Long Reads

The Post-Pandemic Economy's Barriers to Growth

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NEW YORK – As the world grapples with the COVID-19 pandemic and its economic fallout, it is time to start thinking about the potential barriers to global growth in the post-pandemic era. Governments have ballooned as a result of the crisis, and it will be the state's job to shepherd the economy toward recovery as the private sector's contribution to GDP will shrink.

At the same time, major industries that have become more concentrated – particularly in the technology sector – will experience increased regulatory pressure, potentially leading to breakups. The broad trend toward deglobalization will accelerate, undermining trade, capital flows, immigration, and the spread of ideas. The multilateral institutions that have governed the global economy for 75 years will continue to be sidelined.

Fiscal Fallout

Against this background, there will be five major barriers to growth in the months and years ahead. First, government balance sheets will get even bigger than they already are, with both fiscal deficits and public debt continuing to expand in monetary terms. Early in 2020, total global debt as a share of GDP had already reached 322% – a new milestone.

The International Monetary Fund warned that government debt worldwide would surpass 100% of GDP and remain above that threshold for the next two years. Major economies such as the United Kingdom and the United States have already breached this ratio in responding to the COVID-19 crisis.

For the US, this milestone comes a decade after the Congressional Budget Office issued its own warning about the growth of US deficits and public debt, which could render entitlement programs like Social Security, Medicare, and Medicaid unsustainable by 2030. In other words, America's looming fiscal crisis is rooted in decades of profligate spending patterns, not simply in the stimulus and support measures of the past few months.

And the US is not alone. In 2012, German Chancellor Angela Merkel warned about the scale of Europe's welfare system, pointing out that a region representing roughly 7% of the world's population and 25% of global GDP accounted for 50% of global welfare payments. European welfare programs and government spending have only grown since then. In 2018, the US and the European Union together represented 12% of world population, and half of global GDP. It also represents 90% of global welfare payments – partly paid for by increasingly unsustainable public debt levels.

These deficit-financed outlays will increasingly drag down economic growth, especially now that these same governments are taking on mountains of additional debt to deal with the pandemic-induced spike in unemployment. The debt burden from the crisis will plague the global economy for years to come.

The Hungry Leviathan

The second potential barrier is the state's expanding role in the economy. At least since the 2008 financial crisis, governments have increasingly adopted economic policies that go far beyond traditional fiscal stimulus. Likewise, central banks continue to pursue extraordinarily loose monetary policies, reducing benchmark rates to near or below zero and launching asset-purchase programs and other unprecedentedly aggressive measures to maintain liquidity.

In response to both the 2008 crash and the COVID-19 crisis, major governments have rushed to bail out industries such as airlines, cruise lines, and banks. Governments have become not just the lenders of last resort – even going so far as to buy up corporate debt – but also the *de jure* employers of last resort through retention and furlough schemes. According to ratings agency Fitch, direct US fiscal support had reached 11.5% of GDP by the beginning of July.

Moreover, additional structural factors suggest that the government's economic footprint will continue to expand. In addition to weakening economic growth, economies around the world are confronting massive unemployment as a result of the crisis. When the recovery comes, it will likely be driven heavily by technology, raising the prospect of labor-replacing automation and the creation of a jobless underclass or precariat.

As such, many of the current job losses likely will not be temporary. Rather, they will hasten a structural shift toward a more automated, digitized workforce with fewer humans and more long-term unemployment.

Making matters worse, today's dislocations in the global economy are such that there is less investment capital in the private sector. As governments gradually expand beyond the state's traditional role – delivering public goods, regulating the economy, and temporarily intervening when markets fail – they will become more powerful arbiters of the allocation of key factors of production, including capital and labor.

As a result, while the prevailing economic concerns during the pandemic point to the need for even more public support, with governments becoming both lenders and employers of last resort, high unemployment and low growth will make it even more difficult to reverse course. The state's enormous expansion will become permanent.

They Don't Make Them Like They Used to

Third, the corollary to rapid expansion of government is a shrinking private sector. Even before the pandemic, there were concerns that the private sector's contribution to GDP was in decline around the world. For example, in the UK, private-sector output shrank for four consecutive quarters up to September 2019, representing British enterprise's poorest run in more than 25 years. In fact, even as headline UK GDP increased by 1.8% in September 2019, the private sector's output actually fell by 0.8%.

More broadly, there are fewer publicly traded companies today than there were 20 years ago. Notably, listings in the Wilshire 5000, which is often used as a benchmark for the US equity market, have fallen by more than one-half since 1998, from 7,562 members to just 3,451 by June 2020.

There are many reasons for this trend. A lot of companies want to avoid the added scrutiny and transparency that markets and regulators demand, and many other companies have chosen not to be listed in the first place. But the trend also reflects the fact that many important industries are consolidating (bought companies are no longer listed on stock markets).

A fourth major barrier to growth will come from tax and regulatory policy, where there is growing momentum to address market concentration by forcing companies to break up. Such pressure has already inadvertently created oligopolies and monopolies in many sectors. Over time, banking, just a few companies – some the product of mergers, others natural monopolies through growth – have come to dominate energy, pharmaceuticals, airlines, and technology.

The five largest US technology companies are not only dominant in their own sector; they also represent 20% of the entire stock market. This concentration of market power in a few firms' hands has become an invitation for increased taxation and regulatory scrutiny, which could sap the dynamism of the economy's leading growth engines.

Balkanized and Broken

Finally, the post-pandemic era will likely be a period of accelerated deglobalization, as the pre-crisis trends toward protectionism become further entrenched. These zero-sum policies reflect broader challenges to the liberal international order. Governments are increasingly stepping in to defend domestic industries, partly in response to populist pressure from workers and other constituencies.

At this point, there is an acute threat to all five pillars of globalization: trade, capital flows, immigration, the spread of ideas, and multilateral institutions. Aside from the escalating Sino-American trade and technology conflict, there has been a discernible increase in protectionism over the past decade. The World Trade Organization reports that import tariffs and quotas on goods and services have become more commonplace, and that the overall rate of growth in trade has fallen.
Worse, trade arrangements are becoming more fractured as countries pursue bilateral negotiations in lieu of global and regional treaties. This has certainly been US President Donald Trump's preferred strategy *vis-à-vis* South Korea, Mexico, and others, and it is also now the standard approach for the UK. Having officially withdrawn from the EU earlier this year, Britain is conducting bilateral trade negotiations with both the US and Japan.

Similarly, global capital flows are under increasing pressure. DHL's Global Connected Index, which provides a comprehensive, up-to-date view on the state of globalization, was dragged down in 2018 by lower capital flows – notably, declining foreign direct investment. In fact, global FDI had fallen for three consecutive years, from $2 trillion in 2016 to $1.3 trillion in 2018. Moreover, governments, including many in emerging markets, have come under growing pressure to protect and preserve capital, and thus have responded by introducing controls.

Now that the world is reeling from COVID-19, capital flows have fallen even further, with more than $100 billion flowing out of emerging-market debt and equity investments during March and April, according to the Institute of International Finance. And, according to the Pew Research Center, the pandemic is on track to reduce global remittances – which tend to flow from rich to poor countries – by 20% this year. In any case, reduced international capital flows means that it will be more difficult for borrowers to repay dollar-denominated debt, and for countries to attract capital to fund investment and growth.

A Thousand Petty Fortresses

Immigration, too, has come under threat over the past decade. In the US, Trump's chest-thumping nativism has resulted in executive orders restricting even highly skilled workers from entering the country. And in Europe, anti-immigration sentiment fueled the campaign for Brexit and has helped elect populist politicians across the continent.

More generally, migration around the world has become more disorderly. Worse,

according to the United Nations High Commissioner for Refugees, the number of displaced people globally nearly doubled between 2010 and 2019, from 41 million to almost 80 million – a record high. That figure is likely to continue increasing as climate change, rising poverty, disease, and conflicts displace more people around the world.

The spread of ideas is also at risk. Here, one significant emerging threat is the rise of the "splinternet." Within the next decade, the global Internet could end up divided between competing China- and US-led technological spheres. Such fragmentation – of data, platforms, and protocols – would further disrupt global supply chains, adding to the pandemic-related economic damage.

A final form of deglobalization is the retreat from multilateralism more broadly. With some countries (namely, the US) actively undermining global institutions, it has become increasingly difficult to establish any new institutions capable of tackling today's most pressing problems, from climate change to decelerating trade growth. Following the lead of the major powers, more countries are preparing to go it alone in pursuit of narrower national agendas.

Dark Days Ahead

History may offer some guidance as to where we're heading. America's Gilded Age (1870-1910) was a period of robust economic growth, strong corporations, and globalization, but also of monopolies, oligopolies, and widening income inequality. It was immediately followed by World War I and then by the Spanish influenza pandemic, which killed at least 50 million people between 1918 and 1920.

The next big global crisis was the 1929 stock-market crash and the Great Depression, which gave rise to a new era in which government grew and assumed a greater role in the economy. A wave of protectionism, triggered by the 1930 Smoot-Hawley Tariff Act, put a dent in global trade. The welfare state was significantly expanded in many Western countries, and antitrust legislation became more entrenched. The next golden growth phase would not come for another 20 years, and when it arrived, it was largely driven by post-war reconstruction.

Today, the global economy is heading into a period of even bigger government. Policymakers are under growing pressure to increase regulation and taxation, and to break up firms and industries that have become too concentrated. The global architecture that has underpinned international commerce and finance for 75 years is wobbling.

Most worrying, this confluence of factors all but guarantees that we are heading into a period of prolonged anemic economic growth. The global economy was already in a precarious place before the pandemic struck. Many developed and developing regions were experiencing slow or no growth, and some were already contracting.

In 2019, German GDP growth fell to a six-year low of 0.6%, and was close to zero in the fourth quarter. Germany's performance was emblematic of a broader weakening across the EU economy in 2019, with growth slowing to 1.5% from 2.1% in 2018, and to just 0.1% in the fourth quarter. And many of the world's largest emerging economies – such as Brazil, Russia, and South Africa – were failing to generate even these levels of growth. In June, the IMF projected a global contraction of nearly 5% this year.

To put these numbers in perspective, an economy needs to grow by at least 3% per year in order to double its *per capita* income within a generation (roughly 24 years). For poor economies starting from a much lower economic base, the minimum required growth rate to put a real dent in poverty is much higher.

In addition to paltry economic growth, the pre-pandemic global economy was grappling with enormous levels of debt and public deficits that had accumulated in the aftermath of the 2008 financial crisis. Moreover, additional headwinds seemed to be making an already bad situation worse, including the technological threat to jobs; weakening demographics – in terms of population size and age as well as the skill level of workers; rising income inequality; resource scarcities and environmental/climate concerns; and declining productivity.

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Furthermore, there were growing fears that both monetary and fiscal policy had become impotent, leading central banks in the US, Europe, and Japan to cut interest rates ever lower, even taking them into negative territory. Meanwhile, a quarter-century of evidence from persistently low-growth countries like Japan suggests that fiscal policy is too blunt an instrument to stimulate growth sustainably.

None of these threats to the global economy has gone away, and now COVID-19 is compounding and exacerbating all of them. It has magnified large risks that were already there, and it has introduced more barriers to growth in the coming decade. Sadly, the global economy is now facing a prolonged economic downturn, regardless of how quickly the pandemic is brought under control.

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