

Evidence submitted to the Welsh Affairs Committee Inquiry into the impact of Covid-19 on the Welsh economy

Introduction

We are academics from Cardiff University with expertise in economic geography. We have undertaken considerable research on the economic resilience of regions, including how to define and measure it, the factors that influence it, and the policy approaches that help build resilience. We led a major international study into the economic resilience of European regions following the 2008 financial crisis (ESPON, 2015) and have produced a number of outputs based on our findings (*see Appendix for details of most relevant outputs including a recent report by Healy, 2020 for Welsh Government on 'Strengthening Economic Resilience'*).

We are submitting this evidence as we believe there are valuable insights from our body of research which can help address one of the Inquiry's key questions, namely what work can be done to make the Welsh economy more resilient in the face of future crises and potential outbreaks of Covid-19 and other pandemics.

Our evidence focuses on **two key themes**:

- The uniqueness of the economic shock caused by the pandemic and lockdown, and the attendant implications of this both for its impact on the Welsh economy and for the actions required to mitigate this impact;
- The critical policy challenge presented by the crisis which we regard as one of effecting a shift from a *reactive* to a *proactive* resilience strategy, and one which is focused on laying the foundations for longer-term, transformative change in the economy.

The uniqueness of the Covid-19 economic shock

The Covid-19 economic shock is not a conventional one but, instead, is unique in at least three ways: its reach and breadth; the multiple shocks it is delivering at one and the same time; and its particular, and potentially very significant and lasting, effect on demand (both in the UK and in overseas export markets).

The scale of the impact on the global economy is becoming clear, and will be significantly larger than that felt by the 2008 financial crisis, because it has required a very sudden and wholesale cessation of economic activities involving face to face transactions and clustering of workers. Economic activity has been halted and ruptured dramatically to deal with the public health emergency, an action which the US economist Paul Krugman has likened to putting the economy into a medically induced coma. The resulting economic shock is both more widespread and debilitating as a result, impacting across all production and services: both local businesses and global trade; the private and public sectors; and both employers and employees.

Typically, economic shocks are caused by either a fall in demand, a shock to supply or a financial crisis. The global pandemic and economic lockdown has the potential to deliver all three shocks simultaneously: consumer spending has been dramatically halted; global and local supply chains are being disrupted; and financial liquidity has been significantly reduced. The nature of the demand shock which has been unleashed by the lockdown makes it particularly distinctive from other global economic shocks, such as that which hit the global economic post-2008. Whereas the 2008 financial crisis led to falling demand which was staggered over several months, the pandemic has induced a precipitous and immediate collapse in consumer spending. Whilst some of this spending may simply be deferred (e.g. the purchase of cars or replacement household goods), some expenditure (and thus income) has been lost forever (e.g. on major sporting or cultural events). The shock is also likely to result in longer-term, significant changes in the nature of consumer demand, as well as in its overall volume and vitality. The requirements for social distancing will reduce demand in key sectors, notably in travel, transport, tourism and hospitality, and will require significant adaptability amongst businesses in terms of ways of working, and the means used to produce and provide goods and services. The impacts on local high streets will be unprecedented and will inevitably raise serious questions about the future for many local businesses.

What we can confidently predict on the basis of evidence from previous economic shocks, is that the effects of this crisis will be unevenly felt by different places, sectors, communities and households. Our research into what makes some local and regional economies more resilient to economic shocks than others has yielded important insights into what economic resilience means and the factors that influence it. Several factors appear to act as important preconditions for enabling economies to *resist* shocks, which is one critical aspect of resilience. These include: having diversity in economic sectors, businesses and markets to help spread risks; having more economic activities which are rooted in places; and having sufficient financial buffers in households, businesses and governments that can be drawn upon through a crisis. Other factors are important when considering another element of resilience which is the capacity for all the key players within an economy – households, workers, businesses and policymakers - to *respond* to the shock and help it to recover and thrive. These factors relate to how adaptable firms, households and governments are in responding to the uncertainty and change wrought by the shock. These are an economy's *adaptive capacities*, and they are critically shaped by factors such as: the skill levels of workers; the capacities for innovation and openness to change in working cultures and business models; as well as institutional capacities to effectively marshal individual and collective behaviours and actions in transformative ways.

The economic shock unleashed by the pandemic is likely to have a considerable impact on the Welsh economy given its existing economic vulnerabilities, notably its continuing legacy of dependency on external investment, its heavy reliance on tourism and hospitality, coupled with lower overall levels of prosperity and household income. Its capacity to resist economic shocks is already fragile. Our research on how Wales responded to the 2008 economic shock is telling. This revealed that whilst the economy was fairly resilient, particularly in employment terms, the response effected was ostensibly *reactive and short-termist* and focused on maintaining existing levels of employment and job security, often with associated adjustments in working hours and rates of pay. It failed to pay sufficient regard to the development of a more *pro-active and long-term* resilience strategy, focused on facilitating more forward-looking, transformative action for change.

The critical policy challenge – building long-term adaptive capacity and resilience

The policy response to the current economic crisis in Wales and across the UK has been unprecedented and has focused on the immediate challenge of maintaining the viability of businesses, productive capacity and employment. Many of the policies enacted, such as retained worker schemes and the provision of business loans and credit, are exactly the forms of support that our research found to be effective in helping economies mitigate the worst effects of the 2008 crisis. Whilst inevitably costly, they play a vital role in supporting the resistance of economies, and providing important coping mechanisms through the worst of the crisis in the short term.

These reactive policies, whilst important, will not however build economic resilience to future shocks. This requires a concerted and proactive strategy focused on strengthening the adaptive capacities of households, workers, businesses and policy-makers so that they are furnished with greater agility and flexibility in the face of future shocks and change. Research has shown that local and economic resilience is strengthened, for example, where workers have greater capacity to take their skills from one job to another, or to access appropriate training in new areas of opportunity; and where businesses have greater capacity to shift to new, growing markets or change to online provision of goods and services. Simply sustaining economic activities in their current form will not be sufficient for longer-term resilience, nor will this pave the way for longer-term transformation in our economic system. In fact, the current crisis represents an opportunity to focus support on adapting the economy to address major structural challenges including technological change and the shift to online working, the climate emergency, and inequality. The lockdown has certainly highlighted the benefits of reduced air and road transport and consumption of fossil fuels, and of strongly pro-social, community-based activities in support of local businesses, care and wellbeing.

As such, it is vital that as and when the public health challenge recedes and lockdown restrictions are progressively lifted, that preparations are made now for enhancing the Welsh economy's adaptive capacities, for addressing the economy's structural weaknesses, for re-orientating business activities, and building sustainable foundations for economic renewal. A critical element of these preparations will involve the development of a strategic and considered approach to withdrawing the support measures described above in order to, and continuing Krugman's analogy, gently ease the economy out of its induced coma. Both the UK and Welsh Governments will inevitably face pressure to address rising public sector debt and to recoup some of the budgetary costs of these interventions. The fiscal challenge will likely be even greater in Wales. The nature of recent tax devolution in Wales means that if the crisis results in a sharper relative decline in the tax base in Wales compared to England, then the Welsh budget will face a relatively greater squeeze. However a return to austerity when the economy is stagnating will reduce its capacity to build resilience in the long-term. Public sector investment will play an important role in investing in the economy's productive and adaptive capacity and to enable its people and places to rebuild their social and economic infrastructures, particularly as the threat of Covid-19 lingers. Furthermore, there is now a unique opportunity for both the UK and Welsh governments to fulfil this role. The pandemic has demonstrated the significant capacity the state has to reach into and impact our economy and society, as well as its power for positive influence and change. This can be harnessed in support of the longer-term process of rebuilding and renewal that will now be required.

A number of critical recommendations for policy action can be made. These are as follows:

- There is a need to develop a long-term resilience strategy and action plan for the Welsh economy which sets a clear agenda for transformative and values-based change;
- This should be based upon a robust and granular assessment of the region's economic strengths and vulnerabilities by sector, industry and locality;
- It should include appropriate scenario planning for businesses and places to emerge from the lockdown;
- It should be developed in a collaborative manner involving businesses, citizens, universities and intermediary organisations, and should set out how they will work together in support of long-term actions;
- It should aim to focus on strengthening key drivers of economic resilience (such as economic diversity, local ownership and provisioning, place-based development and collaborative networks of knowledge exchange);
- It should explore how investment in recovery from the pandemic can be utilised in support of addressing key structural challenges such as the shift to zero carbon living and working, the wellbeing of future generations, and more pro-social and regenerative businesses, focused on serving local communities.

Achieving this will not be easy of course. Effecting the transition from reactive to proactive policies is particularly difficult in the prevailing context of crisis management and continuing uncertainty around the spread of the COVID-19 virus and the cost of the lockdown. However, there is strong evidence to indicate that crises can act to inspire new thinking and changed behaviours and actions. There are a growing number of examples of cities, regions and nations that are grasping the nettle of the crisis to effect more transformative change including South Korea's commitment to a Green New Deal and Amsterdam's adoption of the doughnut model for a more circular, localised and values-based economic system. Our research suggests similar such actions will be vital if Wales is to be resilient and prosper in the face of future shocks and change.

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Appendix: List of Relevant Research Outputs and Reports

Bristow, G. and Healy, A. (2015) 'Crisis Response, Choice and Resilience: Insights from Complexity Thinking', *Cambridge Journal of Regions, Economy and Society*, 8 (2), pp. 241 – 256

ESPON (2015) 'Economic Crisis and the Resilience of Regions', Final Report of Applied Research Project ECR2 for ESPON (March 2015). Available at: <https://www.espon.eu/programme/projects/espon-2013/applied-research/ecr2-economic-crisis-resilience-regions>

Healy, A. (2020) *Strengthening Economic Resilience*. Report for the Minister of Economy and Transport, Welsh Government; Wales Centre for Public Policy, Cardiff University (March 2020). Available at: <https://www.wcpp.org.uk/publication/strengthening-economic-resilience/>

Sensier, M., Bristow, G. and Healy, A. (2016) 'Measuring regional economic resilience across Europe: operationalising a complex construct', *Spatial Economic Analysis*, 11 (2), pp. 128 - 151.