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Intelligence Briefing

*This paper is based on Chapter 11 of my book 'Een land van kleine buffers' (Amsterdam: Pluim, August 2020).

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Non-technical summary. The thesis of this paper is that the COVID-19 crisis creates opportunities for fundamental change towards a more sustainable economy, for two reasons: structural change in the economy and a change in public opinion. The paper identifies how the COVID-19 crisis accelerates six processes of change that can be leveraged in policy making. With a focus on the Netherlands, it argues for activist government policy because of the tipping-point nature of the economic system in the crisis.

Technical summary. Structural change in the economy and a change in public opinion during the COVID-19 crisis jointly imply that government choices regarding investments, regulation and taxes can now create stronger synergies of cleaner economic growth and employment creation with ecological, social and financial sustainability. The paper details this for six areas, with examples taken from The Netherlands. High levels of private and (in some countries) public debt may become so unsustainable that this prompts a restructuring of financing systems which are more productive and more in support of ecological goals. In value chains, ICT systems and urban transport systems, forced changes such as more work from home, more cycling lanes and more local production may, once in place, be used as proof of concepts for permanently different infrastructures and organizations. Aviation and energy became dependent on public support, which created financial leverage for enforcing change.

Social media summary. COVID-19 creates opportunities for change towards sustainability as it accelerates six processes of change.

1. Introduction: new space for change

In the first 5 months of 2020, the German car industry experienced its lowest sales figures since 1975. On 3 June, the government came to the rescue as it created a EUR 130 billion support package for the German economy. The VAT was temporarily decreased by 3% and a EUR 6000 subsidy was paid out for every electrical car sold. Petrol and diesel cars, which still account for 90% of car sales, were excluded from the support package. Despite the enormous cost – with a EUR 15 billion fossil fuel fleet waiting to be sold – the industry was strongly encouraged to invest in the production of electrical vehicles (Economist, 2020b; Financial Times, 2020b).

This case illustrates that the market changes caused by the coronavirus pandemic are costly, but also that they offer opportunities. Such opportunities can become reality if economic support is combined with incentives for change. The alternative is to delay change. For example, on 30 April 2020, China postponed the effective date of its new, stricter emission standards for passenger cars ('China 6', the successor to 'China 5'), from 1 July 2020 to 1 January 2021.

Tangible structural change in the economy is a first reason why new opportunities for transforming the economy have emerged during the coronavirus pandemic. Car and air travel dropped; so did oil consumption. The use of artificial intelligence and IT has increased, as has the level of sustainable urban mobility. No-one planned this change; it was a reaction to the contact limitations that many individual companies, households and local, regional and national governments were faced with. In this intelligence briefing, I will explore concrete examples of how corona-induced changes can be leveraged by policy into further change towards a more sustainable economy.

A second opportunity for change lies in the suddenly increased awareness of the problems of what I have dubbed 'small-buffer capitalism' (Bezemer, 2020). This refers to a variety of capitalism which has become dominant over the last few decades, in which pressures to reduce costs, shareholder capitalism, fiscal stringency, tax evasion, labour market deregulation and financial deregulations have combined to produce an economy with small financial buffers, insufficient investment in capital goods and innovation, and too much investment in financial assets and real estate. Small buffer capitalism is today's form of what Hyman Minsky (1996) has termed 'money manager capitalism' 25 years ago. The market economy has evolved into a system that drains money away from productive and innovative uses and empties prudent buffers, funneling it towards the accumulation of financial and real estate assets. The ever more lopsided distribution of assets creates inequality – income from capital, rather than from wages, is the main driver of rising income inequality – and it breeds economic instability

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and financial fragility. It also chokes off the financial flows that should support innovations, and it weakens the incentives for work and for entrepreneurship – as Piketty (2014) warned.

The awareness of the problems of small-buffer capitalism has been highlighted as small financial buffers within households and among the self-employed have turned out to be costly to the public purse. Cash buffers are also small in many firms, where despite healthy profits (thanks in part to low wages), the COVID-19 calamity found many unprepared since profit had been squandered on dividends and stock buybacks, mergers and acquisitions, real estate speculation and other financial transactions that left too little liquidity in the firms. Also, by requesting support, large companies have drawn attention to their tax avoidance and their funnelling of financial buffers to shareholders, again at the cost of the government's financial buffer in the form of rising public debt. And it has also suddenly become very clear how vulnerable companies with high levels of debt are. This new public awareness of the problems our economic model has created political space for change. The awareness is evident in print and online media, or in any case it was in spring 2020, and may still be (FT editors, 2020). The new policy space is evident in the tone of the political debate, in statements by politicians, and in election outcomes (Adriaanse, 2020). Before the momentum passes, this awareness and this space must be used. A first area of reform is the crippling high level of private and (in some countries) public debt, which threatens to hold back innovations towards a more sustainable society.

2. The debt problem

In its spring institutional paper published in May 2020, the European Commission (2020) discussed an expected increase in national (public) debts as governments have been covering wages and other expenses in the private sector. Italy's national debt was expected to increase from 135% of its GDP in March 2020 to 153% in 2021, that of Spain from 96% to 114% and France's debt from 98% to 112%. Several major European economies have thus seen their public debts rise to a level that private markets might only want to finance at high costs. This rise in debts is due to the exceptional situation caused by contact limitations which deprives many firms of revenues. It will be followed by further debt increases – both private and public – as a result of a 'normal' recession, due to the bankruptcies and rising unemployment which will inevitably follow.

Private debt is already at record levels, both corporate and household debt. High debt levels are not irrational when rates are ultra-low, but they are sustainable only if the good times are sustained. Corporate debt sustainability depends on prospects for corporate earnings and returns on investment as well as expected debt repayment costs based on forward interest rates. Corporate earnings have now taken a hit and interest rates, some expect, will have to rise in the future as inflation picks up (Goodhart & Pradhan, 2020). Debt service resulting from high corporate and household debt levels also impedes spending on investment and consumption, as Juselius and Drehmann (2019) show.

This was always the case, at least since the 2008 crisis, but the problems have suddenly intensified due to the COVID-related rise in debt. Action is now needed. An early proposal by France and Germany, to immediately support European countries with EUR 500 billion worth of non-repayable funds was initially rejected by the 'frugal four', the Netherlands, Austria, Denmark and Sweden, who were only willing to issue support in the form of loans,

causing the debts to increase further. Later, a mix of debts and gifts was agreed. Countries and companies are entering a danger zone in 2021, in which their debt sustainability is in question (where debt sustainability is the ability to pay one's debt at prevailing interest rates). This may increase pressure to finally tackle the debt problem.

In this way, the corona crisis may act like a catalyst. Unsustainable debt growth is not a new phenomenon; the corona crisis has merely intensified it. The solution that has been advocated for years has suddenly become a viable option: debts should be restructured or even waived. Many emerging economies in Asia, Africa and Latin America already reached the point of unsustainable debts in April 2020 and the International Monetary Fund (IMF) issued non-repayable funds to 25 countries to enable them to continue to bear their debt burdens. But also in Europe the ECB (European Central Bank) is preparing for a wave of 'bad loans' that will not be repaid. The amount could be as high as 1500 billion euros, up from 400 billion euros before the crisis (Enria, 2020). A debt restructuring (which could be a partial forgiveness) may well be unavoidable.

Indeed, already in late May, former Chief Economist of the American investment bank Citi Willem Buiter claimed in a blog-post that neither of these options could be real solutions. The Franco-German plan was too small in scale, whereas loans (and thus, growing debt) would push Italy out of the eurozone – with more countries to follow. A coordinated debt reduction followed by investments is the only possible solution. Many private as well as public debts are already ending up at the ECB, thanks to the central bank's debt purchase programmes. This will make waiving them relatively simple in operational terms – although still politically complicated.

A debt restructuring is the start but not the end of solving the debt problem. Subsequent financing of companies must be arranged in new ways (more equity, less debt), to prevent debts from increasing as rapidly again (Boot et al., 2020). A problem that has been stealthily undermining our economic system for decades has now become an acute emergency, with prospects of real solutions. If we can break the dynamic that drives up debts levels even in good times, European economies will be ready for a financial reset. The new financial freedom can be used to support five other processes of change.

3. Opportunities for change

3.1 Revamp urban transport systems

In March 2020, the city of Milan reserved half of its city centre roads for cyclists and launched a publicity campaign to encourage bicycle use. It was the only way to get the city moving again while maintaining social distancing. Public transport can accommodate only a fraction of 2019 traffic numbers. If everyone else takes the car, congestion levels in the city will skyrocket. Paris and Brussels were also keen to create bicycle lanes in the spring of 2020. Mayor Anne Hidalgo of Paris would like to see 60,000 of the 83,500 parking spaces for cars in Paris street disappear. Hidalgo's 'City of 15 minutes' plan launched in January 2020 attracted international attention. Her vision is that all facilities must be within 15 minutes' cycling distance (Mobiliteitplatform, 2020).

The COVID-19 crisis accelerated the process of making urban mobility more sustainable by enforcing behavioural change, arguably the biggest hurdle. The new habits can be made permanent by creating new urban mobility infrastructures including a

network of designated bicycle paths, a payment system for vehicle kilometres, a permit policy and investments in public transport.

Similar opportunities arise in tourism. The city centre of Barcelona used to be packed in summer. But with social distancing, everyone needs 7 m² of space. Mayor Ada Colau expects major change: ‘The tourism of the future will have to be sustainable’ (NOS, 2020). Again, this development is not new but has merely been accelerated by the coronavirus. Solving the issue of mass tourism was one of the election promises that helped Colau win the Mayor’s office in 2015 – but major interests were at stake and change was postponed. In 2019, 20 million tourists visited the troubled city.

Just like in the car industry, there was no room for change until the old model was forcibly phased out. This barrier, the highest one, has now been tackled. The coronavirus is stimulating people to think up new tourism models. And the same thing that applies to debts, mobility and tourism also applies to communication, energy, industrial innovation, value chains and aviation.

3.2 Accelerated adoption of IT

The sudden rise in online conferencing company Zoom’s share prices speaks volumes. Never before has the acceptance of IT in schools, universities, municipalities and companies happened so fast. It seems unlikely that we will give up the advantages and cost benefits once a vaccine is available. A survey in May 2020 found that a quarter of chief financial officers in firms were already thinking of cutting back on real estate (Thomas et al., 2020). Once again, several important obstacles on the road to change have already been overcome. The behavioural change will no longer have to be enforced – it is happening already. A practical demonstration is far more convincing than reports and arguments. The Dutch economy for instance, with its large service sector, may change radically.

This is not just about Zooming and Skyping; IT applications have also recently skyrocketed in industrial production. Manufacturing is a capital-intensive and therefore conservative sector, where mistakes are very expensive and where digitization started late and proceeded slowly until the virus struck. The Economist (2020a) reported how European engineers were simply unable to travel to Chinese factories to test and adjust newly installed machines. It turned out much of this work can be done by AI algorithms, with the more difficult cases handled remotely by the engineers. In many industrial enterprises, data management and data sharing methods are still relatively old-fashioned. The virus measured forced rapid change. One respondent estimated that 5 years’ worth of innovation was going to be implemented within 1 year in 2020–2021. With the right support policies, this, too, can become permanent.

3.3 An accelerated energy transition

The shrunken economy in lockdown has needed a lot less fuel. The price of oil, which stood at USD 50 per barrel in February 2020, plummeted in April. Attempts at setting production limits by the OPEC+ cartel, and telephone diplomacy by President Trump to support the American oil industry, could not prevent the oil price from briefly dropping to USD 25 per barrel in May 2020. It is now (in November 2020) still below USD 40. A return to pre-coronavirus price levels seems unlikely in the near future for several reasons. The global economy is likely to remain below the 2019 activity level for years to come. De-globalization,

and therefore a decrease in transport, was already happening due to reduced profit opportunities in global value chains. This process has now accelerated.

Collapsed demand has combined with supply that had increased in the run-up to the COVID-19 crisis, as the USA raised its production and became the world’s largest producer. The start-up costs and fixed costs for companies in the oil and gas industry are high, particularly in the fields of tar sand mining and oil and gas fracking which are also the most polluting. These firms go deeply into debt for their investments, even though shale oil production in the USA has been unprofitable for years. In 2019, 50% more bankruptcies occurred in this sector than in 2018, and analysts expected a shakeout of weaker companies in 2020 even before the COVID-19 outbreak. Only the largest companies with a strong government lobby will survive, and the structure of the industry will change (Lahn & Bradley, 2020). The oil price drop raises the question to what extent fossil companies should receive government support, ostensibly available only to future-proof business models – which is not the case if oil prices remain low for long. The answer matters hugely, since state support has become generous. The IMF calculated in 2015 that annual subsidies worldwide amounted to USD 4700 billion (approximately 6.5% of global GDP), 85% of which was spent on petrol and coal (Coady et al., 2019).

The oil price crash also illustrates the danger of ‘stranded assets’: securities that may suddenly become worthless. Shares and bonds in oil, gas and other companies in the ‘brown’ sector are at risk of losing their value as fossil fuels are being phased out. Banks, pension funds and other institutional investors have many such assets in their portfolios. This means that the transition to sustainability should have been accompanied by a careful phasing out of these assets – not too quickly, because that would make the price crash. Now that this has indeed happened, involuntarily due to the pandemic, they are in trouble. This is another process that COVID-19 has accelerated. Access to cheap capital for refinancing is of vital importance to a sector that is deeply in debt. The sudden drop in oil prices creates a problem in decreased revenues and in debt financing.

The fossil fuel industry is not the only energy sector that was affected. In a report published in May 2020, the International Energy Agency (IEA) expects a 50% decrease in investments in the shale gas sector, 30% in oil, 25% in coal and 10% in renewable energy (IEA, 2020). The IEA also warns that investments in renewable energy sources will suffer from the coronavirus recession. This means there are both threats and opportunities. If governments now support sustainable investments while fossil sector subsidies are scaled down, a radically different energy sector will emerge from the coronavirus crisis. Of course the political economy of this is not (yet) promising.

3.4 ‘Slowbalization’ in global value chains

The process of deglobalization has been going on for several years now (Economist, 2019; see also Li et al., 2019). There has been a slight decline rather than growth in international trade and capital flows. This ‘slowbalization’ may also accelerate, now that dependence on remote production (e.g. in face masks and ventilators) has become painfully clear. In April and May representatives from Western governments travelled with bags full of money to China to purchase supplies or acquire factories.

Face masks and ventilators are the most extreme examples of the consequences of a lack of domestic (or regional) production

capacity. For many more products, the COVID-19 crisis has laid bare the vulnerability for transport and trade limitations. The example of face masks illustrates also how global production chains can be shortened. New production capacity is being built up in the Netherlands, for example by 3-D printing face masks (POA, 2020). Once these investments have been made, the old chain may never fully return, even after the transport possibilities have completely recovered. Again, COVID-19 accelerated the slowbalization process: once the start-up and investment costs for alternatives have been incurred, the costs of further change (i.e. the shortening of value chains) are falling.

3.5 A shrinking aviation industry

Another sector in which the coronavirus crisis could lead to real change if opportunities are seized is aviation. Change is certainly necessary here. In the Netherlands, Schiphol International airport near Amsterdam puts enormous pressure on the quality of life in its immediate environment. Subsidies of air travel and the airline industry (Gössling et al., 2017) costs billions of euros in tax money every year. However, any planned shrinkage faces tough lobbying and require sky-high compensations, even supposing the political will is there (which is not). The unplanned decline in the spring of 2020 may have changed everything. The pandemic measures ended most air traffic. KLM airline operated at 15% of its capacity at the height of the crisis and at the time of writing almost a year after the start of the crisis, Schiphol Airport is largely empty. The costs are enormous and initially they fall on the sector itself. This creates a new playing field, where the industry completely depends on the state for its survival.

So far, most states are supporting their airline companies. It is bound to cost the state more to return airports and airline industries to their pre-corona, highly subsidized activity levels. Also, now is the time to attach conditions in terms of sustainability and remuneration policy to any support – this position found a Dutch Parliamentary majority in May 2020. However, government responses vary greatly. The Dutch cabinet only started to talk about conditions when it had already awarded the support. In the meantime, in May 2020, the Ministry of Economic Affairs and Climate presented an aviation policy memorandum (*Luchtvaartnota*) without any ambition (MEAC, 2020), and the conditions attached to the EUR 3.4 billion in support in June turned out to be extremely weak. In contrast, France Finance Minister Bruno Le Maire demanded that Air France halve its domestic carbon emissions by 2024, compared with 2005 levels.

4. Conclusion: seize the day

Already before the COVID-19 pandemic hit the world, the financial buffers of households, governments and corporations in many countries were already rather small due to wage stagnation (for households), corporate tax breaks and tax evasion (for governments) and shareholder payouts (for companies). With the pandemic, both private and public debts rose precipitously and, with a further decline in financial buffers, there is both less financial room and a greater need for innovation and change. Things can now go either way. Either the current form of polluting capitalism is restored with huge support from the public sector, or the support is used to seize the new opportunities and accelerate the necessary transition to a more sustainable society. The German example at the start of this paper is telling. Without subsidies for electric cars, the result will be a diesel car sale and more production. With subsidies, greater

investments in battery and hydrogen-powered cars will be made. At tipping points like these, a small subsidy may have large consequences. The German government has understood this.

In the COVID-19 crisis, government choices regarding investments, regulation and taxes may create synergies of cleaner economic growth and employment creation with ecological, social and financial sustainability. In 2021, the outcome will hang in the balance. Bicycle lanes that were pencilled in could be erased, or a network of bicycle lanes could be built. Shortages of people and resources in healthcare could be forgotten, or the wages and working conditions of people in vital jobs could be improved. We can start working from home 2 days a week and convert offices into apartments, or we could all plunge into traffic jams again. We could buy a EUR 14 plane ticket from Amsterdam to Valencia, or we could take the high-speed train – if we have the courage to invest.

Things usually have to get worse before they get better. We managed the ‘getting worse’ part – for several decades past, and the process has accelerated since March 2020. The ‘getting better’ bit can only happen if opportunities for improvement are actually seized.

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