On March 26th, 2020, Dr. Carmen Reinhart, FIU alumni (BA Economics ’78), Harvard Economics Professor and expert on financial crises talked to FIU Economics students and faculty about the disruptions brought to the US and global economy by the COVID-19 pandemic, as well as about her life and career.

Below you will find a summary of the section of the interview, conducted by Prof. Mihaela Pintea, focusing on the impact of the coronavirus pandemic on the domestic and global economy, as well as some policy recommendations to mitigate these negative effects.

Q: *Your work has provided crucial insights regarding the financial crises in both advanced economies and emerging markets. You also wrote a bestselling book, “This Time is Different” with Ken Rogoff which documents the similarities of the recurring booms and busts that have characterized financial history. We are in the midst of a global crisis, with major disruptions to the world economy brought about by the Coronavirus pandemic. Things are still evolving rapidly. However, how would you compare this crisis to previous crises that you studied?*

CR: I feel that this crisis, “this time truly is different” and let me explain what I mean by that. I also wrote a short piece for Project Syndicate called exactly that “This Time Truly is Different”. There are parts that are going to be completely different, unprecedented for which I'm not aware of useful historical examples and there are parts for which the historical examples will be very useful.

The bottom line on the differences, with respect to other crises, are twofold:

This crisis did not start out as many financial crises do with a surge in bad lending, it started with a real supply shock, the coronavirus. This crisis did not start out because of imprudent lending by banks for a housing boom where you had a bubble, it didn't start with finance. The global coronavirus pandemic is a shock that affected banks that had made what were good loans or seemed like plausible loans to individuals and to businesses. However, due to the coronavirus, all of a sudden businesses have closed their doors, households have lost access to income, and unemployment numbers are beyond appalling.

The policy response of the economies of basically saying look we really value human lives: the response is to really shut down and try to first contain the virus in order to slow down the spread of disease. That's completely opposite from the last major pandemic major, which was the influenza epidemic of 1917-1918. The major reason why it was completely different is because the 1918 pandemic, the Spanish influenza was during World War one, so the idea that you were going to shut down an economy and have people stay at home and have production come to a standstill just doesn't operate in a wartime economy and it certainly didn't operate in those days. The year in which the United States deaths due to the pandemic peaked at 675,000 deaths in 1918, which were the highest death rates, real GDP in the US grew 9%, business failures practically went down to an all-time low. That's completely different from anything we are going to see now because the policy response was entirely different.

In terms of similarities, where knowing the past starts helping us.

This crisis started as a health crisis, a pandemic but it is morphing into a financial crisis and financial crises are characterized by recessions, recessions that are deep, recessions that are longer than the normal recession. They are also characterized by defaults: households can default on mortgages, firms default on their loans country, sovereigns default on their debts.

This crisis is worrisomely similar to the global picture of the Great Depression of the 1930s. I'm not saying we are going there, but there are worrisome similarities. As some counterexample, the 2008-2009 global financial crisis was really not that global. It hit emerging markets and pretty much everyone in late 2008 early 2009, but the emerging markets led by China had a very rapid recovery. That crisis was mostly an advanced economy and really eleven economies that had systemic banking crisis: the United States, the UK, to a lesser degree Germany and France and the really deep ones in Iceland, in Spain, in Ireland, in Portugal and the worst of all in Greece. That crisis was predominantly an advanced economy crisis. In the 1980s when I was working at Bear Sterns, the nineteen eighties was an emerging market crisis, a debt crisis. The 1930s however was a global crisis that affected everyone, advanced and emerging economies. This environment that we are in is really impacting everyone because we don't know to what extent the coronavirus issues will worsen in Central and South America and Africa, in other parts of Asia that haven't been as affected yet. The global reach of the crisis is there, so that is one similarity. Another thing that is similar to the 30s is a crash in global trade and the breakdown of global supply chains. Right now, we all know that the airline industry is paralyzed nobody is traveling, but that also applies to maritime trade (e.g. you have Chilean fruit exported to China rotting into the docks because there are health issues in loading and unloading), and the sheer impact on global trade is very worrisome.

Third similarity is global commodity crisis which was compounded by another major shock which is the Saudi-Russian petroleum wars.

Q: Should we be expecting more countries to default on their debts?

CR: Yes, I am especially worried about Ecuador. They live and die really with the price of oil, oil prices right now in the $20s per barrel are less than half of what they budgeted in their fiscal accounts, so they are having major revenue shortfalls. At the same time, they are the second country in Latin America, after Brazil, in terms of cases of coronavirus, they are a fully dollarized economy and thus they can't really do much with monetary policy.

Let me just start with the most obvious cases which are other oil producers: Angola, Algeria and Nigeria, but this commodity slump is much more widespread. How about the countries that depend fully on tourism, such as the Caribbean islands, or places that are less so, but still very dependent on tourism (e.g. Thailand). All these countries are experiencing very difficult hits. I'm not suggesting Thailand is going to default, Thailand doesn't have that much external debt, but I do think Ecuador will and I think many others.

The critical factor in my view, the critical factor for which I don't know the answer is how long this crisis is going to last, because the longer it lasts the greater the strain on what are already strained budgets. Notwithstanding the large-scale stimulus that we are getting on the fiscal and the monetary side, which I think is all perfectly appropriate, I'm very confident that the longer a shutdown continues at the national level, and the global level the more the economic damage and the more likelihood we will see more defaults.

Q*: We don't know how long the shutdown of the economy is going to last and whether we are going to experience waves, so that we open the economy and have to go back and shut it down again….*

CR: The more discouraging part a comparison with the 1918 pandemic, which as I said this is not about economic effect, is the course of the virus, that it came in waves. The wave that hit the United States the hardest was the 1918, especially late 1918, but the wave that hit India the hardest was in late 1919- early 1920. We thus don't know how long this can impact the global economy, but I believe that the potential for a very serious financial and debt crisis is definitely there.

Q: *What do you imagine or what can you predict full employment US economy to look like and how far are we from it now that COVID-19 has impacted us?*

CR: I have a Wall Street Journal editorial coming out tomorrow morning and one of the points it makes is this we don't know how long it will last, but we know for sure that in terms of v-shaped, in terms of the sheer downward impact of this slide, the global financial crisis is going to look like a piece of cake. I have no idea what the second half of this year is going to like but I can tell you that the stuff that's shaping up for the first half, whether it's the impact on China, the numbers we are already seeing for the US and for Europe are really abysmal. I don't think there are many in the economics profession, although more in the health profession that can say how successful the quarantine measures are. There are hopeful signs for it, for instance from northern Italy that things may be stabilizing, which would be more like a pattern of what we saw in China if you believe the numbers that they've leveled off. I'm not skirting around your question it's just that I don't know how quickly the risk of contagion will be effectively dealt with, and I keep saying this: the longer this goes on the more bankruptcies, the deeper in the recession the bigger the job losses, the duration is important.

Q: *There has been some discussion, as you mentioned, that the current health crisis is morphing into a financial crisis. Unemployment claims for last week were six times higher than the previous high. There are some serious concerns that unemployment could skyrocket to 15-20% in the coming months, which draws obvious parallels to the Great Depression. However, after the Great Depression the United States social safety net was weaved together. Some of the most important and cherished programs came out of the New Deal. If the economy contracts to similar levels, do you see a larger appetite for more social programs, i.e. Medicare for All? What other social programs do you see taking center stage?*

CR: I think the bottom line is that when this is all said and done, the size of US government will be much bigger. It will be much bigger because there will be big interventions. Already the fiscal stimulus is on a scale that, outside of the world wars, we haven't seen anything like this. I don't know what shape the health programs are going to be, what shape the safety net will take but I think that in the aftermath of Covid-19 we are going to have a bigger government as a legacy.

The change that we are going to get will not be as dramatic as the one around the depression, because remember then you started from nothing. At that time corporates did not pay income taxes, people did not pay income taxes, the tax system was very “primitive” relative to what we are accustomed. Size of the government had expanded massively during the US Civil War, but after the war again size of government reverted to something quite small. So you are not going to get as dramatic a change as the New Deal era and the 1930s, but I think it is going to definitely move in the direction of a bigger government role in health, a bigger government role into safety nets and so on and a lot of the things that we have seen on more mature economies like Europe.

MP: *How should countries prioritize spending during this crisis and what should be the role of international aid?*

CR: There are a couple of things that are worth mentioning. At the moment the IMF has repeatedly announced that they have a standing emergency facility, as has the World Bank to deal with governments that need to cover emergency spending. Relative to a normal IMF program, it is a much more rapid disbursement, it is not your standard standby program with all the conditionality, it's a different animal more geared towards this particular crisis, so it's not aid, there are loans, but it's an important bridge. Aid doesn't come from the multilateral organizations, such as the World Bank, the IMF, the Inter-American Development Bank or the Asian Development Bank, it comes from governments and we haven't really seen that much action there.

I mentioned that I have a Wall Street Journal op-ed coming out tomorrow morning and the theme is a debt moratorium geared for countries in need. If you really don't have the resources and you are fiscally constrained, your revenues have plummeted as tourism, manufacturing, commodity prices have plummeted, so if you are in that kind of emergency environment and have very limited resources do you want to devote those resources to fight Covid-19 and deal with the health emergency or do you want to repay your foreign creditors? The point that Ken Rogoff and I make is that this is a global emergency and this is not saying you are not honoring your debts and you may have to deal with those creditors at a later stage, but that temporary moratorium is an appropriate response to deal with those in need.

Q: *How about at domestic level and the 2 trillion dollars fiscal stimulus that was passed?*

CR: The issue that I mentioned of debt moratorium is also very much applicable at the nitty-gritty local level. People don't have incomes, so repaying mortgages, repaying credit cards, repaying any kind of debt is problematic, I suggest moratorium on debt payments. We have had our incomes suspended so the commensurate step is to suspend payment on that. By deciding the stimulus package, which is very substantive, but remember it is not just about households, but also about corporations. People tend to view corporate bailouts in a negative manner, but the businesses are the one that hire people. The fiscal stimulus also includes medium and small businesses, i.e. you had a restaurant or a small store that was working well and now your revenue has gone down to zero, so that's a business, but those people that the restaurant was hiring are impacted by that shutdown. The issue of the debt moratorium applies to households, it applies to business, it applies to sovereign nations.

Q: *Speaking of the trade war between Saudi Arabia and Russia. How long do you think American shale producers will last?*

CR: That's an excellent question and I am NOT an oil expert, but I would say based on my following the developments in that industry that for sure forget about investment, any kind of new investment in that industry. There is no new drilling, new investment is already dead and at a screeching halt. We experienced these levels of oil prices in 2015-2016. I think that for production to be stopped, the oil prices would still have to be lower still. However, what I would say is I do expect a lot of bankruptcies in that industry. I do think however the bankruptcies set the stage for consolidation meaning you will have a bigger, more concentrated industry coming out of this. We saw a preview of that in 2015-2016 with that industry becoming less maverick and more concentrated. I also think the build-up of the US reserves would be very helpful on that score.

Q: *With the mass scale disruption of international supply lines, do you think there will be a change in attitude toward more domestic industries and a rise in more protectionist attitude due how worldwide supply lines are now seen as very vulnerable?*

CR: That is an excellent question. A lot of my work involves a long historical perspective and so to answer that question, let me first tell you a little story about globalization. In my book with Ken Rogoff we talked about the cycles of globalization.

In the mid and late 1800s, we really started to see global integration in trade and in finance (subject to certain technological constraints). The London market was a source of global financing for countries in Africa, Asia and Latin America. Keep in mind a lot of these countries were still colonies at the time, but we saw a surge in globalization.

Then came World War one and with that capital controls and inward-looking policies. At the end of World War one, it looked like globalization was going to get a restart, and it did to some extent, but it didn't really take off because of the Great Depression. During the Depression, protectionism, capital controls and very much an inward-looking focus with a big surge in populism was part of the outcome.

By the end of World War II globalization was at a low point, relative to the middle of the 18th century, that tells you how much of a low point. In the second half of the 20th century, everybody was gung ho about trade and global finance, and globalization peaked before the global financial crisis of 2008-2009. It took a big hit with the global financial crisis because countries like Iceland, Ireland, Spain, Greece, and Portugal were running big current account deficits. You finance a current account deficit by borrowing from abroad and all of a sudden, they couldn't borrow from abroad and so they had to close their current account deficits. That was the first blow to global trade, the second blow was Brexit, the third blow was the Trump -China trade wars and now Covid-19 is on a completely different scale.

Let me say that before Covid-19, you look at the 10 years growth rates in the volume of global trade, the volume of imports plus exports, and that annual growth rate was about 6%. The average growth rate in the decade after the financial crisis was less than 3%, about 2.5%. Growth rates of global trade even before Covid-19 had halved and I think it’s going to take another enormous whack. I think that we are going to see countries becoming much more skeptical about their dependence on global supply chains and governments are going to be much more amenable to more protectionist policies. I think it’s going to shift us further away from the whole view that we embraced before, up until 2008, that we are a global economy, and that global trade and finance benefits everyone. I think we are going in the other direction.

MP*: Thank you so much so you've been so gracious with your time and you are such an inspiration to our students.*