Economics

The U.S. Economy Is Now in Uncharted Waters

Why it's so hard to design an economic response to the coronavirus.

By Tyler Cowen
March 10, 2020, 3:00 AM PDT

Could there be fewer subway cars in New York City's future? *Photographer: Victor J. Blue/Bloomberg*

How bad Covid-19 will be for the U.S. economy is almost impossible to say, since there are few precedents to look to. By considering two extreme scenarios, however, it is possible to get a sense of what the issues are.

First, consider the relatively optimistic view: Covid-19 will have effects akin to what economists call a seasonal business cycle – which is to say, it will be over quickly and without much lasting damage.

For context, note that the U.S. economy usually slows in the first quarter. Christmas sales are over, stores are no longer hiring extra workers, and the pace of activity declines, whether it is publishers releasing books or families going on vacation. These seasonal cycles usually don't make the headlines, because most economic data are seasonally adjusted.

That said, in percentage terms, the economic declines from seasonal cycles are often larger than from recessions. The pain is not so bad, however, because the seasonal cycle is over quickly, and by the time the second quarter rolls around the economy is usually picking up steam again.

So if Covid-19 were to hit the economy like a seasonal cycle, it might look as follows: Public events, entertainment and face-to-face services would all dramatically contract, starting sometime this month. Employers in those sectors would cut back on employee hours and lay off some marginal workers. Uber and Lyft rides would plummet. There would be a more general decline of purchasing power, and that in turn would spread the decline to many other sectors.

Still, in this scenario there is also a rapid path back to recovery. At some point the terror of Covid-19 will lift, just as cases in many parts of China now seem to be declining. Once public health conditions improve, retail, entertainment and services can gear back up. Both production and purchasing power will bounce back, similar to how they normally do after the first-quarter doldrums.

In fact, after having been cooped up for a few months, U.S. workers might be especially eager to get back to their jobs and U.S. consumers might be very keen to get out and spend.

But there is a much more worrying scenario. Rather than drawing an analogy with temporary seasonal cycles, an alternative model draws a parallel with cascading disruptions. Have you ever tried building a sand pile and noticed that, at some point, adding a few more handfuls of sand causes a kind of avalanche, leaving just an amorphous heap?

This less sanguine option might look like this: The Chinese economic slowdown leads to a permanent loss of momentum and a global recession. At the same time, with Lombardy closed down, the Italian government defaults, but the European Union is unable to resolve the matter (and the associated bank failures) in a timely and resolute manner. Governments vacillate between policies that make it easier for people to stay at home to limit the spread of the disease and policies designed to get them back in the workplace.

The U.S. would be caught up in the general loss of confidence, as well as the contagion from European banks. But that is only the beginning. As schools close to limit the spread of Covid-19, single parents would have to stay home, and the resulting production bottlenecks would plague the U.S. economy. Maybe New York City would have to cut back on the number of subway trains it runs, and much of the city's economy would grind to a halt. Supply chain problems from China would persist, hitting everything from medicines to the ordinary goods found in a Walmart.

The problems of missing goods in the supply chain, workplace absenteeism, family health emergencies, and investor uncertainty would compound each other. Any individual act of spending or production, rather than jump-starting further economic activity, would run up against another bottleneck and fade to insignificance. The confidence boost would fail to materialize. Untangling this mess of problems is much harder than just getting people to go back out to dinner and the movies again, and could take years. Traditional demand-side stimulation from the Fed or from the fiscal side would not itself reverse the stagnation.

I don't think anyone knows which of these scenarios – or the intermediate possibilities – is most likely. That makes an appropriate macroeconomic countercyclical policy hard to design. From an economics standpoint, these are uncharted waters. That's all the more reason to focus on solving the underlying public health problems as soon as possible.

To contact the author of this story:
Tyler Cowen at tcowen2@bloomberg.net

To contact the editor responsible for this story:
Michael Newman at mnewman43@bloomberg.net

Tyler Cowen is a Bloomberg Opinion columnist. He is a professor of economics at George Mason University and writes for the blog Marginal Revolution. His books include "The Complacent Class: The Self-Defeating Quest for the American Dream."

Read more opinion

Follow @tylercowen on Twitter

COMMENTS

19

In this article

UBER
UBER TECHNOLOGIE
21.71 USD ▼ -0.90 -4.00%

WMT
WALMART INC
107.79 USD ▲ +3.74 +3.59%