

## ARGUMENT

# Coronavirus and the Limits of Economics

Why standard economic theories have no answers for this kind of crisis.

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BY SANJAY G. REDDY | MARCH 31, 2020, 2:52 PM

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**T**he coronavirus pandemic has dramatically disrupted the everyday social and economic patterns of societies around the world. Economists have focused on its economic impact and on what central banks and governments should do in response to an unusual simultaneous disruption of both supply and demand. There is consensus that governments will have to support businesses and workers who are losing income—or risk dangerous knock-on effects on banks and the real economy—and find a way to finance these expenditures. There is also an urgent need to ramp up the production of essential commodities such as ventilators, gloves, and masks; to provide hospital beds; and to ensure that required personnel can themselves turn up for work. Despite disruption to supply chains and restrictions on the population, essential goods and basic services must be provided, firms must be kept from going bankrupt, and employment and incomes must be maintained.

These circumstances raise fundamental questions about the role of the market and the public sector in doing what is needed on the required scale and with sufficient speed. Some economic thinkers are rightly attacking these problems with urgency.

But addressing such practical ends also calls for us to rethink more basic economic ideas. The economics discipline has provided the most influential framework for thinking about public policies, but it has proved inadequate, both in preparing for the current emergency and for dealing with it. The pandemic underlines the necessity for a rethinking of our received ideas about economics and points in some directions that this rethinking should take.

## The public interest and rational choice

Let's first take the view of mainstream economics of the relationship between individual and collective rationality in a situation like the current pandemic. It conceives that what seems rational for the individual to do can end up being irrational from a collective standpoint. Conventional economists conceive that the actions of individuals who propagate an infectious disease generate an externality in

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whom they interact with, in turn), thereby raising the disease risks in society at large. It may be reasonable for an individual to judge that an interaction with a specific other individual is low risk for both of them, but many such interactions multiplied across a population would greatly increase the speed of transmission of the disease and the ultimate risk of infection, not merely for the person concerned but for others

There is not much to quarrel with here. The trouble comes later. Externalities can be such that some are harmed by them or that everyone is harmed by them. The current pandemic involves aspects of both of these cases, but in either instance, a rethinking is needed.

Since mortality rates from the current pandemic are overwhelmingly greater for the old, and younger people most often experience small direct harms compared with the benefits they receive from an uninterrupted life, a framework for making public health choices in the current pandemic must go beyond the question of whether all can be made better off and instead undertake interpersonal comparisons of well-being to determine whether the benefits of a specific action to some outweigh the losses to others. Most conventional economists studiously avoid such comparisons, focusing instead on efficiency considerations that rank outcomes only according to whether all are made better off by a course of action. In this situation, such an approach will get us nowhere. The economist Lionel Robbins famously attacked interpersonal comparisons as being questions of “Thy blood or mine.” But in this case they may be questions of “Thy blood or my livelihood.” Interpersonal comparisons permit us to judge whether prospective additional losses of life of some may be viewed as outweighing the inconveniences and economic or social harms, possibly also serious, experienced by others.

A pandemic allows us to see why it is absolutely necessary, even if far from straightforward, to weigh different people’s interests. Such comparisons can of course be fraught. In the best case, meaningful public deliberation on them can provide some social and political legitimacy. Drastic decisions by governments in Europe and the United States to stem the pandemic so far appear to have earned public support, even in the absence of much public discussion. But ultimately, societal deliberation is unavoidable about the weights to be attached to different interests, not only to gain adherence to them but to ensure that justifiable trade-offs are being made.

If there is a case for having restrictions on day-to-day life in place for a sustained period, it must be based on a willingness to weigh the interests of different people against each other. Similarly, the case for requisitioning private resources (such as medical facilities, buildings, or intellectual property concerning the makeup of pharmaceuticals or the design of ventilators) in order to serve the immediate public purpose of fighting the pandemic can be best understood in terms of exceptional but reasonable trade-offs between the vital interests of some and the less vital interests of others. The willingness and ability to undertake such trade-offs is inherent to the concept of the public interest.

On a more fundamental level, the pandemic also shows the inadequacy of the conventional economist’s understanding of individual rationality. In some measure, the control of a pandemic aims to avoid

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rationality, as the standard framework would suggest (as, for instance, in the famous example of the prisoner's dilemma). Rather, it requires viewing individual rationality differently and more expansively than economists have typically preferred. This is not a new idea. Critics of the narrow understanding of rationality in economics have long underscored the need to understand strategic interdependence from a broader perspective, for instance that of enlightened self-interest—a concept that was advanced by Adam Smith and recognized by Alexis de Tocqueville but has largely fallen into disuse. Similarly, moral philosophers, in particular Immanuel Kant, underlined that a reasoned approach to morality required evaluating one's own actions by how they would be judged if undertaken by others. All of these thinkers believed that rationality, properly understood, must include reasons that lead away from the relentless and myopic pursuit of individual advantage.

Only with this more comprehensive approach to rationality can one meaningfully make an appeal for voluntary compliance with the requirements of the social good. It is noteworthy that in the model most prominently used by policymakers to inform their response to the present crisis, only partial compliance with social restrictions has been assumed. Although abiding by such restrictions might be motivated by fear of punishment or by respect for authority, it can also stem from a willing alignment of one's own reasoned choices with a societal effort at coordination. Either way, the current situation requires policymakers to go beyond the narrow toolbox of mainstream economic theory to justify, and to motivate compliance with, public health measures that diminish individual freedom.

## Uncertainty, judgment, and justification

A second reason that conventional economic thinking offers very limited guidance in the present circumstance is the presence of fundamental uncertainty. Economists have long made the distinction between uncertainty and risk. Uncertainty is typically understood as involving outcomes that cannot straightforwardly be assigned a probability, unlike risk. Economics offers limited resources to understand how to make decisions in the presence of fundamental uncertainty. But a still deeper form of uncertainty is one in which the possible outcomes cannot easily be anticipated at all. Such a wildly unpredictable outcome has come to be popularly known in recent years as a black swan event.

The coronavirus pandemic might at first appear to have been such a black swan event, but that claim does not withstand scrutiny: The possibility of such a threat was long recognized by experts. This recognition led to scenarios being discussed at the highest levels of governments. The possibility of a pandemic was therefore a “known unknown” rather than an “unknown unknown.”

The prospect of a pandemic involving a coronavirus thus involved fundamental uncertainty of the first type: an occurrence that could be anticipated—indeed, was anticipated—even though it could not be assigned a probability, nor could it be known whether, when, and in what form it would happen. Given

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For instance, at the global level, the World Health Organization (WHO), which plays a central role in the surveillance of and response to emerging diseases, may have been inadequately financed. It is a different matter that WHO has also been accused by some of a poor initial response to the pandemic. A similar claim could be made about the national public health infrastructure in many countries.

The fundamentally uncertain nature of the evolution of the pandemic gives rise to continuing deep dilemmas as to the so-called rational response to the current coronavirus emergency. Consider the metaphor of “flattening the curve,” which has informed governmental and societal responses to the pandemic. The potential results of measures such as the closure of schools and universities, restaurants and bars, and social distancing have been underpinned by simulations that are, inevitably, based on specific assumptions and limited evidence and that focus mainly on one goal (avoiding deaths from the disease). The motivation for undertaking specific measures is based on the expected direction of their impact, but what actual effect they will have, in relation to the spread of the virus, let alone other health and non-health consequences, is unknowable from the models that have been used. This is implicitly admitted by the model builders, who have therefore studied the impact of periodically turning restrictions on and off as information about the success or failure of policies comes in.

The inadequacy of existing models leads to reasonable disagreement on the right course of action. The effects of the draconian closure of borders, and the shutting down of many aspects of day-to-day life, on other aspects of physical health, mental health and loneliness, sociability, economic prosperity and inclusion, public finances, education, and birth and death rates, among many other factors, add to the uncertainty confronting societies. Each of these relates to the others in complex ways. The effects of such draconian policies are difficult to know. Some effects of policies may be persistent or permanent. Others may be temporary but highly disruptive. The plausible chains of causation are diverse. An effort to chart them is essential to making prudent public decisions but also necessarily encounters serious limitations.

The late sociologist Ulrich Beck, who spoke of the emergence of a “risk society” that generated “bads” as well as “goods,” distributed according to often unknown or unknowable chains of causation, was not far off the mark. The need to undertake adequate measures to stanch the disease must be balanced against our knowledge that we do not, and cannot, know all that we need to know to make informed decisions. Although a public health emergency highlights the need for executive powers, and the need for expertise, it also underlines their limits. In a democratic context, public decisions must be underpinned by judgments that are capable, in the light of day, of being supported by reason and sustained by societal deliberation. Judgment must therefore be combined with justification.

The fundamentally uncertain nature of the impact of the pandemic and its evolution will influence private sector responses, and this must in turn be taken account of by public policies. The famous Ellsberg paradox showed that individuals have an aversion to uncertainty that goes beyond their aversion to risk. In a situation where both the “state space” describing possible events and the probability to be attached to each such event are unknown, the emotional element in decision-making is

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reasons for the collapse of market sentiment as a result of the pandemic, the enormous day-to-day fluctuations in stock prices in its aftermath appear to be a form of excess volatility that cannot be fully understood as rational.

Public policy in response to the pandemic must focus on providing an anchor and assurance to private actors. This can create expectations of stability so that private actors continue where possible to spend and invest, plan for the end of the public health emergency, and avoid actions that could create adverse knock-on effects on public health or economic outcomes, such as firing workers. Panic is itself a risk factor and can be triggered by the wrong public actions or calmed by the right ones. Governments can provide a backstop that ensures the survival of firms and the continuity of employment and incomes so as to maintain aggregate demand and broad-based solvency and liquidity. This may require outright subsidies and transfers in order to enable economic activity to go on and to avoid irreversible damage. But these are ways of dealing with uncertainty, not dispelling it. Identifying the necessary interventions that take note of the interdependence between public health, economic stability, and other factors is in the nature of a “wicked problem” and demands extraordinary public leadership, at a time when trust in government is unprecedentedly low. There is, moreover, no formula for it. Although economics can provide required input, no one discipline, nor indeed all of them together, suffices to turn art into science.

## What is an economy?

Third, consider that an economy cannot be separated from society: It is socially embedded. The notion that the economy can be analyzed independently of the public health, political, or social processes—often promoted by the dominant tradition in economics and reflected in general equilibrium theory—is shown by the pandemic to be not merely fragile but false.

One way to see this is that the appropriate economic policy response to the pandemic depends on what is held to be of value—and the values to be considered go beyond the narrowly economic. Former White House chief strategist Steve Bannon reportedly said that “a country is more than an economy.” He was right, if for the wrong reasons. The global response to the pandemic would have seemed impossible even yesterday: nations isolating themselves, motivated not by the desire to protect their economies but to protect the public health. Implicit in this overriding of economic priorities is the importance of an idea of common citizenship and shared fate. Many societies pay little heed to this idea in normal times. But the pandemic underlines that the public health is a consequence of regulations, institutions, policies, norms, habits, and economic and social arrangements. As a result, state and societal action, or lack thereof, becomes paramount. The impact of paid sick leave or access to health care on the spread of infectious diseases provides examples of how political and economic choices generate the transmission

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instrument, but when causal interlinkages are deep, the instruments—in this case, public health and economic policies—must be coordinated to achieve the objectives.

The pandemic also blurs the dividing line between the private and the public. The goal of flattening the curve has been embraced because there are insufficient hospital beds, ventilators, and other facilities to look after all of the potentially sick at one time. This capacity constraint is, however, the result of prior public and private decisions not to invest in what may then have seemed to some—but not to all—to be excess capacity. The current severe curtailments of private freedoms, in particular of movement and assembly, and disruptions of patterns of life—with potentially damaging economic, social, and health consequences—are the result of what appear in retrospect to have been prior underinvestments. Changes in the structure of supply chains, once motivated by efficiency considerations, may also have made it more difficult to increase rapidly the output of required necessities, generating marked inefficiency as a result. Keynesian economic thinking has long underlined the societal interest in adequate investment, whether public or private. The pandemic brings to the fore that this interest can extend beyond how much investment there is to what investment there is. Current efforts to raise the supply of the constraining resources rapidly may require public coordination and redirection of private resources. A pandemic, like a war, makes the distinction between the private and the public spheres less meaningful. It brings into high relief previously obscured interdependence. This is not mere theory but thinking that makes sense of practice, especially but not only in extraordinary times.

A rational response to the pandemic requires recognizing that interdependencies between the spheres of life are central to economic phenomena just as they are to epidemiology. The kind of knowledge that is required demands active collaboration between the various social and natural sciences. Whether it is in conceptualizing the public interest, making sense of the relation between what is rational when viewed individually and when viewed collectively, recognizing the role of fundamental uncertainty and the consequent need for judgment and justification in making public policies, understanding the economy in its social context, or in other ways, the discipline of economics must open itself to new insights and retrieve old ones. The required rethinking of concepts and methods is most likely to come about due to the demands, and in the crucible, of applied problem-solving. Difficult moments such as the present one make a beginning.

**Sanjay G. Reddy** is an associate professor of economics at the New School for Social Research in New York. Twitter: [@sanjaygreddy](https://twitter.com/sanjaygreddy)

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