Covid's economic reset: making the quixotic quotidian

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Abstract

It is easy to become dispirited. Despite my concern about the near-term outlook, advising business leaders requires that I look past the pandemic. Akcigit and Ates argue that greater concentration among firms and a slowdown in business dynamism is the cause of a myriad of factors that slow economic growth. Furthermore, a slowing pace of growth of the working-age population and an increase in older members of the workforce, as well as a greater number of retirees, has significant economic consequences for the pace of startups. In contrast, it is possible that the shock from COVID may have boosted business formation and pushed technology adoption across generations, perhaps mitigating some of the demographic impediments to technology adoption. Yet for a large portion of the population, COVID has only meant devastation and despair. Here fiscal assistance is imperative.

Keywords Pandemic · Business dynamism · Productivity · Economic growth · Demographics

As I thought about this year's conference theme and what to cover, I was faced with no shortage of topics. There are the economic inequalities that COVID has brought into stark relief. The disproportionate way that COVID impacts low-income families is like no other recession of the last century (Long et al. 2020). There are the new frontiers for monetary policy and the changing nature of central bank balance sheets; what was once unconventional is now a valued part of the tool kit. The once quixotic is now quotidian. In addition to economic topics, many past presidents have covered topics relating to business economics generally, the state of NABE, and the role business economists play in their firms and as part of civil society.

1 NABE update

Duncan Meldrum's 2004 address in Philadelphia asked a critical question of our membership, what do we want to be when we grow up? Do we want to be a professional

organization, a membership organization, or a hybrid? At the time, Duncan was speaking to a membership that was shrinking, falling by 12% over the previous 3 years. Thanks to the stewardship of our past presidents, the board, our many engaged roundtable chairs and last but not least our cohesive and dedicated staff led by Tom Beers, NABE is in a very different place today. And this is despite the enormous economic challenges we are confronting every day due to COVID. Throughout the pandemic, a steady stream of pandemic-related webinars and two previous on-line conferences have contributed to a growing membership. I so wish everyone on the NABE staff could hear our round of applause in appreciation for all you have done to keep NABE front of mind for those seeking insight on economic topics. Bravo!

Thanks to the vision of our dearly departed past president, Frank Schott, we have been offering the Certified Business Economist designation for 5 years and we have 161 CBEs. Frank proposed the idea of a certification in his 1978 Presidential Address entitled Continuing Education In Business Economics—Toward A More Systematic Approach (Schott 1979). It certainly cannot be said that economists rush into things without giving them thorough vetting and development. While the current CBE designation rate comprises a mere 8.4% of our core membership, over time we expect this to include the majority of core NABE members. Indeed, I think we should set a goal that by 2028, 50% of our core

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members will have the CBE designation. It would certainly be fitting for us to achieve 50% on the 50th anniversary of Frank's presidential address. Too quixotic? Perhaps, but I believe for the quotidian to have meaning, we need to have quixotic goals from time to time. In order to achieve this, NABE will need to make sure the CBE is relevant and fulfills the self-interest of up-and-coming economists as well as their employers. NABE is already thinking through ways to refresh and update the CBE coursework. Tara Munroe is expanding our partnership with universities and the NABE Foundation Diversity Scholars Program will help ensure we have an impact on the diversity of the pipeline for the economics profession for years to come.

NABE is an organization that works diligently to maintain its relevance and utility for its members. During the pandemic our community came together to help one and other. In the midst of lockdown, companies such as Open Table, Home Base, Alphabet, and Apple began to share their data, viewing it as a public good that would help economists and policy makers understand this silent threat to our lives and our economy. The ADP Research Institute collaborated with economists at the Board of Governors and University of Chicago, allowing their wealth of data to illuminate the contour of the labor market impact from COVID. NABE began organizing groups of economists for regular sharing sessions. We now have a monthly meeting of labor market economists, real estate economists, and forecasters, where participants share data and insights and collaborate on research.

So it is not surprising that core membership is up 6.6% year over year and has grown by 25% since the global financial crisis. Indeed one could say this has been a golden age for economists. The relatively new field of tech economics has opened additional opportunities for newly minted Masters and PhDs at firms from Amazon to Wayfair to Uber to Zillow, and many more. The Bureau of Labor Statistics recently released estimates suggesting that the growth for economists from 2019 to 2029 will be 14%, well above overall jobs growth of 4%. I have every reason to believe NABE's own growth will keep pace with the growth of the profession, especially as we hold the fortunate distinction of being both a member and professional organization.

2 COVID economic impact

Turning now to issues in the economy, it is easy to become dispirited. Without further fiscal assistance, millions of Americans face the prospect of lasting scars from job loss, home loss, and falling credit scores. According to the Census Pulse survey of small businesses, close to 75% of firms are experiencing a moderate to large negative impact from the pandemic. This in turn risks breaking the firewall

that has been built around the parts of the economy most impacted by COVID. The firewall from the CARES Act has not been perfect, but has been quite good. So far the firewall has prevented massive mortgage delinquency and bankruptcy despite extraordinary job loss. Indeed personal bankruptcy filings were more than 24% below pre-pandemic levels in June, but these data are stale; they do not capture the hardship households are experiencing now that additional unemployment insurance payments have expired. In the most recent data, one can see the slowing rebound in everything from jobs data to retail sales to restaurant bookings to public transportation usage. I am very concerned that without further fiscal assistance, in the face of a very pernicious virus, we risk long-term economic scars. Despite my concern about the near-term outlook, business leaders I advise in the course of my role, a role many of you play your firms, requires that I look past the pandemic.

3 Past the pandemic

It is the future of the economy overall that I want to focus on for the remainder of my talk. I am going to weave together a decades' long obsession with productivity, demographics, and debt levels. The pandemic induced recession, and our response to it will greatly influence the extent to which we engineer a successful economic reset.

All three of these factors, productivity, demographics, and debt levels, are tied together via our focus on growth and interest rates. Expectations of future growth, at least among economists, have been tempered over the years. Most economists anticipate potential GDP for the U.S. somewhere between 1.8 and 2.0% a year versus 2.5% or higher as outlined by George Kahn in his 1996 paper, *New Estimates of the U.S. Economy's Potential Growth Rate*. Yet every company I know strives to grow above average. Families want their children to be better off than they were growing up, this is even true for those in the top quintiles of income. So our obsession with growth rates is rooted in the very fabric of our society. We all know that a rising population drives demand, which in turn helps to drive investment, which helps to drive productivity. We also observe that as potential GDP slows, firms, households, and governments turn to debt to help maintain growth rates or, in the case of households, living standards. I will first examine slowing growth rates of GDP and productivity and how the COVID shock is interacting with factors such as business dynamism and technology diffusion. I will then examine some demographic factors before dipping my toe into the $r < g$ debate as it relates to sustainable debt levels.

This year's Jackson Hole Symposium, *Navigating the Decade Ahead: Implications for Monetary Policy*, naturally

addressed the issue of declining growth rates. In their paper, entitled *Slowing Business Dynamism and Productivity Growth in the United States*, Akcigit and Ates (2020) argue that greater concentration among firms and a slowdown in business dynamism is the cause of a myriad of factors that slow economic growth. Among them are a falling labor share of output, less dispersion of technological improvements that drive widespread productivity gains, and a corresponding gap between frontier and laggard firms. Empirical work which shows that gaps exist between laggards and frontier firms is not new. In 2015, economists at the OCED published *Frontier Firms, Technology Diffusion and Public Policy: Micro Evidence from OECD Countries* (Andrews et al. 2015). The OCED work illustrated that global frontier firms are not only more productive but more capital and patent-intensive, and interestingly, younger. The idea that younger firms are the wellspring of innovation is well documented in the literature (Henderson 1993; Baumol 2002; Benner and Tushman 2002), as the OECD points out. The OECD shined a light on the lack of diffusion as being one main reason productivity has declined over recent decades. Akcigit and Ates make a significant contribution to this conversation by exploring why there is low diffusion and how it can be linked to business dynamism; their work shows that at U.S. firms, the share of inventors employed at young firms is falling. Not only that, but inventors' behavior has an important impact on the level of productivity concentration. Inventors, it turns out, start firms that demonstrate greater employment growth than those founded by non-inventors. Inventors are also increasingly likely to switch to larger firms in order to earn more money to capitalize on their inventions. This reinforces the monopolistic and semi-monopolistic power of larger firms. In sum, Akcigit and Ates' work suggests the reduction in the ability of competitors to catch up to the market leaders reinforces concentration and markups. This is compounded by the reduction in experimentation by large leading firms which leads to lower overall productivity.

A reinforcing factor in the productivity debate is the structural factor of demographics. As Karahan et al. (2019) show in *Demographic Origins of the Startup Deficit*, a slowing pace of growth of the working-age population and an increase in older members of the workforce, as well as a greater number of retirees has significant economic consequences for the pace of startups. The authors show that roughly two-thirds of the decline in startups over the past 40 years can be explained by demographics. In the United States, favorable immigration policies helped buoy birth rates and the growth of the working-age population for decades. Immigration is the only realistic lever to pull in order to increase the working-age population. However, it is not just working-age people who influence business dynamism, an aging workforce and an aging population also have consequences. As Eggertsson (2020) pointed out in

his commentary on Akcigit and Ate's Jackson Hole paper, older people are less willing to adapt to new technology-based products. There is a wide body of literature (Bain 1956; Bronneberg et al. 2012; Bornstein 2018) which suggests older populations do not adapt new technology at the same pace as younger ones. As Paula Poundstone would say, you need a study for that? Seems obvious, but the economic consequences are significant. At the end of 2019 there were 5.9 million workers in the 16–19 age cohort and 5.9 million workers in the 65–69 cohort. A remarkable development that illustrates the preference for younger people to stay in school and for older people to remain in the workforce. As recently as 1999, these numbers were 8.3 million for the 16–19 cohort and 2.1 million for the 65–69 cohort. The latter is a cohort we only started counting in 1985, as previously the labor force participation of older workers was too small to consider meaningful. Of course, these are the tails of the labor market. If we consider simply the workers over age 55, this has risen from 12.5% of employed persons in 1990 to 23.9% as of September 2020. One can see that the structural demographic landscape could be a strong headwind for future productivity growth acceleration.

What might the shock of the pandemic do these facets of the economy? Will it reinforce them or will it shock the system such that new trends might emerge? Frequently, productivity rises during recessions. This is in part due to steeper declines in labor hours than in output. According to a 2013 paper by Lazear et al., it is also due to the fact that people work harder during recessions.¹ The authors examined individual worker productivity at a large firm during the global financial crisis and found that this firm got more effort from fewer workers. If we were in person I would ask for a show of hands to see if anyone in the audience can relate. So far this year, more than 250 NBER working papers have presented pandemic-related research, more than the number of papers, on all topics, produced in the full year of 2019. Economists have certainly been working harder!

Another important part of Lazear et al.'s work was not only that people work harder during recessions, it was also that there appeared to be insufficient evidence that re-sorting of workers resulted in higher productivity workers being the ones who remain employed and lower productivity workers being the ones who are let go. This has implications for technology diffusion. If productive workers are let go at the same rate as unproductive ones, presumably there is the potential for a burst of diffusion during the recovery as those productive workers get rehired. Furthermore, if workers make due with less during a normal recession, one could hypothesize that during this recession workers are not only

¹ Sadly, Ed Lazear, a frequent speaker at NABE meetings, passed away in November 2020.

making due with less, they being forced to embrace technology at a much faster pace than before the pandemic. We see this in a myriad of examples with our clients. Those that did not have sufficient cloud computing capability needed to build it to work remotely. Those that did not have sufficient digital collection of data find it indispensable when planning during such uncertainty.

But let's not rely on anecdotes, let's illustrate this point by looking at recent data. We can see from the retail sales data that on-line shopping rose significantly during the period of maximum lockdown in the United States. On-line retail sales as a percentage of the control group rose to nearly 30 during April, in part because the denominator fell while the numerator rose. Now that more of the economy is open and we have seen a sizable rebound in auto sales, which is not part of the control group, one can put into context the current level of 24% compared with a level of 20.8% during 2019. This increase in digitization is coming from consumers as much as it is coming from firms. Firms that had on-line offerings pre-pandemic were able to capitalize on this channel. Many firms pivoted quickly in terms of which customers they served, for example, many B-to-B firms made their products available in retail channels. KPMG's 2020 CEO survey (<https://assets.kpmg/content/dam/kpmg/us/pdf/2020/09/2020-us-ceo-outlook.pdf>), which was conducted between July 3 and August 5, showed that firms had accelerated plans for digital transformation. 75% of the respondents reported that progress had accelerated by a matter of months or years with 22% saying the pandemic led to a sharp acceleration of digital transformation, putting them years ahead of previous plans!

In 2018, the World Economic Forum conducted a survey about the intention of firms to use machine learning (ML) in the near future. 75% of the respondents said they intended to make use of machine learning in the coming years. This included a wide variety of sectors: Information & Communication Technologies, Automotive, Aerospace, Supply Chain & Transport, Consumer, Global Health & Healthcare, Aviation, Travel & Tourism, Energy, and Utilities. The study also asked which firms did not understand the opportunities presented by ML, here 60% of the firms responded they did not understand the opportunities. When looking at the data to interpret the results, it occurred to me that the area with the greatest potential opportunity for my firm was those firms that intended to increase their use of ML but who did not fully understand the opportunities ML presented to them. This included the following sectors: Consumer, Global Health & Healthcare, Energy and Utilities. Interestingly, these three sectors are among the most shocked by the pandemic. Indeed we have heard other speakers mention the importance of tele-health and machine learning on not just productivity in the sector but in increasing the ability to deliver care across geographies. Just yesterday Erik

Brynjolfsson tweeted out news that Google's lung cancer detection AI outperformed human radiologists with an average of eight years' experience. If firms in the consumer, health care, and energy and utility space can harness the full benefit of machine learning and artificial intelligence, there is a good chance that incremental productivity will rise.

Turning now to business dynamism, one must examine that another feature of the pandemic has been the increase in business formation. I probably speak for many of us when I say I was surprised to see business formation turn around in such a significant way. Not only is it up from the start of the year, it is up substantially more than the average of 2017–2019. Business formation is up YTD by 23%; this compares with an average growth rate of 5.8% from 2017 to 2019. High propensity business formation, that is the formation of businesses where founders intend to employ workers, is up 15% YTD. In fact, high propensity business formation is back to levels not seen since before the global financial crisis. Surely the combination of low interest rates, a large pool of savings, and the changing needs of the economy due to the pandemic are working in tandem to produce this surprisingly good result. Naysayers could argue that this speaks to the churn in the labor market, which is unprecedented as a result of the pandemic. To be sure, we still have just over 12.5 million unemployed persons in the economy compared with 5.7 million before the pandemic. Speaking on business churn, Steven Hamilton from George Washington University was cited in the *Wall Street Journal* as estimating that the economy will shed 700,000 firms this year. Nevertheless, the surge in new business formation to a level not seen since before the global financial crisis is a promising sign for future growth and may even presage a pickup in productivity.

As numerous economists have noted, however, we will need fiscal assistance to shore up the firewall created around the COVID-impacted parts of the economy. This will mean increasing the debt level to provide much-needed fiscal assistance in response to a virus that is lasting much longer, and with much more impact, than many likely anticipated. As with all decisions regarding taking on debt, it is important to consider the return on capital invested. In our mid-April economic update, *A Bridge Past COVID-19, Charting the Economic Cliff*, we discuss our assumptions around fiscal multipliers. The piece of work we found most informative was by Leeper *et al.* (2017), Clearing Up the Fiscal Multiplier Morass: Prior and Posterior Analysis. In addition to developing a very interesting model (a Bayesian prior and posterior analysis of a monetary DSGE model extended to include fiscal details and two distinct monetary-fiscal policy regimes) to quantify government spending multipliers in U.S. data, they were able to gain new insights into the transmission mechanisms that underlie multipliers. Further, the model allows for conditions to dictate if public

goods substitute for or complement private consumption. Ultimately the paper concludes that getting the prevailing monetary-fiscal policy right is the first order of business for understanding macroeconomic policy impacts. Importantly, the fiscal and monetary multipliers are greater than 1 when the policy mix is complementary. This, along with other research, supports the idea that a well-crafted fiscal assistance program would result in growth being greater than the rate of interest. In the time while COVID is still wreaking havoc on our communities, even a broadly targeted set of fiscal policies that maintained income support to the unemployed, provided continuing assistance to the self-employed and those in alternative work arrangements, gave assistance to firms in the heavily impacted leisure and hospitality sector, and devoted resources to fighting the virus would do much to prevent the pandemic from causing lasting scars.

However, the pandemic has also brought into stark relief some areas for much needed investment. A fiscal plan that focuses on closing education gaps, those that existed pre-pandemic and those that have grown due to the pandemic, would do much to ensure that r remains $< g$. Investment in infrastructure that will help enable future growth and capitalize on some of the positive shocks that the pandemic has brought about such as greater digitalization would also help ensure that r remains $< g$. In the years after World War II, the government played an important role in re-focusing economic activity on civilian activities. One significant area of investment was health care: the Hill–Burton Act spurred the building of over 280 new hospitals and a significant investment in public health. A similar investment in health care today would help the United States achieve better health care outcomes in the future; centralized records for example would allow for better research using machine learning and more effective communication with vulnerable populations. Investment in government systems is sorely needed and could greatly improve the productivity of government programs. It is difficult to imagine this would not help r remain $< g$. As Robert Gordon points out in Part III of his 2016 masterpiece, *The Rise and Fall of American Growth*, the years prior to World War II were years of massive innovation that were not fully exploited at the time the war erupted. Likewise, the years after the global financial crisis ushered in inventions that have been neither fully exploited nor fully diffused. Perhaps the shock of the pandemic coupled with sensible fiscal assistance could nudge the economy into a more productive state by capitalizing on the widespread adoption of digital technology, a quixotic idea that has the potential to create quotidian improvements in the economic health of the country.

I will end with the opening words of Frank Schott's presidential address, in it he quotes Alvin Johnson of the New School who said that "ideas are high explosives, and

there is no adequate defense against bad ideas except good ideas" (https://digitalarchives.library.newschool.edu/index.php/Detail/objects/NS010101_000041). In closing, I think it is possible that the shock from COVID may have pushed technology adoption across generations, perhaps mitigating some of the demographic impediments to technology adoption. In terms of productivity, COVID has brought forward digital transformation that will likely improve the diffusion of technology to a wider array of firms. Yet for a large portion of the population, COVID has only meant devastation and despair, here fiscal assistance is imperative so that the economic scarring from COVID does not remain. Perhaps my quixotic idea that we can overcome our demographic destiny and improve productivity with the proper investment from firms and the government can gain increasing consideration, perhaps it can even become quotidian.

Thank you.

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