The COVID recession: what does it mean?

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Yesterday saw the release of long-awaited figures on the UK economy. They confirmed what we all knew: there has been a massive slump in output and we have been in a recession. In fact, this slump has been the largest amongst our European and global peers, a fact I shall revisit later in this blog.

Yet all is not necessarily as it seems. Superficial comparisons to previous recessions suggest that the severity of the current situation is off-the-scale. To highlight just a few of the figures given by the Office for National Statistics, the estimated quarterly fall in GDP (20.4%) is an order of magnitude greater than the second largest fall (2.7%) since modern records began in 1955. For context, the largest quarterly fall in 2008/9 was 2.0%.

Yet is this a fair yardstick by which to measure things? After all, the recession of 2020 was a deliberate and intended function of policy. The entire point of "lockdown" was to prevent many types of activity. Yet GDP measures economic activity.

Now, not all activities prevented were economic in nature – I was unable to visit relatives (even outdoors) or sit down in the park for several weeks – but a great many *were*. The entire hospitality sector was deliberately shut down by fiat, as was non-essential retail for most of the period.

Moreover, many other businesses (notably in construction and manufacturing) had to temporarily shut down activity whilst they reconfigured operations in order to adhere to government guidelines. The same government decree meant that offices shut and childcare facilities have been greatly curtailed and leisure travel was strongly discouraged[1].

I do not remember the government intentionally shutting down vast swathes of the economy in 2008/9. Or at any other point. Unlike that period, this recession is also destined to be short. A large increase in economic activity (relative to that low point) is already "baked into the cake" (we're already half-way through the third quarter).

In contrast, predictable factors (especially Christmas and summer holidays) cause economic output to vary quite dramatically within each year[2]. The overall impact of this is close to zero (and in official figures gets "smoothed" away by seasonal adjustment).

Look at the third largest quarterly GDP fall on record: the second quarter of 1958. Yet nobody remembers the recession of 1958 because there wasn't one. The next quarter, GDP bounced back and kept growing after that.

That tells us something hugely important: the real impact of a recession is not determined by a single quarter (or month). In fact, I would argue that the nature of the recovery is far more important than the size of the maximum quarterly contraction.

Severe recessions are typically both deep and long. Most recently, this was true in 2008/9, when output began to decline in the second quarter of 2008. It didn't finish falling until over 12 months later.

However, perhaps a better measure of the "true" severity of a recession is how long GDP per person takes to fully recover. It took 3 years and 6 months for GDP per capita to surpass its peak during the Barber boom of 1973.

It took 4 years for GDP per capita to fully recover in the recession of the early 1980s (and, of course, far longer for some areas that continued to be blighted by industrial decline and joblessness for years afterwards). The commensurate figure for the early 1990s was 3 years and 3 months.

By this measure, the 2008/9 recession stands out. It took over 7 years for GDP per capita to fully recover. Tempting though it might be to label the 2020 recession the “biggest ever” and prognosticate on how awful things will be, it is simply far too early to do that.

Yet the all-important recovery is likely to be shaped by government. Some factors are beyond anyone’s control: a safe and effective vaccine or treatment would of course be a silver bullet. However, some factors are clearly within the state’s purview.

Government can effectively “cryogenically freeze” parts of the economy, which is what has partially happened with the job retention (furlough) scheme. This makes some sense when the government forces firms to shut (as during the “lockdown” period). Once this period ends, the economy can be “unfrozen”, the support scheme is withdrawn and everything goes back to how it was before. This avoids mass unemployment and the economic scarring associated with such an enforced downturn.

Yet the world isn’t going back to how it was before. SARS-CoV2 is still with us and will be for some time to come. As a result, behaviour will change. The problem of such “cryogenics” (if you’ll pardon my analogy) is that it promotes inefficiency and depresses output. The inefficiency grows greater the longer such schemes are in place for.

Companies that make more money when their workforce stays at home (at someone else’s expense) than when they’re operating are not viable. It is staggeringly inefficient to effectively pay them to not operate. After all, workers who aren’t working by definition don’t produce any economic output!

However, it is also clear that there are some sectors that *cannot* operate profitably and efficiently during the pandemic. End the pandemic and their operations would swiftly return to profitability. Other sectors will be on the receiving end of a permanent shift in tastes and operating procedures. Maybe the growth of online shopping, maybe reduced demand for travel, maybe increased homeworking. Who knows?

And that is the key point: as yet we have no idea what permanent shifts will have been induced by the current crisis. What we do know with certainty is that the claimant count is currently double the level it was in February[3], whilst there are fewer than half the usual number of vacancies[4].

This will be concentrated in certain industries. Stories abound of hundreds of applicants applying for a single job. It is difficult to see the value in sending hundreds of thousands to their local Job Centre in such an environment. Two policy measures are required in response. Firstly, we must continue targeted business support measures throughout the remainder of the current financial year. Secondly, we must urgently consider how best to support areas and individuals during industrial transition and a Basic Income must be a part of this.

[1] *The timing of relaxation of these measures has varied across the UK, but most of the relevant restrictions were in place across all 4 nations for the overwhelming majority of Q2. Due to its relative population size, the timing of relaxation in England will have had the largest impact on figures for the UK as a whole.*

[2] *As anyone who has been to France during August or tourist-driven economies during the winter can attest!*

[3] https://www.nomisweb.co.uk/query/construct/summary.asp?mode=construct&version=0&dataset=11

[4] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/timeseries/jp9z/unem