Welcome to the Inefficient Economy

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May 27, 2020

Aggregate demand and the public finances dominate most economic policy discourse. What Boris Johnson's Government could do to "stimulate" activity through taxes or public spending, or how much relief it can sustainably provide, will command most airtime even as economic reopening begins.

Insufficient focus, as ever, is given to the supply-side – our ability to produce goods and services at prices people are willing to pay. Yet Rishi Sunak and Alok Sharma will soon be facing the reality of what I'll call the Inefficient Economy. There are good reasons to think that economic activity will struggle far beyond the demand-sapping impact of the Coronavirus on travel, hospitality and bars and restaurants.

First, rational changes to business practices will breed inefficiency. Fewer people will be dining in restaurants, going on planes, or getting hair cuts as regularly, yes. But those who do will find middle-seats left free on flights, wide spaces between tables, and extensive cleaning of hairstyling tools. The revenue-potential of an hour of operation in these sectors will fall.

Winning trust from customers and workers will actually require businesses to invest in what would ordinarily be considered inefficiency on their premises. Cleaners will disrupt workplaces more often to keep workspaces sanitised. Temperature testing might delay workers getting to the day job each morning. Employees still working from home often, or in office shifts, or unable to travel internationally, will entrench communication inefficiencies. Then there's staffing difficulties with workers self-isolating when they get symptoms or disruptions to child-care.

All this inefficiency will be compounded by uncertainty. Why replace those inefficient industrial dryers in your dry cleaning business without knowing when or if your key local hotel customers might re-open? Yes, some businesses will perish from the demand shock. But even those that survive will find they can't do things as efficiently as they once did.

If that wasn't enough, the economy will also face a labour market shock. Jobs will be permanently lost, while others will be created. Delivery companies are hiring, as are supermarkets. Some wholesalers who used to sell to commercial outlets may add workers to become more retail-oriented. The demands for consultants, website managers, contact tracers and more may rise in some areas, as companies think of new ways of doing business.

But while we see job churn at the best of times, the scale and breadth of this reallocation will weigh on our productive potential. Many job relationships of people well suited, specialised, or experienced in their previous roles will be lost. It takes time to find the right workers for new positions and resources to train them. That means both elevated unemployment *and* workplace inefficiency for some time.

All this will prove a headwind against a sharp economic bounce-back. With a vaccine running into difficulties already, and no political or social prospect of a collective decision to just all "go back to normal," the Inefficient Economy is here for a year, at least.

So are we powerless? We certainly cannot wish away reality. But the Government can take steps to avoid worsening this inefficiency and to allow businesses and workers to find solutions to it. But that requires as bold a deviation from ordinary policy as the extraordinary relief efforts we saw before.

1) Prices

Supply-side inefficiency would ordinarily lead to higher prices in certain product markets. With swings in demand too, prices might jump all over the place as activity re-opens. These price changes play a vital role in coordinating how resources get re-allocated across the economy in this new world.

Yet the government's Competition and Markets Authority has warned businesses against raising prices during the pandemic, pledging to stamp down on "rip offs." If businesses take this threat seriously, an unwillingness to raise prices in new situations will create an invisible effective price cap that will cause shortages in certain areas. It is crucial, as lockdowns are relaxed, that the government makes clear prices can be freely set again without reaction, to avoid compounding inefficiency with inefficiency.

2) Business and Worker Regulation

To help companies adjust, the Government should suspend regulations that prevent innovations to opening hours and on-site activities. Some of this has been done already, with councils changing planning and Sunday trading laws to allow restaurants to become takeaways and shops to extend hours.

Working hours' regulation may also need to be suspended given pent-up demand in certain industries. Careful thought will need to be given to statutory holiday time too – are employees still going to be entitled to 28 days off through the end of the year as businesses struggle during reopening?

Then there's the national living wage, which the government raised again in April. A lot of low-paid jobs in hospitality, restaurants, and more will be less "productive" than before – the revenue per worker hour will have fallen. If the government insists on maintaining a high wage floor devoid from companies' ability to pay, some jobs will be lost and the reallocation problem compounded.

3) Labour market policy

In theory, the inefficient economy need not mean high unemployment, however. Companies will need lots of workers for cleaning, security, testing, delivery, repatriated manufacturing businesses and many other roles.

But avoiding permanent scarring from mass layoffs requires a rapid reallocation of workers. This can be encouraged by both deregulation and temporary government activism. Deregulation, in the form of relaxing rules surrounding occupational licensing and suspending the minimum wage. Activism, in the form of tools to help people in job search and financial incentives for workers to take up new roles.

There is a strong case for a temporary "big push" on hiring good job centre personnel and developing better clearing houses for job and re-training opportunities, for example. But we also need financial incentives to work in lockstep.

Here, Jonathan Portes and Tony Wilson's idea for how to wind-down the furlough scheme has merit: if both worker and employer agree that the prospects for a job that necessitated furlough money are good, then continue partial government support for short-time working.

If either worker or business thinks the job unviable, give the worker the option of a lump-sum grant or retraining, alongside a wage subsidy for a set period in any *new* job they take. That ensures relief to those with most to lose from the furlough scheme ending, but without compromising economic efficiency too much.

When it came to extraordinary government spending through relief, the Government did the unthinkable by subsidising over a fifth of all employment, and was celebrated for it, even by many classical liberals, given the extraordinary circumstances.

Now we approach a new extraordinary period in regard the economics of this pandemic – the Inefficient Economy – which only business and worker flexibility can partially offset. Let's see how willing other thinkers are to suspend their ordinary policy priors.

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