A New World Post COVID-19
Lessons for Business, the Finance Industry and Policy Makers
edited by Monica Billio and Simone Varotto

Introduction

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Pandemics are disruptive events that have profound consequences for society and the economy. This volume aims to present an analysis of the economic impact of COVID-19 and its likely consequences for our future. This is achieved by drawing from the expertise of authors who specialise in a wide range of fields including fiscal and monetary policy, banking, financial markets, pensions and insurance, artificial intelligence and big data, climate change, labour market, travel, tourism and politics, among others. We asked contributing authors to write their chapters for a non-technical audience so that their message could reach beyond academia and professional economists to policy makers and the wider society. The material in this volume draws from the latest research and provides a wealth of ideas for further investigations and opportunities for reflection. This also makes it an ideal learning tool for economics and finance students wishing to gain a deeper understanding of how COVID-19 could influence their disciplines.

The volume begins by taking a historical perspective. Moreno, Ongena, Ventula Veghazy and Wagner explore the linkages between the Great Recession of 2008-09 and the current pandemic. They argue that the ways in which the former crisis was fought may have a bearing on the severity of the outcomes of the current crisis. Governments that piled up debt to bail out banks in their country may have diverted resources away from critical sectors including public health services. This in turn may have curtailed the ability of those countries to contain the spread of the virus and offer adequate health treatment to the sick. Similarly, job losses following the Great Recession, especially among young people (e.g. in Italy and Spain) may have created a greater incentive for younger generations to live at home with their parents. Such proximity between younger and older people, with the latter more vulnerable to the infection, may have led to higher mortality rates during the pandemic. Finally, forbearing bank supervisors that have allowed banks to keep in their balance sheet 'zombie' firms following the last crisis may have created the pre-conditions for government funding to fall in the 'wrong hands' of failing companies, rather than healthy ones, during the current crisis.

Historical comparisons are further stretched back by Bell, Lacey and Prescott who look at the lessons from the Black Death of 1348-51, which may still be relevant today. They argue that restricting freedom of movement, especially if protracted in time, can generate resentment and lead to social unrest and political turmoil. Events in fourteenth century England suggest that governments need to act quickly to address social injustice when social tension is high because of a pandemic. History also teaches us that psychological reactions of crisis-affected masses may lead to nationalistic tendencies. This is further explored by Halikiopoulou who focuses on the rise of populism in Europe. The author distinguishes between countries already dominated by populist movements and those where populists are in opposition parties. A pandemic, and the resulting economic crisis, may create an opportunity for populists in opposition to gain more support from the voters that are worst affected by the economic downturn. A likely consequence of 'my-country-first' policies, which can find quick appeal in periods of economic and health crises, is protectionism. Laker identifies clear signs of protectionist trends emerging from the pandemic and warns that these can have disproportionate consequences for developing economies as they are more dependent on imports for critical medical supplies and their population's basic needs.

The UK experience during the First and Second World Wars as well as the Great Recession is examined by Scott to shed light on the fiscal implications of COVID-19 and the likely consequences for British taxpayers. He argues that the austerity measures that could follow fiscal expansion during the current pandemic would be misguided. Past events suggest that fiscal austerity may have the unintended consequence of slowing economic growth and generating mass unemployment, while a less fiscally conservative approach would lead to a stronger and sustainable recovery.

Busetto, Dufour and Varotto extend the fiscal policy analysis to continental Europe. They show that pre-existing debt levels influence governments' ability to sustain their pandemic-hit economies. Germany's relatively low debt-to-GDP ratio has helped it to implement a 'fiscal bazooka' to protect its economy without paying the price of a substantially higher cost of borrowing. Italy, on the other hand, with a more contained fiscal expansion, is expected to experience a more punitive increase of its borrowing costs. This, in turn, would have a further negative impact on its already anaemic growth prospects.

Financing costs in European countries are also explored by Billio, Costola, Mazzari and Pelizzon who look at the repo market. Specifically, they focus on the effect on repo rates of monetary policy announcements made by the European Central Bank (ECB) during the pandemic. They find that countries in Europe's periphery, e.g. Italy and Spain, may be highly dependent on the ECB support to keep their repo rates in line with those of other countries. An announcement made by the ECB that it would not intervene to support countries with higher sovereign risk was sufficient to generate a substantial divergence of their repo rates from those of low risk countries. A subsequent ECB announcement which clarified that the Central Bank would indeed support weaker economies caused an immediate realignment of the repo rates. This highlights the critical role that monetary policy can have to contain the effect of the pandemic on financial markets.

The connection between sovereign risk and bank risk has become more evident since the European sovereign debt crisis. Andries, Ongena and Sprincean observe that such connection and feedback loop have become stronger during the pandemic but are not as important as they were during the sovereign crisis. This is partly the result of stricter bank regulation that has made banks better able to withstand periods of instability. Lazar and Zhang examine in detail some aspects of the new bank rules and conclude that they might lead to banks overestimating risk and keeping higher than needed equity capital levels, which are sub-optimal.

Stock markets reacted strongly to the spread of COVID-19. Ramelli and Wagner analyse the stock performance across 90 countries in different phases of the crisis: incubation, outbreak, fever and recovery. They find highly levered companies to be the ones with a more volatile behaviour, which confirms the role of debt in amplifying economic shocks and uncertainty. Worryingly, corporate debt levels have increased since the start of the pandemic, which may contribute to further market instability in case of future outbreaks of the virus. This has reawakened the debate about whether corporations should still be incentivised to pile up debt through the tax deductibility of interest payments.[1] The authors also perform an industry analysis that

1 See *Financial Times* article "Should We End the Tax Deductibility of Business Interest Payments?". 22 July 2020. `https://www.ft.com/content/426c1465-9561-4300-8d3e-2430e4124c93`.

reveals how energy firms, banks, consumer services and the transportation sector were the worst affected by the crisis. Dufour breaks down these effects at the country level for the US and the UK and observes similar patterns. Banks are badly affected as loan defaults are expected to rise and low interest rates compress banks' profit margins. Regulatory restrictions on banks' dividend payouts have put further downward pressure on bank stocks. Energy firms and, particularly, oil companies have suffered from the largest contraction in demand ever recorded. Kalyuzhnova and Lee explain that this, combined with persistent excess supply, produced a 'perfect storm' for the industry. Furthermore, demand may not go back to pre-pandemic levels for some time. This may be caused by lower oil consumption resulting from, among other factors, changes in people's attitude towards air travel and companies embracing more extensively working-from-home practices and virtual meetings instead of international corporate travels. An obvious casualty of travel restrictions following COVID-19 lockdowns worldwide is tourism. Palmer considers the short-term and long-term consequences of the pandemic on consumer behaviour. He argues that lifting restrictions will not automatically reset the clock back to pre-pandemic times. The lockdowns are likely to make tourists more prudent when planning their holidays, at least in the short term. But in the long run the sector is likely to recover thanks to its capacity to reinvent itself as it did repeatedly in the past.

Travel restrictions have also had profound consequences for the real estate sector. In addition, Mattarocci and Roberti argue that the residential and commercial real estate markets in Europe were also impacted by site-visit limitations, the lower disposable income of householders and falling revenues of commercial tenants. The authors suggest that householders may seek bigger dwellings in the future to be able to work from home more comfortably. The preferred relocation areas for households and offices could be outside city centres because of their greater affordability and their lower infection risk as they are less densely populated.

The insurance industry was also affected by the current pandemic. However, Ioannides explains that insurers and reinsurers are well capitalised to absorb the shock of this crisis, even though their losses so far have been substantial at US $200 billion. Sutcliffe argues that the increased elderly mortality rates because of COVID-19 may benefit life insurers and defined benefit pension funds, but only in the short run unless there are further and extensive infection waves. He concludes that those who moved out of their defined benefit pensions or cashed in their defined contribution pensions during the pandemic, when asset prices were depressed, are losers from this crisis.

An obvious question for institutional investors and individuals is how to structure an investment portfolio in such a way that makes it resilient to pandemic risk. González, Jareño and Skinner explore this question by investigating the risk reduction that may result by diversifying portfolios into cryptocurrencies. They conclude that some cryptocurrencies (Ethereum and Bfinance) have the potential to control risk, while others (Bitcoin, Litecoin and Tezos) are less effective in this respect. However, risk reduction comes at the cost of lower risk adjusted returns.

Social distancing has limited our ability to see family and friends and also to participate in leisure activities. Football fans across Europe have been prevented from attending live matches and the football industry has suffered financially as a result. Reade and Singleton point out that football's decision makers should rethink the allocation of resources within the industry to help it recover. Greater investment in women football, a small role for agents and perhaps state intervention could all contribute to resolving football's current and more long-standing issues.

Borri takes a close look at Italy, the first country to witness high infection rates in Europe. From a careful analysis of the measures taken in the country, which varied across cities and regions, he concludes that the Italian experience can be a useful case study for policy makers to assess the costs and benefits associated with different approaches to tackling future waves. Donadelli, Gufler and Castellini argue that COVID-19 containment measures were introduced with delay and were badly communicated by the Italian government. The resulting uncertainty had the strongest effect on the construction, education, manufacturing and hospitality sectors and may slow down their recovery phase.

Arundale and Mason examine the coronavirus crisis from the perspective of private equity (PE) and venture capital firms. Their assessment is that the inevitable short-term contraction in this industry's activity is likely to revert to pre-pandemic levels in the not-so-distant future. The undervaluation of public companies may generate good opportunities for PE firms. However, start-ups may struggle to find funding in the current economic environment unless governments support their growth. Antypas predicts that PEs as well as hedge funds will be big players in the mergers and acquisitions market over the next few months. Before the pandemic, these firms had accumulated a lot of 'dry powder', that is capital available for investments. Furthermore, their long-term investment horizon makes them particularly attractive to distressed firms.

The drastic reduction in air travel and road congestion in cities around the world has undoubtedly had a positive impact on the environment with lower levels of pollution and CO_2 emissions. Battiston, Billio and Monasterolo review the fiscal and monetary policies in Europe and challenge their short-term objective of taking the economy back to 'business as usual'. Instead, the authors suggest that the adoption of longer term objectives aiming to an alignment with the EU Green Deal and the EU corporate taxation policies would be more beneficial and as cost-effective. Indeed, the European Central Bank has recently taken a pro-environmental stance that is in line with the authors' proposed policy response.[2] Bardsley also proposes that central banks should support an environmentally friendly recovery. But, he points out that this should not be done through bond purchases in the secondary market, which are "regressive and strategically blind". Instead, he favours an open monetisation of public sector borrowing and discusses different ways in which this could be implemented.

Unemployment has risen dramatically during the pandemic. Razzu examines the pandemic consequences for the labour market in the UK with a focus on gender inequality. His analysis of recent studies and the data available so far reveals that unemployment has increased more for low paid jobs and in sectors such as retail, accommodation and food services where women are more likely to be over-represented. He also finds that, because of school closures, women are more likely than men to devote additional time to childcare and household work, which may have a substantial impact on their career prospects. The gender pay gap may also have increased during the current crisis and the government's suspension of the requirement for large firms to publish the gender pay differentials among their employees has not helped bring more equality to the UK labour market.

A form of labour market inequality that has had a dramatic impact in India concerns seasonal workers. Daripa reports that 120 million villagers were made unemployed overnight when the Indian government sanctioned a total lockdown on March 24, 2020. These workers were left without any support and 9 weeks after the lockdown the vast majority of them could still not benefit from government sponsored food rations under India's Public Distribution System. The author argues that the lack of political representation of these workers has left their voice unheard when it comes to government policy.

Mouritzen, Rezaei and Liu focus on how the coronavirus influenced the flow of international talent and specifically examine the experience of European researchers in China. Cross-country mobility of researchers can increase scientific productivity with ultimate benefits for the economy. The authors show preliminary evidence that a large proportion of European researchers that were based in China before the pandemic has now left the country and is not planning to return or is uncertain about that possibility, which is a concern.

2 See "Lagarde Puts Green Policy Top of Agenda in ECB Bond Buying". *The Financial Times*, 8 July 2020. https://www.ft.com/content/f776ea60-2b84-4b72-9765-2c084bff6e32.

COVID-19 has also accelerated the adoption of digital technology and artificial intelligence (AI) in the corporate world. Pasha explores what this means in terms of the skillset that employees need to develop to thrive in the new working environment. Adaptability emerges as a key quality for personal success. Liu and Guo further analyse the business transformation that AI, big data and data analytics are producing in the business world. They also discuss ethical and cybersecurity implications. Finally, Chen looks at how alternative data sources can be used to support decision-making especially in critical times like those faced during the current pandemic. Therefore, unlocking the potential of new data sources can be key to making our society better equipped to face future crises.