

19 COVID Lessons and a Social Contract for Resilience

Markus Brunnermeier

Princeton University

*Based on
New Book*

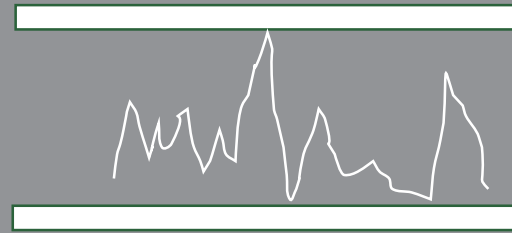
*Based on webinar series
<http://markusacademy.Princeton.edu>*

26. November 2020

Resilience

- Risk management - squeezed between concrete wall

- Variance
- Tail Risk Analysis

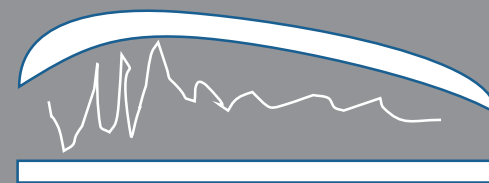


- Resilience management - squeezed between rubber wall

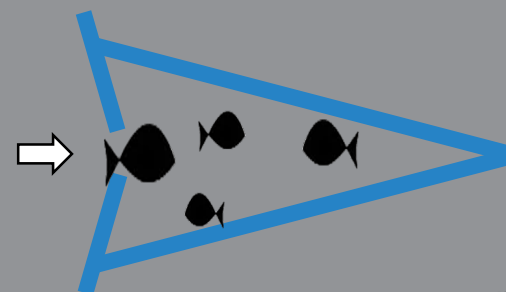
- Mean-reversion
bounce back



roly-poly toy

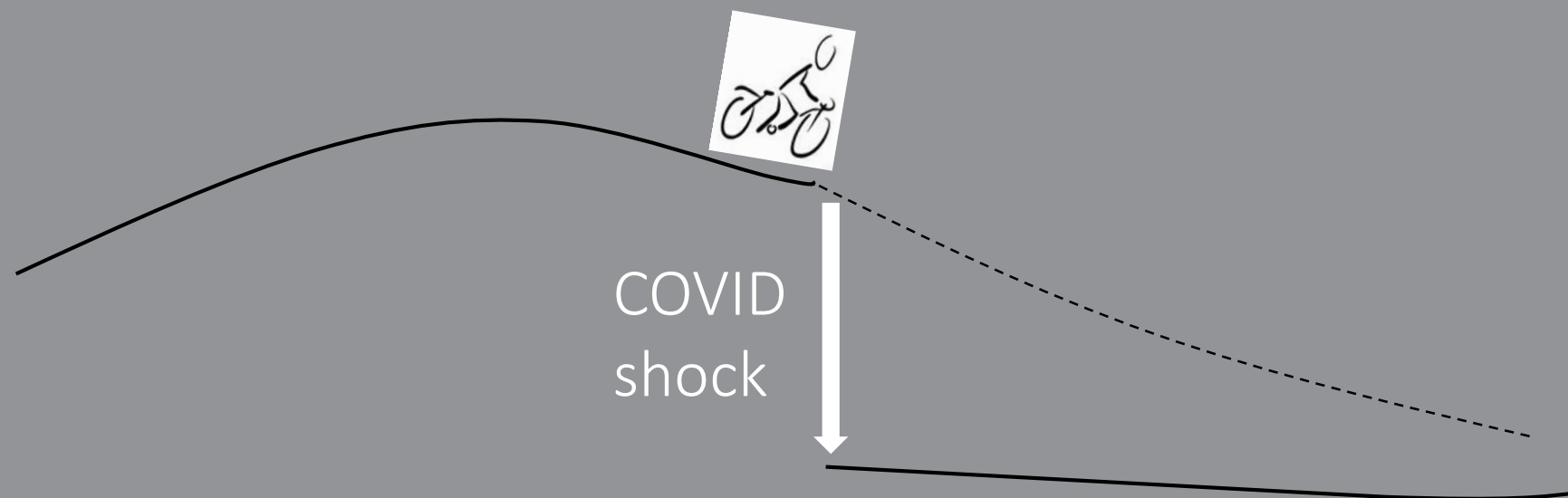


- Trap Avoidance Analysis



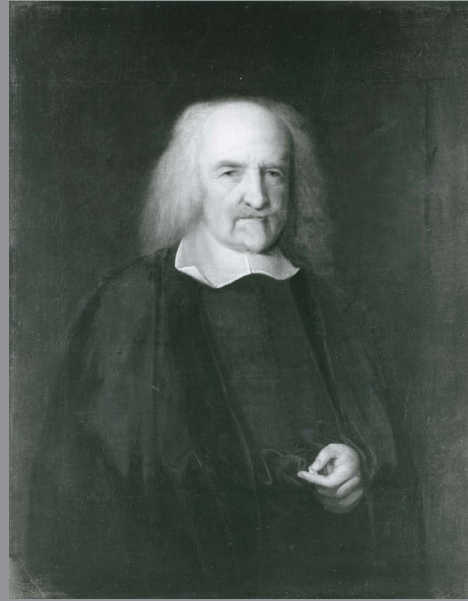
COVID as **Naked Swimmer Moment** and **Trend Accelerator**

- Health externalities
 - No universal health care
 - No sick leave
 - Death rate across minorities
- Trend accelerator
 - Optimal speed – growth vs. disruption (human capital)



Social contract

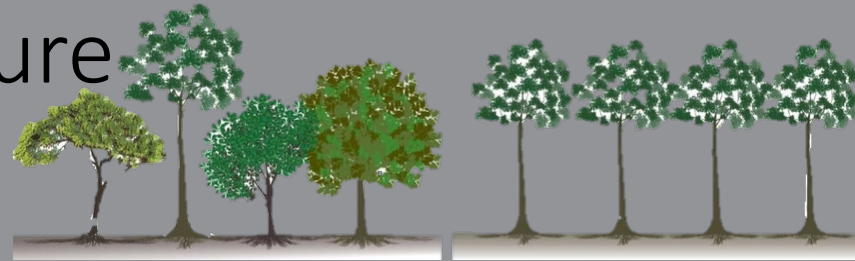
- Thomas Hobbes, (*Leviathan*, 1651),
John Lock,
Jean-Jacques Rousseau
- An externality interpretation



- Social contract to limit
 - Externality from others
 - Shocks (externalities from mother nature)
 - John Rawls and the “veil of ignorance”
 - Not insure, but provide resilience
 - Ladder to get out of the hole – not universal basic income
 - Dignity and limits moral hazard

Diversity, Flexibility, Growth, and Resilience

- Diversity vs. Monoculture



- Shocks are more idiosyncratic than symmetric
- Reduced willingness to insure each other (Alesina)

- Flexibility



- Growth

- Bicycle analogy



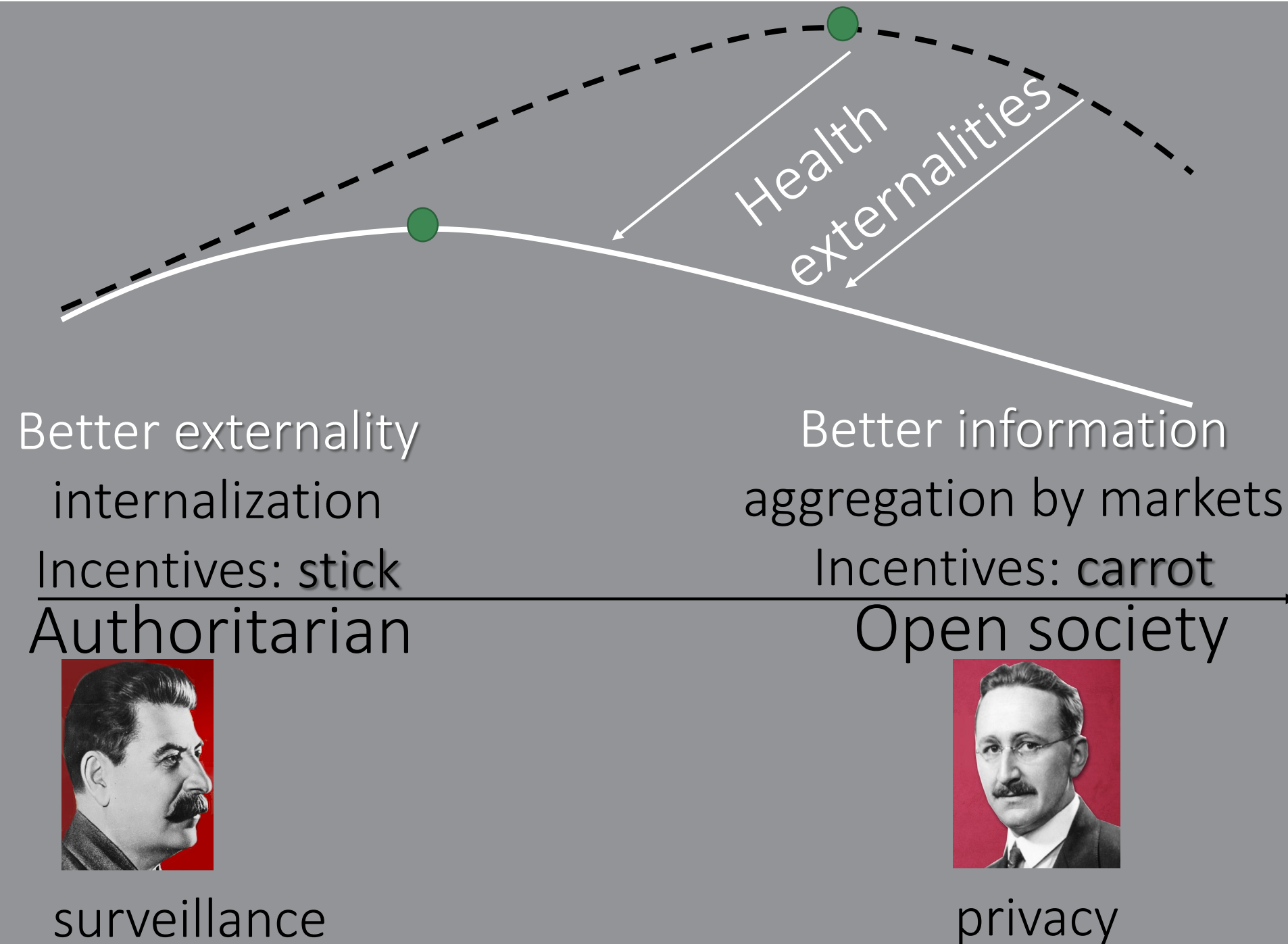
“A social contract that boosts inclusive growth stabilizes the social contract.”

Implementing Social Contract

- Social Norms
 - Japan as example
 - Common identity, sense of community, (homogeneity)
- Government enforcements
 - Command and control
 - Pigouvian taxes/subsidy “stick/carrot”
 - Surveillance vs. privacy
- Markets (+ property rights)
 - Information aggregation
 - Explicit insurance contracts
 - Limited liability, defaultable debt
 - Growth stabilizes social contract

Temporary or permanent shift?

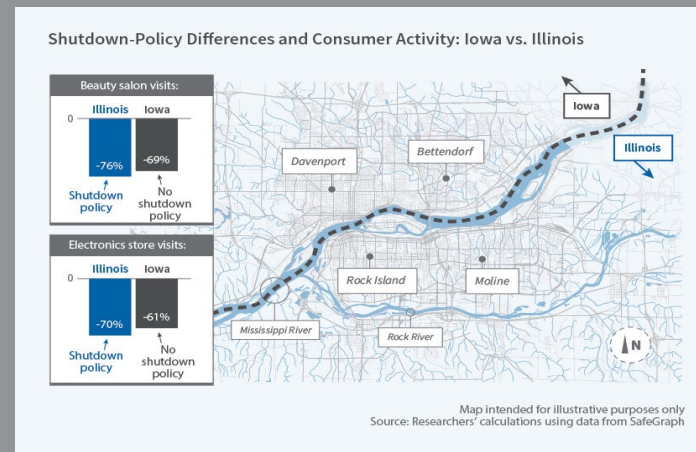
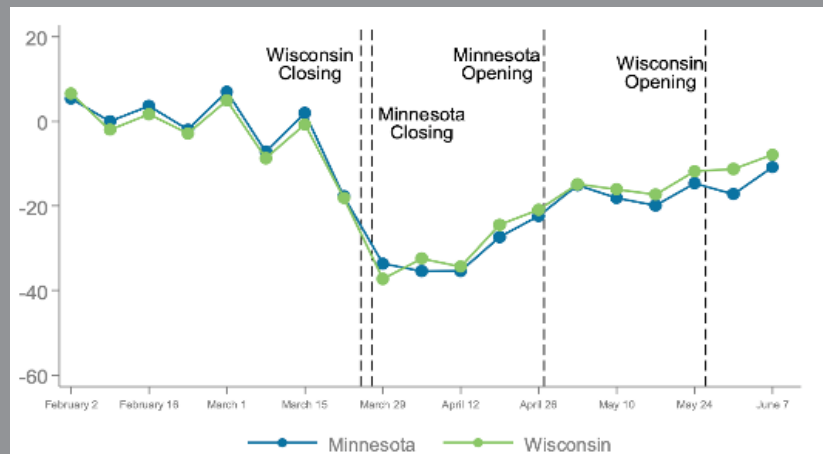
- Will we return to the pre-COVID social order?



What changes people's behavior (social distancing)?

1. Wave: COVID Fear

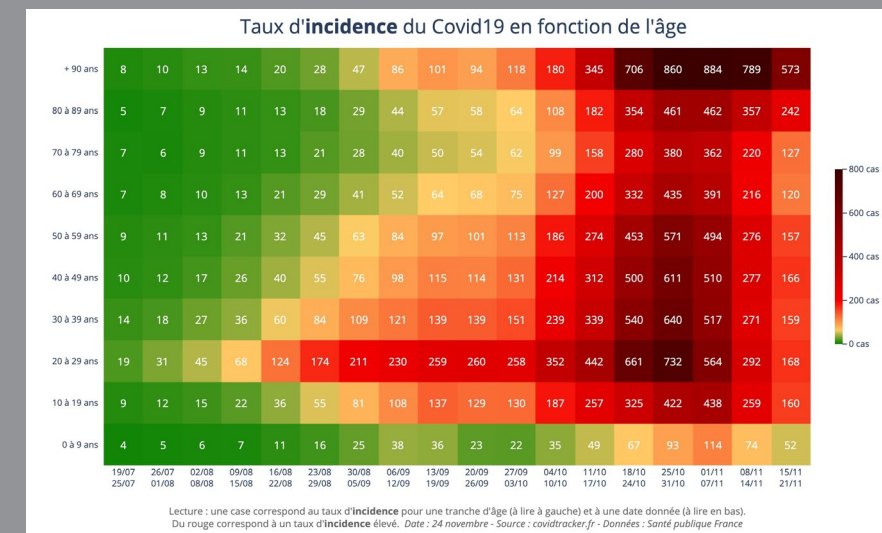
- Sweden vs. Denmark
- Wisconsin vs. Minnesota



Chetty et al. (2020)
Gooldsbee & Syverson (2020)

2. Wave: COVID Fatigue

- Endowment effects
- Optimal Expectations (Brunnermeier & Parker, 2005)
 - Optimistic beliefs if it doesn't distort behavior
 - Government limits choice
 - Externality



Illusory Health-Wealth Trade-off

- **In AE: Dynamic trade-off**

- Lock-down now
 1. Wave: Reduction in GDP would happen anyways due to fear
 2. Wave: Fatigue
- Better future health and wealth

- **In EMDE:**

COVID death vs. starvation

- Lives vs. visible lives

(power of accounting)

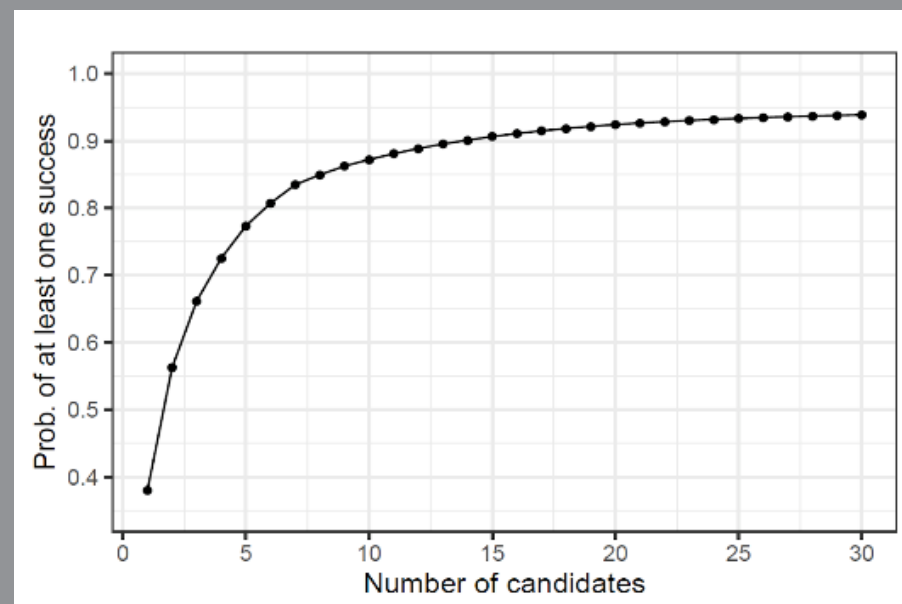
- Side-effects of lockdown

- COVID – starts as a crisis of the rich/travelers
airport in big cities (connection to China)
- COVID spread first in big cities
- Lock-down:
migrant workers returned to home (to country side)
 - Spreading across regions to the poor who are especially hard hit

“What is measures
will be managed”

Cost of testing/vaccines tiny compared to lockdown

- Weekly cost: US \$80bn, World \$200bn, need >> efficiency
- Testing, testing, testing
- How to fund vaccination development?
 - Don't: normal profit margin, fail lost your money
 - Way 1: X prize/excess profit margin, but commitment problem
 - Better Way: insure against failure
- 14 vaccine development in parallel (redundancy)
 - How many? Depends on correlation



- Vaccine distribution

The Future of **Globalization** (Slowabilization)

- From **cost minimization** to  **Resilience**
 - **Just-in-Time**  **Just-in-Case**



Poly-poly toy

- Cheap
 - Cheapest supplier/country

Reliable/sustainable

3 different suppliers (dual sourcing)
from 3 different continents



How Great Powers Compete Economically

1. Global infrastructure – power projection -

Brunnermeier, Doshi, James
Washington Quarterly 2018



Berlin-Bagdad Railway



Belt Road Initiative

historical comparison: Imperial Germany vs. UK – China vs. US

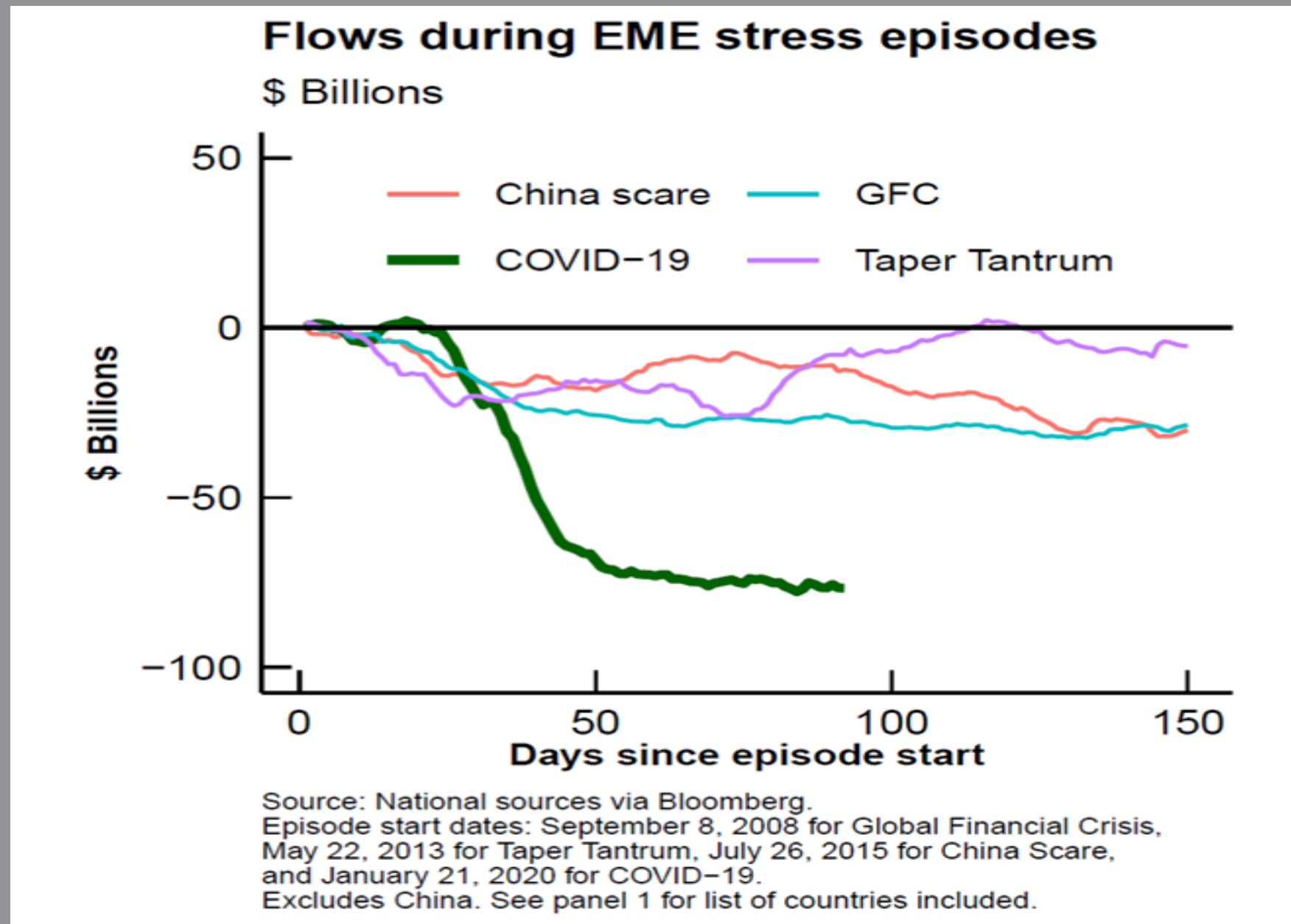
2. Finance: Weaponization of dollar, digital money tech (digital RMB, Libra, ...)

3. Standard setting: GSM, 5G, ...

4. Digital borders – privacy considerations

Global Financial Crisis – just avoided in March 2020

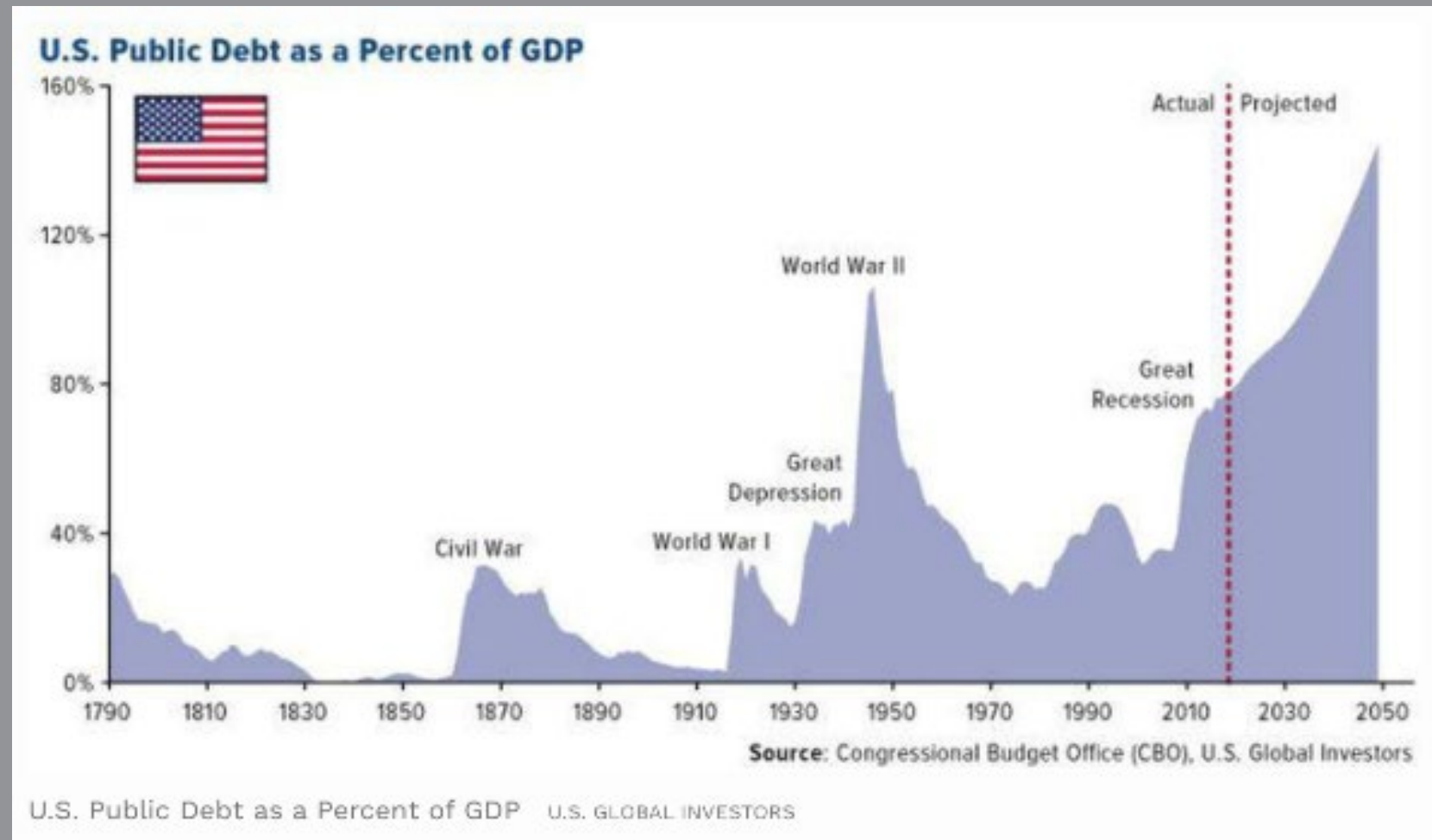
- Flight to safety in the US dollar



- Fed interest rate cut and repo facility

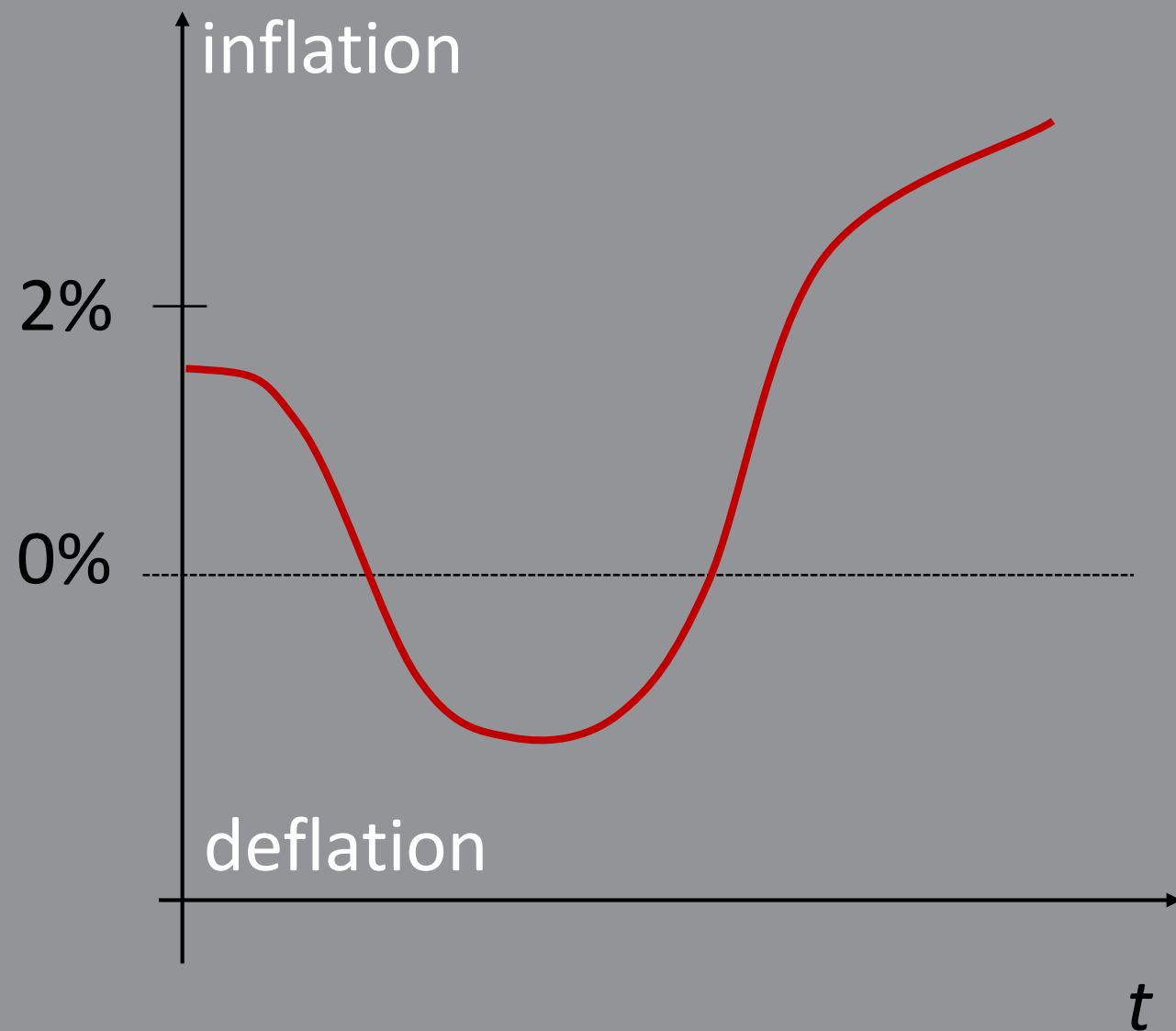
Public debt and interest burden

- Fiscal space



- Vulnerability to interest rate spikes
- Who benefits from social programs? Who should pay for it?
 - Credit card receivables

Tail/Trap Risk: “Inflation whipsaw”



■ Inflation/deflation pressures

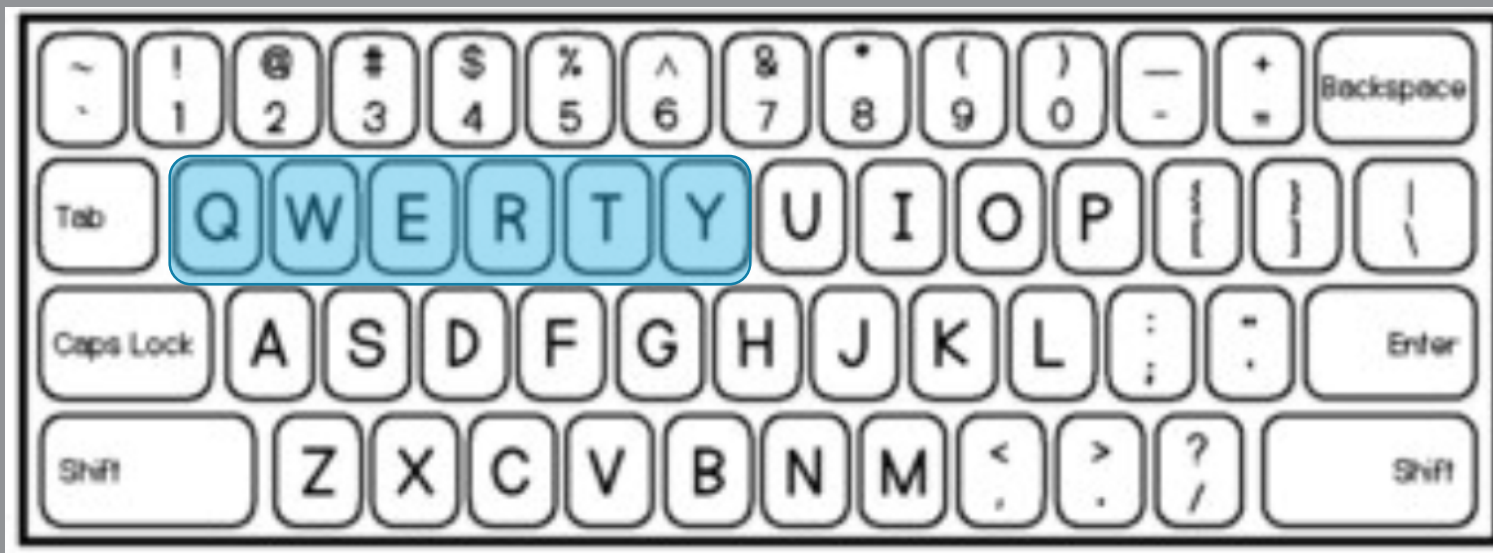
- Risk
- Forced savings
- + Pent-up demand
- + capital misallocation
- + (re)-distribution
- + government commitment
- /+ Lending policy
- + Margin for large firms
- Weak financial sector

low supply
higher demand

- Innovation

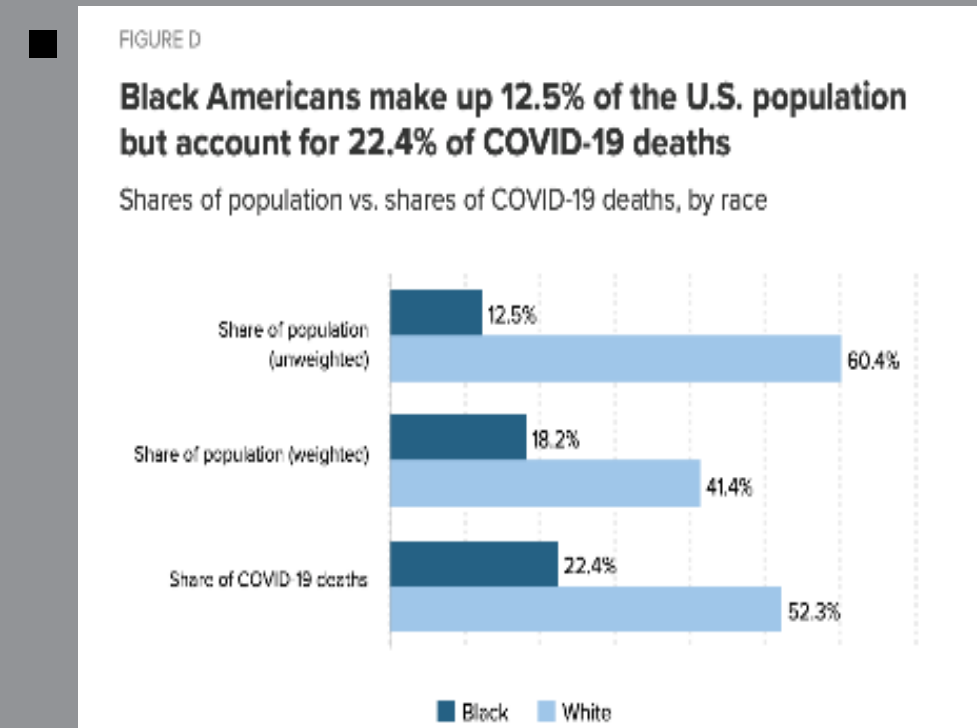
Overcoming cannibalization, QWERTY problem, and regulatory shackles

- Tele medicine
- Home office and urbanization reversal
- Online learning/conferencing
- Digital Money
- Virtual world



COVID as inequality enhancer

- Typically wars and plagues are inequality levelers



- GIG economy and job security
- Residential inequality: poor in rich neighborhoods
- Online learning by high(low)-income schoolkids

2020 is not 2008

	2008	2020
Pre-crisis	Build-up of imbalances <ul style="list-style-type: none">- Run-up of credit/housing- Thinly capitalized (shadow) banks	Well balanced <ul style="list-style-type: none">- US gov. debt expansion- Corporate debt
Trigger	Re-evaluation: real estate <ul style="list-style-type: none">- Regional correlation	Corporate cash flow crash
Amplification	HH & banks' balance sheets	Corporate sectors balance sheets
Fin-sector	Shadow banks (part of banks)	FinTechs for mortgages Banks still for SMEs
Structured finance	CDOs	CLOs
Policy objective	Demand stimulus	Survival
Speed	Fast	Extremely fast

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