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OPINION | COMMENTARY

The Economy Will Survive the Coronavirus

Don't despair. Even amid the doom and gloom there are many things to be glad about.

By Vernon L. Smith

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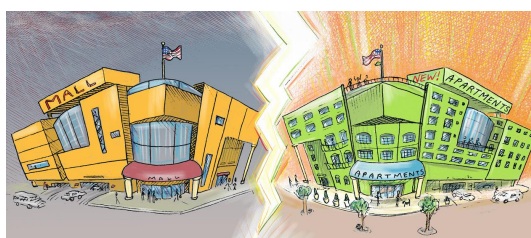


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People are worried about the Covid-19 pandemic's long-term effects on the economy and our collective future. While hunkered down in your homes, try to make the most of this rare opportunity to observe extremely uncommon events unfold in real time. It isn't all bad news. There are economic blessings to be counted.

Consumers have emptied the shelves of the supermarkets and drug stores. That means these and related industries are prospering. Workers in those industries are prospering, too. As the Journal reported last week, pharmacies, groceries and big-box retailers are taking on more part-time employees and paying more overtime.

We still have diversity of choice in this stressed but predominantly decentralized economy. My wife, Candace, realized recently that we needed a printer-copier-scanner that would enable us to sign and send documents. She called several stores before finding the device she was looking for—the last one in stock! Home appliances of all kinds are in demand as people are becoming more cognizant of in-home needs. Managers are rightly using context-dependent local information to ration access to goods.

I have yet again been made aware of what Alfred Marshall referred to as Adam Smith's "unsurpassed powers of observation, judgment and reasoning." In "The Theory of Moral Sentiments" (1759), Smith models human sociability, as it arises from our sense of fellow-feeling. Among many deep insights, Smith refers to the asymmetry between joy and sorrow. Our distress is far greater when we fall from a better situation to a worse one than we ever can enjoy rising from a worse to a better. We seek security, therefore, and to avoid exposing ourselves to loss of health, fortune, rank or reputation.

Our concern for security is the first motive for saving and investment. It's why we normally find inventories of the goods we want waiting for us on the shelves. If an investor loses sales because an item is out of stock, all other investment in the supply chain is worthless.

Reputation and esteem require us to take care in being properly compassionate for our fellow citizens who contract Covid-19. Generally, we are also focused far more on the downside and its costs than on the upside—its relief, and the eventual return of prosperity. Perhaps that stance better prepares us for whatever is to come. It's always better to be pleasantly surprised than disappointed.

Now is also a time for learning from our erroneous beliefs. Being wrong is what teaches us all the things we didn't even know we could know. In my career in experimental economics, my beliefs have been spectacularly wrong three times. Each led to new learning of enduring importance. First, I believed that supply-and-demand models for nondurable goods were abstract ideals that couldn't predict prices and outcomes. They could and did. Second, I thought asset markets with complete transparent information on their fundamental value wouldn't yield price bubbles. They could and they bubbled. Third, I predicted that anonymously matched pairs in two- and three-person trust games wouldn't overcome their self-interest and reach cooperative outcomes. Astonishingly, many can and did. Adam Smith, who understood human mutual fellow-feeling, wouldn't have been surprised.

When we are right, we merely confirm what we already thought we knew. This is the fount of "confirmation bias," the form of self-deceit that Smith asserted was "the cause of half the troubles of this world."

Projecting out, people ask how costly three months of quarantine will be. Perhaps it will hasten the decline of companies and products that are already under competitive pressure, like brick-and-mortar department stores and movie theaters. Such businesses occupy large buildings and may be rescued by innovative conversion into apartments, with handy downstairs theaters and discounters. Such experiments are lubricated by the market's deep discount of abandoned revenueless space.

The hastened decline of old patterns of service will be more than matched by the growth of mail order, delivery, takeout and related services. Growth firms in these areas are already benefiting from transportation technologies with low transaction costs that match buyers to sellers in real time, place and circumstances.

The businesses lost in a long quarantine will tend to be small and young, as will those that are gained. Today's larger firms were in many cases the small firms of the 1990s. They found ways to serve customers and escape bankruptcy after the dot-com bust. They matured.

As this crisis unfolds, don't think of decline in labor and product markets; rather think of the churn, growth and survival that is happening. We are neither a feeble society nor a feeble economy. If, beyond your neighbor, you have leftover compassion, think of those in North Korea and Venezuela. They don't need a pandemic to know what it's like to live with empty store shelves.

Once the pandemic passes and we go back to work, the country will recover quickly. The economy will reach new levels of prosperity. The crisis is going to be felt mainly by businesses offering final-demand consumer goods and services. People rent hotel rooms, just as they rent an airplane seat, for use, not to hold as an asset or to resell. As much pain as airlines, hotels and their consumers are experiencing now, these businesses aren't in a long-term decline. Once the pandemic passes and vaccines and treatments appear, people will be ready again to spend on services, travel and hotels.

Don't despair. This economic crisis will pass, and pass quickly, once the clampdown is lifted; especially if the financial shock is reduced by fiscal and monetary relief. A more common postcrisis question may be whether policy makers overreacted when fear and uncertainty were at their height. We will never know the answer, but the current anxiety of economic doom will surely pass along with the pandemic.

In fact, with more money chasing goods in stretched production schedules, inflation is a real possibility. Inflation disrupts and distorts the ability of the pricing system to coordinate and direct economic productivity. When everyone rushes to spend for fear that prices will rise, we observe the destructive opposite of what happens when everyone is stuck at home. Witness the

nightmare inflation rates in Zimbabwe and Venezuela.

The world being a complicated place, some of my predictions may not pan out. But so what if I'm wrong? It will give me another opportunity to learn.

Mr. Smith is a professor at Chapman University and the 2002 Nobel Laureate in Economics.

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