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New Horizons Hub: Covid-19 and the end of individualism

Humans have never been atomized individuals, but social beings whose every decision affects other people, argues Diane Coyle for Project Syndicate. So will Covid-19 mark the end of individualism and deepen social awareness around collective goals? We pick up on this in our top selection of this week's stories from trusted third-party providers

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New Horizons Hub

Covid-19 and the End of Individualism

Just as a spider's web crumples when a few strands are broken, so the coronavirus has highlighted the risks arising from our economic interdependence, writes Diane Coyle for Project Syndicate

Covid-19 is just one of the many collective problems facing humankind

Aristotle was right. Humans have never been atomized individuals, but rather social beings whose every decision affects other people. And now the Covid-19 pandemic is driving home this fundamental point: each of us is morally responsible for the infection risks we pose to others through our own behavior.

In fact, this pandemic is just one of many collective-action problems facing humankind, including climate change, catastrophic biodiversity loss, antimicrobial resistance, nuclear tensions fueled by escalating geopolitical uncertainty, and even potential threats such as a collision with an asteroid.

As the pandemic has demonstrated, however, it is not these existential dangers, but rather everyday economic activities, that reveal the collective, connected character of modern life beneath the individualist façade of rights and contracts.

Those of us in white-collar jobs who are able to work from home and swap sourdough tips are more dependent than we perhaps realized on previously invisible essential workers, such as hospital cleaners and medics, supermarket staff, parcel couriers, and telecoms technicians who maintain our connectivity.

Similarly, manufacturers of new essentials such as face masks and chemical reagents depend on imports from the other side of the world. And many people who are ill, self-isolating, or suddenly unemployed depend on the kindness of neighbors, friends, and strangers to get by.

Covid-19 shifts balance from privacy to trust

The sudden stop to economic activity underscores a truth about the modern, interconnected economy: what affects some parts substantially affects the whole. This web of linkages is therefore a vulnerability when disrupted. But it is also a strength, because it shows once again how the division of labor makes everyone better off, exactly as Adam Smith pointed out over two centuries ago.

Today's transformative digital technologies are dramatically increasing such social spillovers, and not only because they underpin sophisticated logistics networks and just-in-time supply chains. The very nature of the digital economy means that each of our individual choices will affect many other people.

Consider the question of data, which has become even more salient today because of the policy debate about whether digital contact-tracing apps can help the economy to emerge from lockdown faster.

This approach will be effective only if a high enough proportion of the population uses the same app and shares the data it gathers. And, as the Ada Lovelace Institute points out in a thoughtful report, that will depend on whether people regard the app as trustworthy and are sure that using it will help them. No app will be effective if people are unwilling to provide "their" data to governments rolling out the system. If I decide to withhold information about my movements and contacts, this would adversely affect everyone.

Yet, while much information certainly should remain private, data about individuals is only rarely "personal," in the sense that it is only about them. Indeed, very little data with useful information content concerns a single individual; it is the context – whether population data, location, or the activities of others – that gives it value.

Most commentators recognize that privacy and trust must be balanced with the need to fill the huge gaps in our knowledge about Covid-19. But the balance is tipping toward the latter. In the current circumstances, the collective goal outweighs individual preferences.

Collective goals are far more important in a world of increasing interdependence

But the current emergency is only an acute symptom of increasing interdependence. Underlying it is the steady shift from an economy in which the classical assumptions of diminishing or constant returns to scale hold true to one in which there are increasing returns to scale almost everywhere.

In the conventional framework, adding a unit of input (capital and labor) produces a smaller or (at best) the same increment to output. For an economy based on agriculture and manufacturing, this was a reasonable assumption.

But much of today's economy is characterized by increasing returns, with bigger firms doing ever better. The network effects that drive the growth of digital platforms are one example of this. And because most sectors of the economy have high upfront costs, bigger producers face lower unit costs.

One important source of increasing returns is the extensive experience-based know-how needed in high-value activities such as software design, architecture, and advanced manufacturing. Such returns not only favor incumbents, but also mean that choices by individual producers and consumers have spillover effects on others.

The pervasiveness of increasing returns to scale, and spillovers more generally, has been surprisingly slow to influence policy choices, even though economists have been focusing on the phenomenon for many years now. The Covid-19 pandemic may make it harder to ignore.

Just as a spider's web crumples when a few strands are broken, so the pandemic has highlighted the risks arising from our economic interdependence. And now California and Georgia, Germany and Italy, and China and the United States need each other to recover and rebuild. No one should waste time yearning for an unsustainable fantasy.

The full original article first appeared on Project Syndicate here.

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Richard N Haas: Deglobalisation and its discontents

The current state of the world is defined by global challenges and how well or poorly the world addresses them. Above all, this means we need to avoid false cures, writes Richard N. Haas for Project Syndicate

Did globalization reach its peak?

Increasing global interconnection – growing cross-border flows of people, goods, energy, emails, television and radio signals, data, drugs, terrorists, weapons, carbon dioxide, food, dollars, and, of course, viruses (both biological or software) – has been a defining feature of the modern world. The question, though, is whether globalization has peaked – and, if so, whether what follows is to be welcomed or resisted.

To be sure, people and goods have always moved around the world, be it over the high seas or the ancient Silk Road. What is different today is the scale, speed, and variety of these flows. Their consequences are already significant and are becoming more so. If great power rivalries, and how well or poorly they were managed, shaped much of the history of the past few centuries, the current era is more likely to be defined by global challenges and how well or poorly the world addresses them.

Globalization has been driven by modern technology, from jet planes and satellites to the Internet, as well as by policies that opened up markets to trade and investment. Both stability and instability have promoted it, the former by enabling business and tourism, and the latter by fueling flows of migrants and refugees. For the most part, governments viewed globalization as a net benefit and were generally content to let it run its course.

Globalization can be destructive as well as constructive

But globalization, as is clear from its various forms, can be destructive as well as constructive, and in recent years, a growing number of governments and people around the world have come to view it as a net risk. When it comes to climate change, pandemics, and terrorism – all exacerbated by globalization – it is not hard to see why. But in other areas, the increased opposition to globalization is more complicated.

Consider trade, which can provide better-paying jobs in export-oriented factories or agriculture, as well as consumer goods that are often higher quality, less expensive, or both. But one country's exports are another country's imports, and imports can displace domestic producers and cause unemployment. As a result, opposition to free trade has grown, leading to calls for "fair" or "managed" trade in which the government plays a larger role to limit imports, promote exports, or both.

A similar trend is under way when it comes to information. The free flow of ideas might seem to be a good thing, but it turns out that authoritarian governments regard it as a threat to their political control. The Internet is being balkanized into a "splinternet." China's "Great Firewall" led the way, blocking access to online news and other suspect websites and ensuring that Chinese users cannot access content deemed politically sensitive.

The ability of people to cross borders in large numbers was traditionally accepted or even welcomed. Immigrants in the United States have been the foundation of the country's economic, political, scientific, and cultural success. But now many Americans view immigrants warily, seeing them as a threat to jobs, public health, security, or culture. A similar shift has taken place in much of Europe.

All of this adds up to a shift toward deglobalization – a process that has both costs and limits. Blocking imports can cause inflation, reduce consumer choice, slow the pace of innovation, and lead others to retaliate with import restrictions of their own. Blocking ideas can stifle creativity and impede the correction of policy mistakes. And blocking people at the border can rob a society of talent and needed workers, while contributing to the misery of those forced to flee as a result of political or religious persecution, war, gangs, or hunger.

Globalization cannot be solved, it needs to be managed

Deglobalization is also bound to fail in certain policy areas. Borders are not barriers to climate change. Closing them does not shield a country from the risks of disease as citizens can easily return home with the infection. Sovereignty guarantees neither security nor prosperity.

There is a better way to respond to the challenges and threats of globalization. Effective collective action can meet the risks of disease, climate change, cyber-attacks, nuclear proliferation, and terrorism. No single country on its own can make itself secure; unilateralism is not a serious policy path.

This is what global governance (not government) is all about. The form of the arrangements can and should be tailored to the threat and to those willing and able to cooperate, but there is no viable alternative to multilateralism.

Isolationism is not a strategy. Nor is denial. We can stick our heads in the sand like the proverbial ostrich, but the tide will come in and drown us. Globalization is a reality that cannot be ignored or wished away. The only choice is how best to respond.

The critics are right in one sense: globalization brings problems as well as benefits. Societies need to become more resilient. Workers require access to education and training throughout their lives, so they are ready for the jobs that emerge as new technologies or foreign competition eliminate their current jobs. Societies need to be better prepared to cope with inevitable pandemics or extreme weather events caused by climate change.

Globalization is not a problem for governments to solve; it is a reality to be managed. To embrace wholesale deglobalization is to choose a false cure – and one much worse than the disease.

The full original article first appeared on Project Syndicate here.

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Opinion | 20 May 2020 New Horizons Hub

VoxEU: Perpetual bonds are not the best way to finance the European Recovery Fund

The cheapest way to finance the European Recovery Fund would be to issue joint EU debt at shorter maturities, then pass those low-interest rates onto member states through loans at low margins over funding costs and with very long maturities, writes Giancarlo Corsetti, Aitor Erce, Antonio Garcia Pascual for VoxEU

Source: Shutterstock

French President Emmanuel Macron and German Chancellor Angela Merkel during a joint video press conference as they propose a 500-billion-euro European programme to support the economic recovery following the coronavirus crisis.

Perpetual bonds could boost EU stability...

A number of prominent voices have put forward the idea of funding a large investment package (€1.5-2 trillion) to support the EU recovery from Covid-19 by issuing EU perpetual bonds (consols). Such a joint recovery plan is seen as vital for the stability of the EU.

One argument in favour of using consols is that committing to joint perpetual debt delivers a high degree of mutualisation. However, by borrowing through perpetual bonds, the EU would stand in sharp contrast with the recent practice of countries like the US or Germany that, when facing unexpectedly large financing needs, have relied heavily on the shorter part of the curve.

How come the Debt Management Offices (DMOs) in Germany and other European countries prefer not to issue perpetual bonds or very long-term debt? What are they (we) missing?

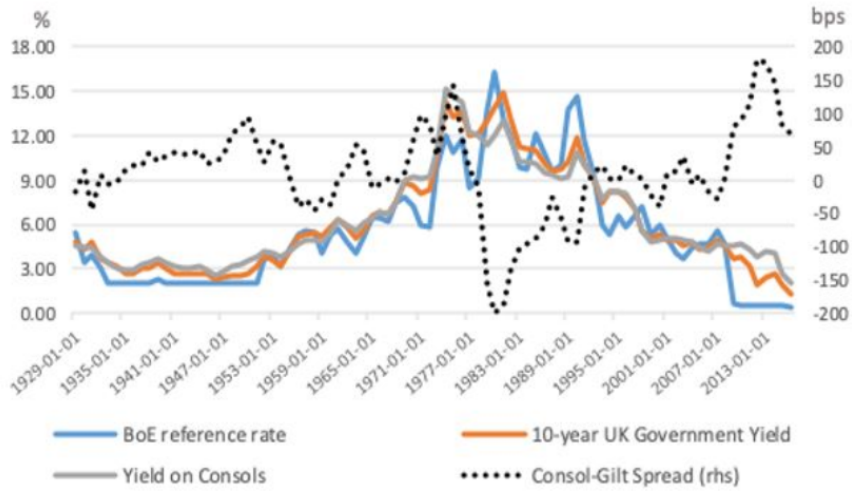
...but are they the most cost effective option?

There is one essential problem with financing the current crisis issuing consols.

In a world of ultra-accommodative monetary policy, not taking full advance of ultra-low rates de facto amounts to working against the efforts of the monetary authorities which try to keep down the interest burden weighing on private and public debtors. Why would AAA-rated treasuries that can issue debt at negative interest all the way up to 10 years want to pay comparatively higher coupons by issuing consols? When the UK announced the redemption of the last consols in 2014, the head of multi-asset allocation at Threadneedle Asset Management argued "I hope that this move is the first of many to cut the interest bill and save taxpayers money" (Financial Times 2014).

This divergence in funding costs is exemplified in Figure 2, which uses data provided by the Bank of England.

Figure 2 One century of Gilts, Consols and Bank of England Rates



Source: Bank of England

A key quote from the article:

"Strong issuers can afford to borrow short term at very low rates and engage in debt roll-over as debt matures, reducing the term premium they pay. The picture is different for weaker issuers. Weaker issuers face both higher borrowing costs and more uncertain future access to capital markets.

For these issuers, using long maturity debt to finance long-term projects makes more sense. Matching the duration of assets and liabilities is a sound practice when refinancing risks are non-negligible. The question is hence whether there is a way for Europe to allow all countries to benefit from matching long-term investment spending with shorter term liabilities? We argue that there is.

The EU is a strong issuer which can use the asset and liability side of its balance sheet as two separate policy levers. European loans given to member states for support should be long maturity in order to improve debt sustainability and reduce near-term gross financing needs. Instead, the financing of the loans, through the issuance of EU bonds, should rely more on the front-end of the yield curve to take full advantage of ECB's accommodative monetary policy.

In other words, by using the two sides of its balance sheet wisely, the EU can deliver powerful 'maturity transformation' on behalf of its member states. Crucially, this exercise of maturity transformation is financed by borrowing countries, hence it does not rely on transfers or use of taxpayers' money from other countries."

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VoxEU: Venture capital-backed innovation and recessions

Although governments have taken steps to bolster their venture capital sectors in response to the Covid-19 crisis, we find that early-stage venture investment falls sharply during recessions, writes Sabrina Howell, Josh Lerner, Ramana Nanda, Richard Townsend for VOXEU

Source: Shutterstock

Governments shore up the venture capital sector

In the wake of the Covid-19 crisis, governments around the world have raced to buttress their economies (Baldwin and di Mauro 2020). National venture capital sectors have not been exempted: Canada, France, Germany, the UK, and many other nations have committed billions of dollars to shore up venture firms and the companies they fund.

The interest in promoting venture capital reflects four considerations.

The first three are well documented. First, across the developed world, productivity growth appears to be slowing, as compilations by the OECD and many national governments have documented. Second, basic research spending and research efficiency appear to be lagging at large corporations, which traditionally accounted for the bulk of R&D expenditures (Arora et al. 2019, Bloom et al. 2020, Miyagawa and Ishikawa 2019). Against this backdrop, the third consideration –

the ability of VC funds to stimulate innovation – is increasingly relevant (Akcigit et al. 2019, Bernstein et al. 2016, Kortum and Lerner 2000).

> *One rationale for these public policy interventions has received less scrutiny: the concern that venture-backed innovation is particularly vulnerable to downturns such as the one we are experiencing*

But the final rationale for these public policy interventions has received less scrutiny: the concern that venture-backed innovation is particularly vulnerable to downturns such as the one we are experiencing. For instance, leading British venture capitalists and entrepreneurs recently argued that absent targeted government aid, "companies of the future such as ours… will be put at risk". Their claim led the UK Treasury to introduce its so-called "runway" program.

This proposition raises questions. Venture capital firms, like other types of private equity, usually employ a ten-year fund structure and make private, long-term investments. This should provide some insulation from downturns. Moreover, venture investors are fond of pointing to successful companies launched in recessions, such as Airbnb, which received its initial funding in 2009. At the same time, we know that certain financial aspects of venture capital – such as the volume of investment, company valuations, and exits through IPO or acquisition – are pro-cyclical (Kaplan and Schoar 2005, Gompers et al. 2008, Robinson and Sensoy 2016).

In our recent working paper (Howell et al. 2020), we explore VC activity and VC-backed innovation during recessions. We start by examining the very recent past, and show that US VC activity fell precipitously during the initial phases of the Covid-19 crisis. The number of weekly early-stage VC deals declined by nearly 38% in the two months starting on 4 March 2020 relative to the previous four months. In contrast, later-stage VC has remained much more robust thus far.

Second, they show that the Covid-19 crisis is not an anomaly in this regard. Examining historical data on VC investment activity, they document that aggregate deal volume, capital invested, and deal size all decline substantially in recessions. Investors who specialise in early-stage deals are significantly more responsive to business cycles than later-stage investors.

We then examine whether the volume and quality of VC-backed innovation is higher or lower during recessions, and the potential reasons for these patterns. We use data on VC financing matched to the patenting of VC-backed startups over the period from 1976 to 2017. The analysis focuses on comparing innovation by VC-backed firms to innovation conducted more broadly in the economy.

But VC investment is pro-cyclical…

First, patents filed by VC-backed startups are of higher quality and greater impact than the average patent. Citation counts provide one indicator. For instance, 29.4% of VC-backed patents are in the top 10% of most-cited patents (defined relative to all patents whose applications were filed in the same month), and 4.7% are in the 1% most highly-cited patents. Moreover, VC-backed firms are disproportionately likely to have more original patents, more general patents, and patents more closely related to fundamental science. This is consistent with VC-backed firms playing a disproportionately important role in job creation and productivity growth (Puri and Zarutskie 2012).

Second, VC-backed innovation is pro-cyclical, even more so than the broader economy. Specifically, we find that relative to all other patent filings within a technology class, the number of patents applied for by VC-backed firms, as well as the quality of those patents, is positively correlated with the amount of VC investment in startups in a given month. Even after controlling for the lower amount of VC finance available to startups in recessions, we find these periods are associated with particularly low levels and reduced quality of innovation.

Third, we find that our innovation results, like the deal volume results, are driven by startups financed by venture groups who specialise in early-stage investment. In some specifications, there are few differences in the volume of innovation across the business cycle for startups backed by late-stage investors. The fact that late-stage VC appears to be more insulated from the public markets is consistent with Bernstein et al. (2019), who find that investment at private equity-funded companies was less sensitive to the 2008 financial crisis.

Fourth, the shift in innovation we measure during recessions stems from both the types of firms receiving VC financing during recessions and a change in the nature of innovation within VC-backed firms over the course of the business cycle. Specifically, our results appear to be driven by startups that raised their most recent round either during the recession or many months before it started. Startups that raised their most recent VC round during the six months before the recession started (i.e. during the boom period) experience no relative decline in innovation quality.

These findings underscore the policy concerns that motivate the policy interventions discussed in the first paragraph. They cannot, however, address some of the larger questions around public initiatives to support venture-backed startups in recessions. For instance, we might wonder about the public return from these expenditures relative to cash grants for hard-hit individuals. Similar questions surround the optimal design of such initiatives, given concerns about earlier programs targeted at high-technology firms (e.g. Howell 2017, Lerner 1999).

But the pro-cyclical nature of venture-backed innovation provides a powerful rationale for exploring interventions in this area.

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