

# 19 COVID Lessons and a Social Contract for Resilience

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*Based on  
New Book*

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

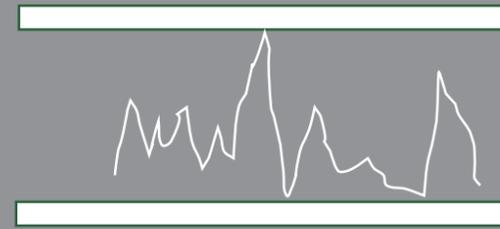
26. November 2020

# Resilience

- Risk management

- Variance
- Tail Risk Analysis

- squeezed between concrete wall



- Resilience management

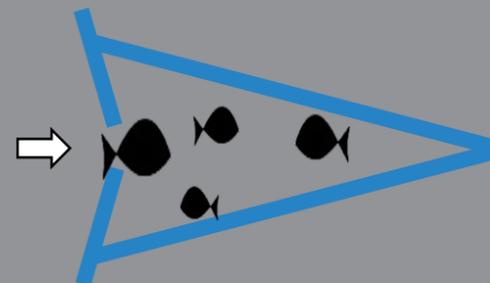
- Mean-reversion  
bounce back

- squeezed between rubber wall



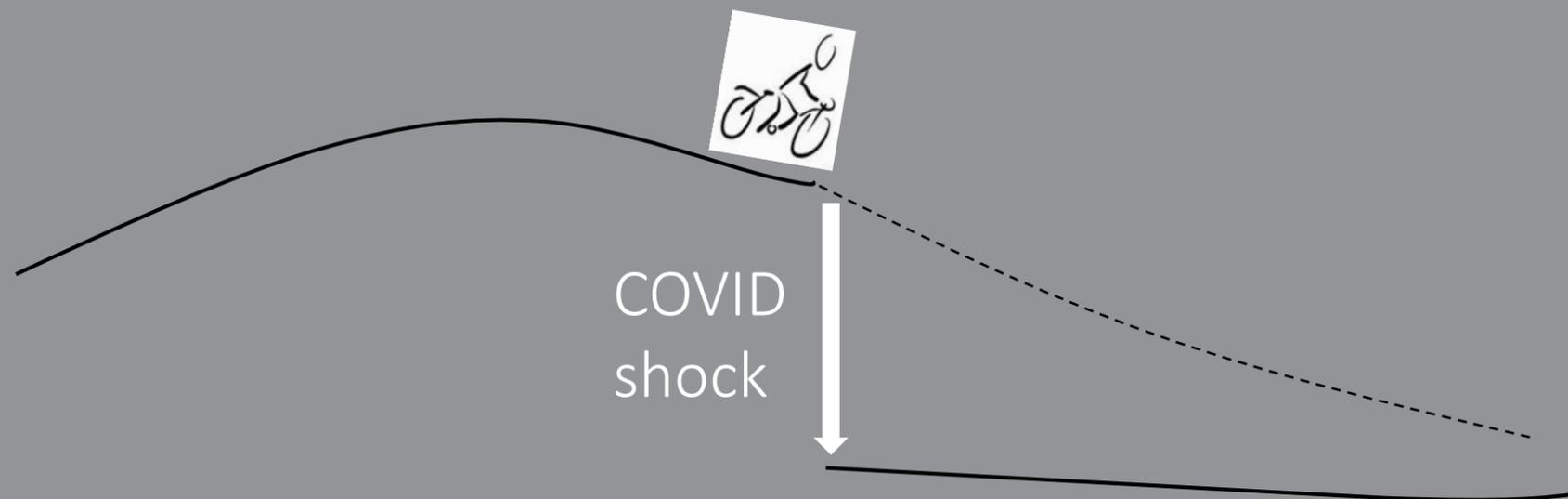
roly-poly toy

- Trap Avoidance Analysis



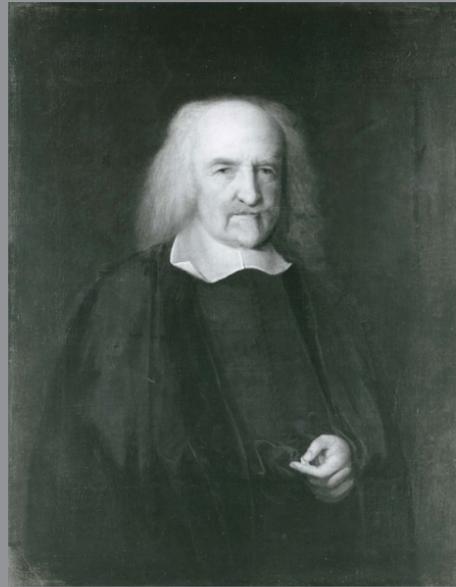
# COVID as **Naked Swimmer Moment** and **Trend Accelerator**

- 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



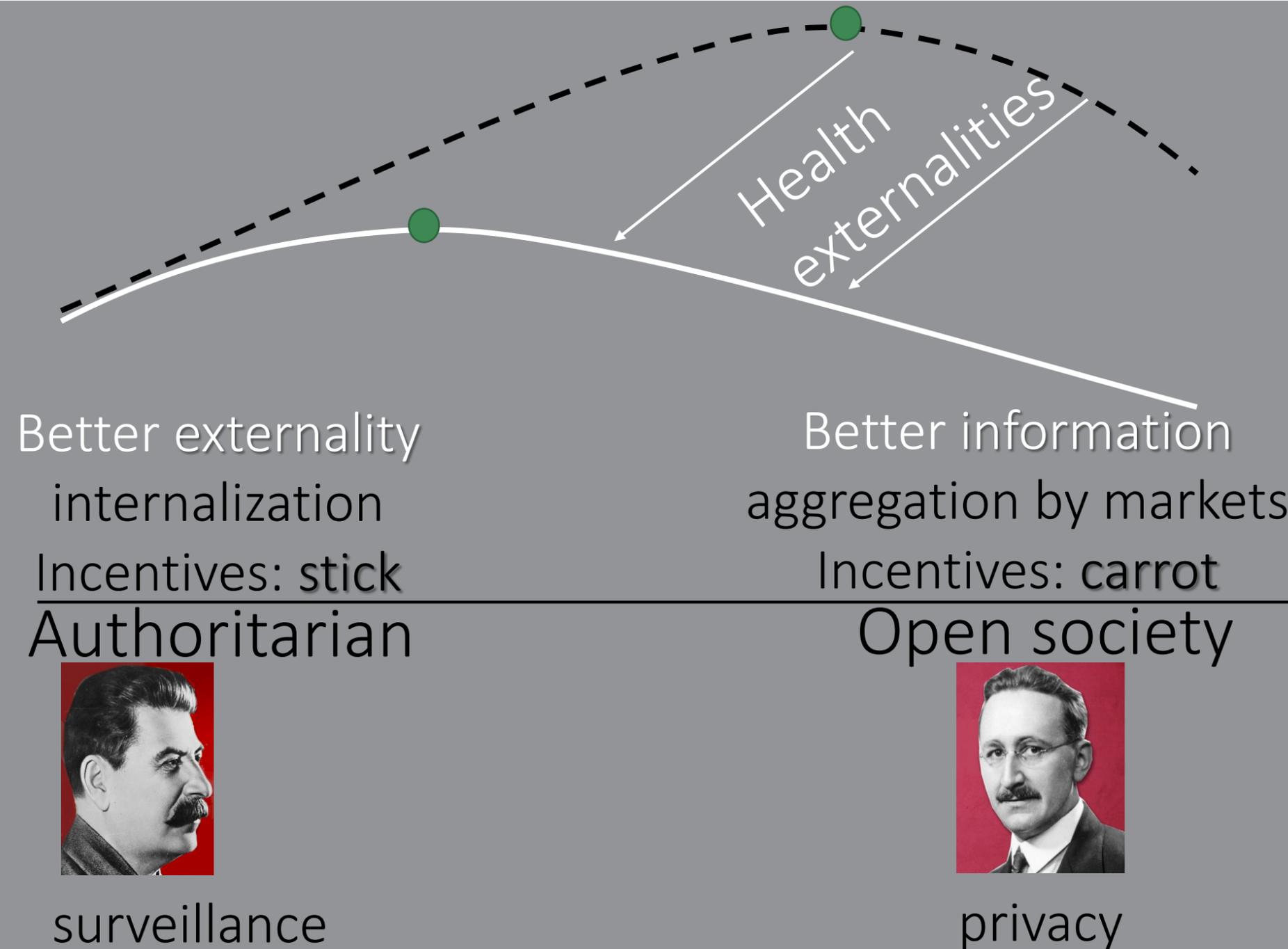
“A social contract that boosts inclusive growth stabilizes the social contract.”

# 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?

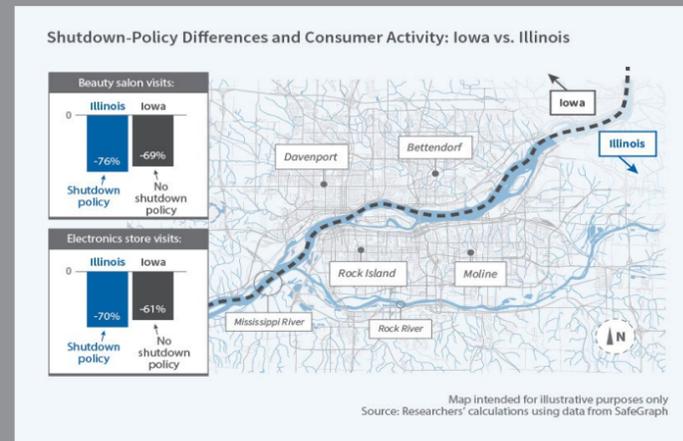
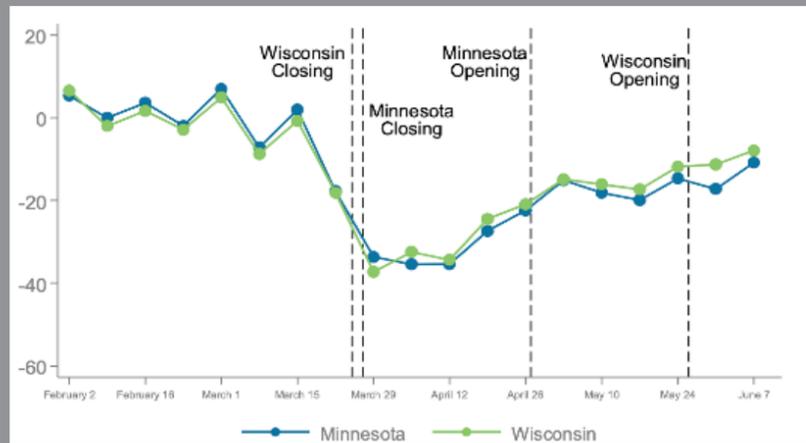
- Will we return to the pre-COVID social order?



# What changes people's behavior (social distancing)?

## 1. Wave: COVID Fear

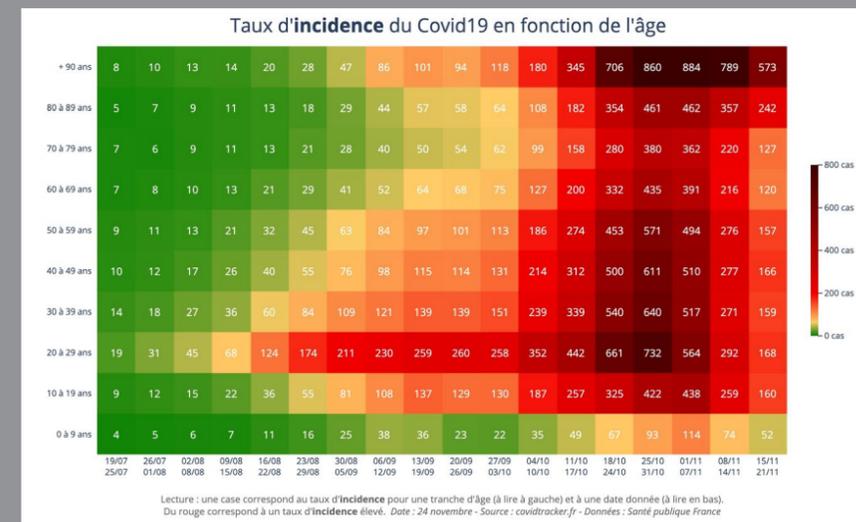
- Sweden vs. Denmark
- Wisconsin vs. Minnesota



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)

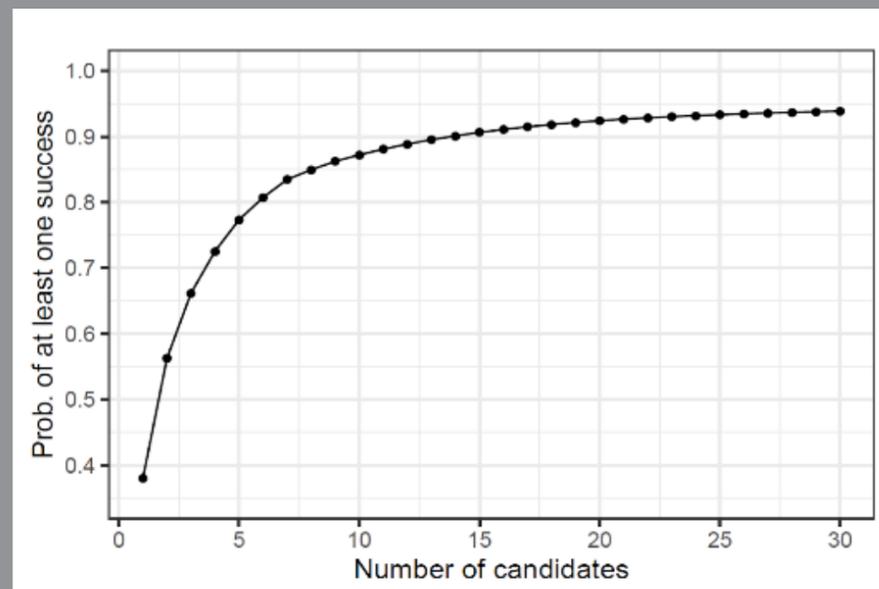
## ■ Side-effects of lockdown

- 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 measured  
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

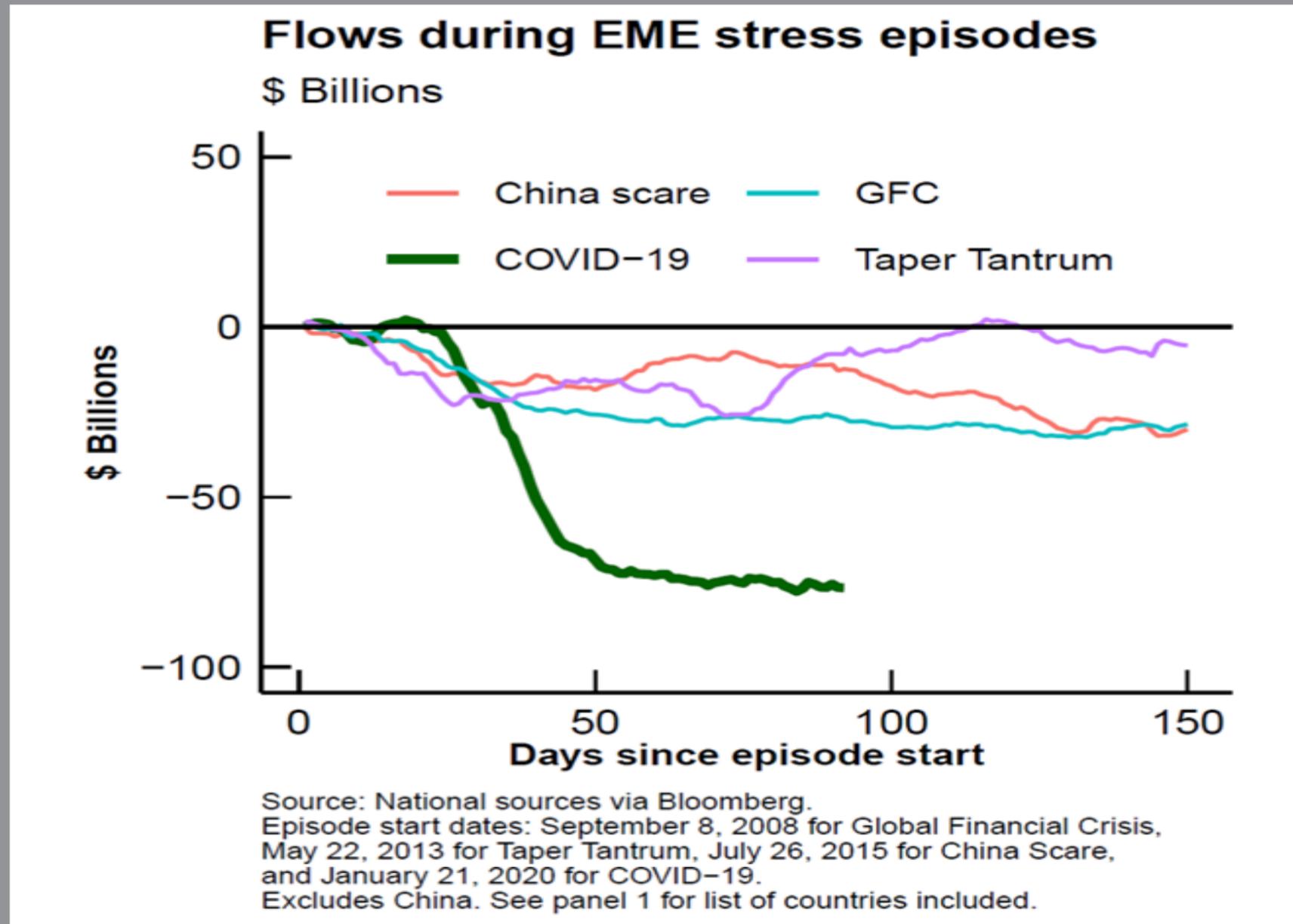
## 2. Finance: Weaponization of dollar, digital money tech (digital RMB, Libra, ...)

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

## 4. Digital borders – privacy considerations

# Global Financial Crisis – just avoided in March 2020

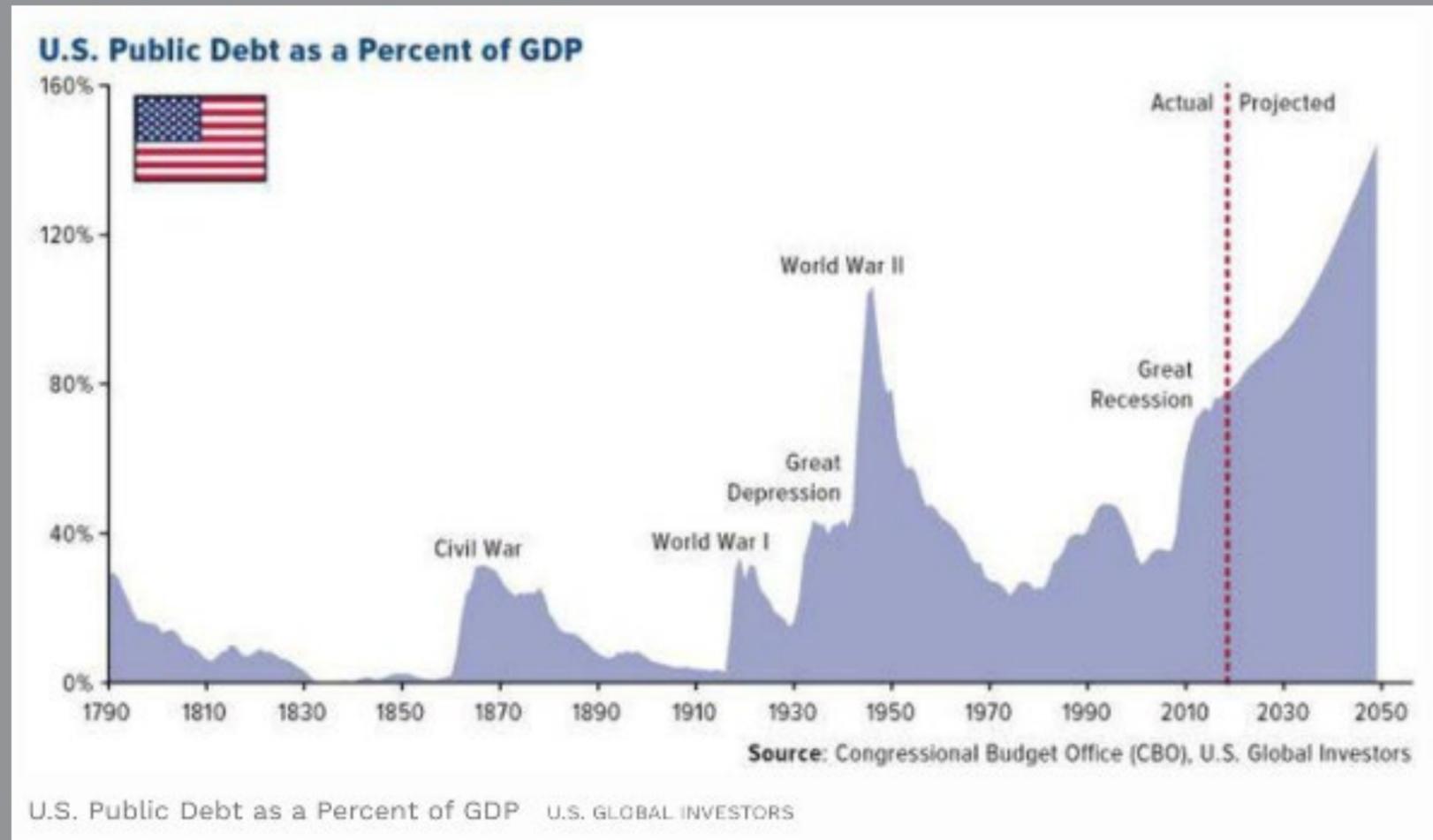
- Flight to safety in the US dollar



- Fed interest rate cut and repo facility

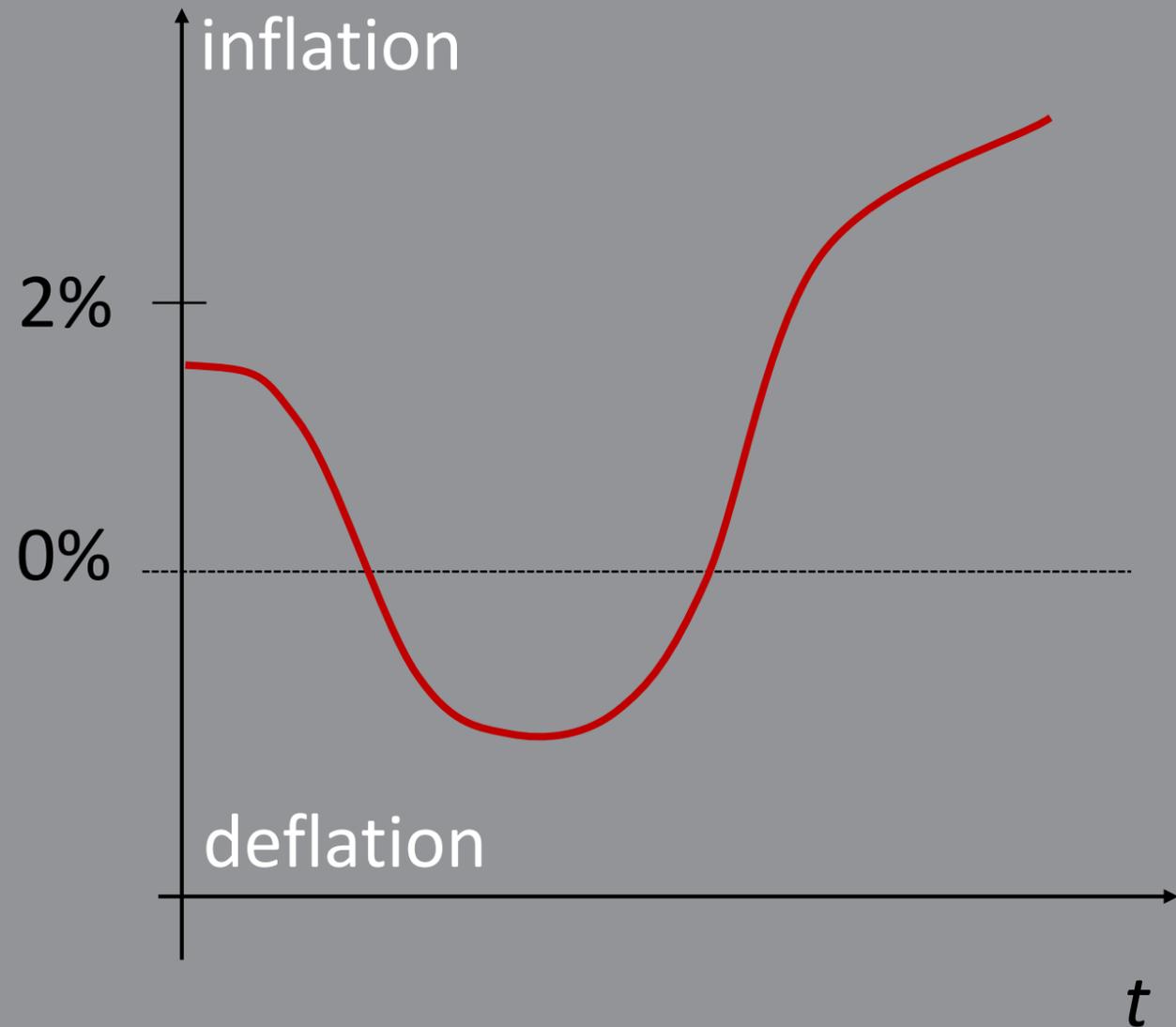
# Public debt and interest burden

- 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

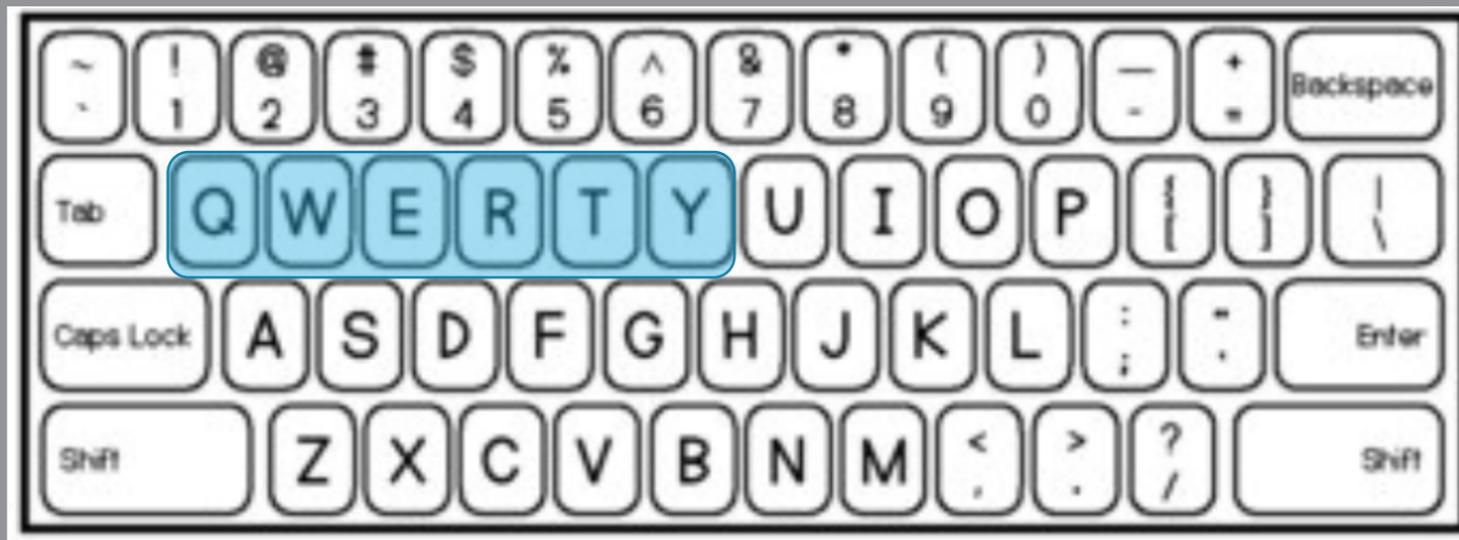
low supply  
higher demand

# Innovation boost

- Innovation

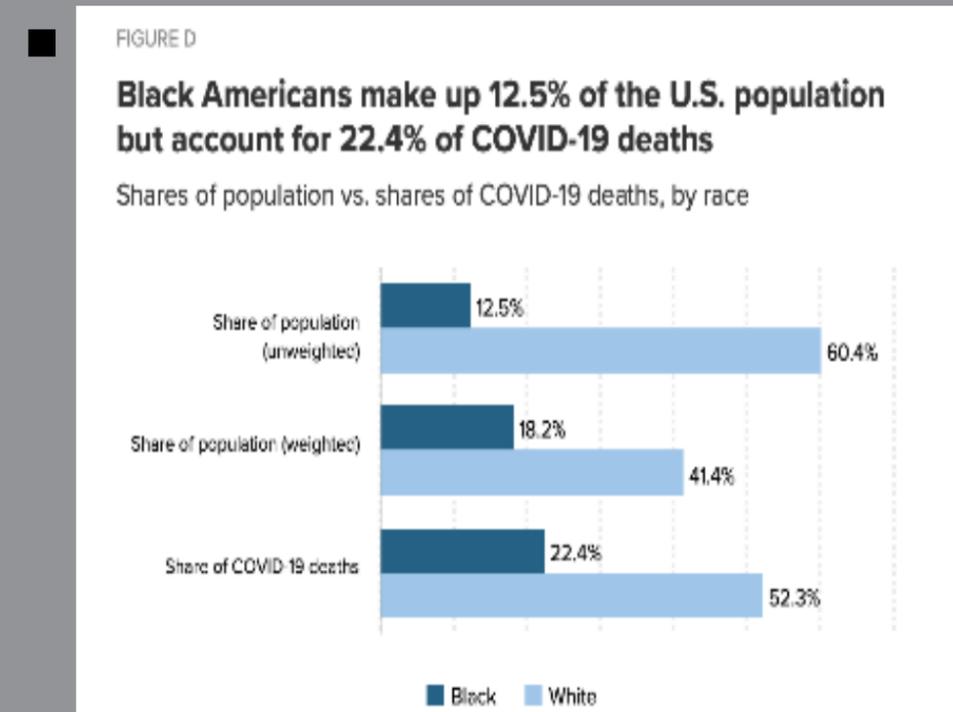
Overcoming cannibalization, QWERTY problem, and regulatory shackles

- 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 - Run-up of credit/housing - Thinly capitalized (shadow) banks	Well balanced - US gov. debt expansion - Corporate debt
Trigger	Re-evaluation: real estate - Regional correlation	Corporate cash flow crash
Amplification	<b>HH &amp; banks' balance sheets</b>	<b>Corporate sectors balance sheets</b>
Fin-sector	Shadow banks (part of banks)	FinTechs for mortgages Banks still for SMEs
Structured finance	CDOs	CLOs
Policy objective	<b>Demand stimulus</b>	<b>Survival</b>
Speed	Fast	Extremely fast

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