

The Era of the Safety State

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Current Crisis

The current coronavirus pandemic has had a profound effect on human health, mass psychology, and the global economy. Financial markets have reflected these outcomes with the most rapid and widespread depreciation of asset prices ever seen in the history of finance.

The unique nature of the economic dislocation – its unprecedented speed, depth and breadth, and the fact that it is driven by both supply and demand considerations – has created a psychological environment for people marked by extreme fear of the future.

Investors clearly remember the market turmoil of last decade's Great Recession and also recognize that this market crash began from extremely high levels of optimism and valuation, after a decade of exceptional economic growth. There is a sense that we have fallen off a cliff and landed on what may only be the first of many ledges until the ultimate bottom is reached.

Given the rapid market collapse, and breathtaking multi-trillion dollar policy responses, it is no surprise that there has been a vigorous asset price rebound.

Some see this as the start to a rebound back to normality, following a nasty but transitory supply shock, while others peg it as a dead cat bounce or a sucker's rally, the typical way in which bear markets destroy investor wealth as they draw in even more money before plunging further.

The investment recommendation is clear from this: buy the dip or sell the rally, according to the investor's preference. Either way, this is a macro perspective, a top-down call on market price direction that mostly presumes that all boats float or sink together. There is merit in this approach, given extremely high correlations across markets and assets, huge price volatility, and the common global flow of information about the pandemic, the economy, and the policy response.

However, there is also much more than this to an unprecedented break in the economy, as we saw so clearly a decade ago, when the Great Recession spawned social disruptions and populist political movements that are still reverberating strongly today.

What then is the fundamental change that the past few weeks have wrought, what is the shape of things to come, and how can citizens and investors respond to this new trend, in a way that adds value to our prosperity and social wellbeing?

The Safety State

In the same way that 9/11, a mere one day event, triggered an endless global war on terrorism and the rise of the security state, ***I believe that the social and political response to the pandemic is ushering in the era of the safety state***, a fundamental change and a response to today's complete breakdown of social trust and stability. The crisis moment will dissipate with time but the safety state will continue, bolstered by permanent policy actions and the barnacle-like development of new institutions, technologies, and social habits.

There are three essential characteristics of the safety state.

First, it is a world that is turned upside down.

Everything is uncertain: our jobs, our income, our investments, our personal health, even the lives of our parents and children.

Everything is unstable: our work, our social relationships, our interactions with nature and with each other.

Everything is confused: information and social commentary, our roles as citizens, workers, and family members, the immediate future, the longer term future, the ultimate end point in this process.

It is a world where we imagine that anything can (and maybe will) happen and where many of those assumed outcomes are bad. This sense of dysphoria will last well past the time of the immediate crisis and it creates an unprecedented demand for stability and certainty.

Second, it is anchored in a lack of trust in other people and in social structures.

This lack of trust extends decades-long trends and is amplified by us seeing today's failed and biased leadership, institutions that are flawed and slow to react, and a corrosive social and political discourse, amped up by all of humanity sharing its fears and grievances on social networks.

The enemy is invisible and so it is everywhere and nowhere: not only the virus and other fears, but also the very personal effects of impersonal markets, economic recession, and government fiat.

It is also an atomistic process, fundamentally leaving us feeling alone and focused on ourselves, even though the rhetoric of unity and common effort is a common refrain from political leaders. We want to participate in a one-for-all and all-for-one process but experience suggests that we alone will bear most of the costs of the current social failures.

In sum, trust is an increasingly scarce commodity, but it can be earned and will be rewarded.

Third, there is a deep yearning for certainty and protection.

We are isolated, vulnerable, and relatively powerless, and so we crave safety.

We are personally and significantly exposed to risk. There is a rally around the flag effect and deference to leadership, where that leadership proves itself.

We fear further pain and loss and so we are willing or forced to trade-off other values: liberty, independence, opportunities, time, and money.

We want answers and action and, in a time of impatience, considerable wealth and advanced technology, we expect quick and effective results. Our desire for safety extends to our health, our social interactions, our basic needs, our incomes, and the natural environment. Those who can deliver on these expectations will have enormous markets and highly valued products and services.

Thus, the start of the era of the safety state is marked by an epic sense of crisis, fear and pessimism, extreme risk aversion, low expectations, and a craving for new forms of living that will re-create our sense of personal safety. The longer that this period of exceptional uncertainty lasts, the greater will be the demand for solutions of all sorts that deliver piece of mind and a sense of stability to people in their daily lives.

Post-Crisis

The crisis period will inevitably lift as financial markets find their level and the risk of financial collapse passes, as the initial waves of job losses and bankruptcies spike and then peter out, and as viral infections peak and then gradually decline. One could easily see this as a temporary but brutal reckoning with a once-in-a-century public health incident and then we will all move on. That perspective is probably wrong, however, owing to the magnitude of what has happened and the fact that politics is everything in today's hyper-connected social world.

There are many reasons to think that the aftershocks of the crisis will last much longer than usual:

The risk of a renewed pandemic outbreak is high, given the example of past pandemics and the unknown nature of this one.

We are likely to have continuing financial market dislocations and will see weaker financial institutions and the possibility of collapse there.

General risk perceptions and sensitivities will remain high and exaggerated and people will continue to act on those fears.

Restrictions on economic activities will be slow to be lifted and some may remain in place for years, bogging down innovation and economic transitions.

The economic dislocation will be permanent in many ways, as many jobs and firms disappear in a re-sorting of market demand and an inability to access capital due to higher credit risk thresholds.

The economy will settle into a slower growth track and the extra zing from the recent period of easy money and euphoric expectations will be gone.

Monetary and fiscal policy responses will last for years and are of such a magnitude that they will adversely affect the functioning of both financial and real sector markets.

Government is a renewed and very active player in society, in finance, and in the economy and it is not going to go away.

Political responses to the crisis are likely to inhibit investment, risk taking, and entrepreneurship and there is a high likelihood of mass disaffection and a definite risk of civil unrest. Populism is getting its second wind.

The most important reason for expecting a not-so-brave new world is social. The magnitude of the economic and market shock is such that it will remain in our collective memories for years.

Fear of pandemic and of health concerns in general will build on the towering edifice of the climate change consensus to overwhelm our public discourse. We cannot un-remember what we have gone through for the past few months and we are not yet even at the end of the crisis period.

This is a benchmark moment in history and the existence of our globally connected on-line lives ensures that the memory will stay at the forefront of our collective consciousness for many years. We have had a psychic break with the past and, like the war on terror, things will never be the same again.

The New Order

One especially important change is the powerful reappearance of a timeless social player: the government.

In the ultimate irony, globalization writ large (the internet, social media, mass communications, migration and tourism, integrated trade and markets, and multilateral institutions) has only reinforced the primacy of nation-state governments.

The pandemic, the market crash, and the recession were scaled up and rapidly transmitted because of our global interconnectedness. In response, when push came to shove, we all turned to the nation-state (and lower levels of government) for support and answers and they in turn wielded unilateral powers to create solutions and enforce their will (and will continue doing so). Decision-making during the pandemic shows clearly that every country put itself first, even while relying to a considerable degree on international cooperation and information sharing.

We have all reverted to our national tribes (physically and virtually) and broad social decisions going forward will start and end with national interests as the primary goal. The national government will inevitably be the dominant player in those discussions.

A consequence of such nationalism, the logic of pandemic control, and the effort to protect the economy and markets from collapse is that we are driven together collectively at the expense of those outside our circle. Localization comes to the fore and this autarkic process segregates people and their activities into smaller and smaller units, destroying social, economic and political interactions (to the ultimate extreme situation where individuals have been involuntarily quarantined in their homes). The early part of the safety state can be a very small world.

We now need to restore our connections, as the current shutdown and restrictions are not natural or sustainable or consistent with the traditional liberties or even the functioning of open societies. The post-crisis question is how and to what extent we will re-establish our links with each other. Our response to this question will determine the broad contours of our societies going forward.

The challenge of essentially rebuilding civilization is certainly not all about or even mostly about government (ignoring for the moment the dead hand effect of their arbitrary bans and restrictions). Technology and the private sector have a major role to play in the safety state. The virtual world is one obvious answer but there is a longing for physical contact and joint effort that must now be met in new ways that pay heed to our overriding demand for safety and security.

Those organizations and companies that can deliver safe connections between people are going to be the ones that reap the undoubted opportunities that are arising. Those that cannot will be quickly sidestepped by the market, which has shifted dramatically towards values of trust, security, stability, reliability, community, and safety. People will be heard and they are currently yelling at the top of their lungs for something new. That something is the safety state and it will make its impact felt across our societies for years to come.