpin the world economy are proving to not be resilient. When China closed down its production, it had a drastic impact on the IT and automotive industries. The pharmaceutical industry and health care equipment production seem to be totally dependent on Chinese production facilities. Efficiency and low production costs have led to specialization and complex global supply chains. Resilience and redundancy have been forgotten, and now the Coronavirus pandemic has revealed systemic fragilities.

Now that the risks associated with the current supply chains are visible, companies are planning to address them. For some products that are considered essential, such as medical supplies, pharmaceuticals, food, and military supplies, supply chains and outsourcing networks will become simplified and critical parts of production will be brought back to home countries. However, only a fraction of the jobs will move with the production. Companies will replace the cheap labor production function with automated production facilities closer to their home markets. Robotics and IoT are two of the drivers needed to increase productivity and efficiency and compensate for the high labour costs in western countries. For non-essential products that are price sensitive, companies are planning to build resiliency and redundancy into their supply chains by setting up production facilities in multiple low-cost jurisdictions such as Asia, India, and South America.

2. Structure of production factors

The current wealth of our (western) economies is an outcome of increased labor productivity that has fuelled continuous growth since the early years of the current century. Now productivity growth has slowed down. The economists around the world have been debating why increasing digitalization has not been reflected in the productivity statistics. There are companies, such as the digital giants known as GAFA (Google, Amazon, Facebook, Apple) that apply new technology and outperform traditional industries, but overall labour productivity has not increased.

The economic transformation being triggered by the Coronavirus is expected to be realised mainly through digitalization and automation. But the main production factor that is producing the transformation is capital, not labor. It is evident that manufacturing and even services will be more capital intensive in the future. And the gains of technology implementation are going to capital. Labour is losing its role (except for the most knowledge-intensive, creative, and service/healthcare jobs), and in the worst case, we are returning to a similar setting we had at the early stages of industrialization.

3. Structure of wealth

Increasing capital intensity is supporting the current trend of the concentration of wealth. Ownership of capital is in fewer hands and the middle class is losing their wealth relatively speaking. The anticipated long recession the pandemic has generated will, in the worst

case, lead to permanent loss of jobs in the developing world, but also within the middle class.

4. Structure of global governance of trade

As we have seen (a graph from NYT) from the development of the political atmosphere in the USA, the middle class feels it is losing its foothold and is susceptible to populist policymaking. This leads to increasing protectionism and weakening the role of global governance, such as the WTO. Voters do not believe in the benefits of free trade but are supporting those politicians that seem to be capable of gaining short-term improvements in the global game of protectionism. In many countries the industries and large companies have strong lobbying capabilities that can build 'holes' or focused 'shields' to protectionist trade barriers (Huawei case all over the world).

5. Structure of the geopolitical field

The Coronavirus pandemic has also increased the magnitude of shocks to the global geopolitical structures. Their protectionist response to the pandemic has accelerated the weakening role of the USA as a leading global power. The same applies to the European Union. The commitment for collaboration was first shaken by migration issues and now the slowing down of the economy is reintroducing the old divide between the 'good housekeeping' Northern countries and 'relaxed housekeepers' of the Southern countries. Russia is struggling with record low oil prices and the pandemic. China may have managed the Coronavirus crisis but their lack of transparency at the beginning of the pandemic has weakened their credibility internationally. Domestically, the main question is "will their authoritarian governance model be able to survive its first recession?"

Concluding remark:

All of the above indicates that the dominating behavior patterns of the global economy will be reinforced by the Coronavirus pandemic. While there may be the possibility of positive outcomes in some areas, the global system will be dominated by increasing volatility and uncertainty. All of this implies that the keys to success for both national economies and individual companies is to build a resilient culture capable of adaptation and agile behavior.