Public & Social Sector Practice

Reimagining the postpandemic economic future

As the COVID-19 crisis continues to devastate US lives and livelihoods, policy makers are challenged to emerge from it in a way that lays a foundation for a strong, healthy economy in the long run.

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The scale of the economic challenge created by the COVID-19 pandemic has not been faced in the United States in nearly a century. The pandemic has not only exposed weaknesses in US health systems but also, just as quickly, exposed economic vulnerabilities. The impacts across employment and productivity are at levels not seen since the Great Depression.

To date, crisis-recovery planning has focused primarily on delivering the historically unprecedented levels of relief that are providing lifelines for individuals and businesses trying to remain solvent. It is also addressing the complex choreography required to reopen economies safely while minimizing resurgence of the virus—a challenge underscored by the recent rollback of or pause on reopen plans in many states.

Now is the time, however, for governments to turn their attention to reimagining a stronger economic future by very deliberately addressing the vulnerabilities the crisis has exposed. National monetary, fiscal, and other policy decisions will provide large-scale boosts to aggregate supply and demand and will help create the conditions for renewed economic growth. Yet it is state and local leaders, together with their business and civic communities, who will shape the speed and inclusivity of the recovery. The COVID-19 crisis is forcing states and localities to balance a surge in demand for government expenditures with unprecedented funding shortfalls. At the same time, it is requiring them to find ways to build and fund strategies and programs to deliver stronger, more equal, and more resilient economies.

Identifying where the COVID-19 crisis has caused the most economic damage

The first step toward reimagining a more resilient economic future is to understand how and where the pandemic has most damaged the US economy at the state and local levels. Our analysis suggests that the COVID-19 crisis has had the worst impact in the following six areas:

— *The most vulnerable have borne the brunt of the economic impacts.* The pandemic has attacked the economically vulnerable, much like it has attacked those with preexisting health vulnerabilities. The economically vulnerable portion of the population is the least able to withstand this disruption: 86 percent of the US jobs that are vulnerable to pay cuts, lost hours, and layoffs are held by workers earning less than $40,000 a year. People of color and less-educated workers disproportionately work in those occupations. In contrast, only 1 percent of jobs paying more than $70,000 and 13 percent of those paying between $40,000 and $70,000 a year are vulnerable to layoffs, furloughs, and reduced hours. Additionally, 40 percent of the revenues of Black-owned businesses are generated in the five most vulnerable sectors, compared with 25 percent of the revenues of all US businesses.

McKinsey's late-March 2020 Consumer Insights Survey found that, nationally, 52 percent of Black workers and 57 percent of Hispanic workers say the COVID-19 pandemic is a major threat to their personal financial situations, compared with 44 percent of white respondents. While those living from paycheck to paycheck have turned to unemployment assistance and food stamps, US billionaires' wealth increased by $584 billion, or 20 percent, between mid-March and mid-June.

— *Many small businesses are on the brink of failure.* Small and medium-size enterprises (SMEs), particularly young SMEs, are the lifeblood of employment growth. In the United States, 78 percent of net employment growth between 2013 and 2018 was generated by companies less than five years old.[1] The COVID-

[1] *SSTI Digest*, "Useful stats: Job creation by firm age, 2014–2018," blog entry by Colin Edwards, September 26, 2019, ssti.org.

The sectors of the US economy that have suffered the most during recent recessions are also the ones experiencing the greatest economic impacts from the COVID-19 crisis.

19 crisis has put particular strain on this segment. SMEs have fewer cash reserves to maintain employee salaries when shocks occur and have more trouble navigating and accessing channels of aid. The median SME has 27 days of cash on hand, yet the crisis is now approaching the six-month mark in the United States.[2] Results published in June 2020 from a series of McKinsey surveys of small businesses indicate that, absent any intervention, 25 to 36 percent of the businesses were at risk of closing permanently because of disruption from the first four months of the pandemic.[3]

In addition, racial and ethnic minorities—who are already vulnerable, as previously described—own a quarter of the small businesses in the most affected small-business sectors but only around 15 percent in the less-affected sectors. As a contrast to the state of SMEs, tech-company stocks have soared, up almost 20 percent since the start of 2020 versus a less than 1 percent increase in the S&P 500 index over the same period. Of course, the real economy—as measured by jobs and GDP—has performed far worse than all of the major stock-market indexes.

— *Investment in innovation is at risk.* The pandemic presents new challenges to innovation ecosystems, since history suggests that venture-capital (VC) firms may be less likely to raise new funds and start-ups less likely to receive funding in such circumstances. In the Great Recession, the total amount of VC raised declined by almost 60 percent between 2008 and 2009. R&D funding could also be at risk: business R&D funding declined 3 percent during that recession. History also suggests that the timing is unfortunate, since countercyclical investments in innovation pay dividends. Some of today's most successful unicorns were founded in the aftermath of the Great Recession. Research on Organisation for Economic Co-operation and Development countries suggests that governments that are innovation leaders increase public R&D spending during recessions whereas innovation laggards cut back.[4]

— *The crisis has again exposed regions with high concentrations of vulnerable sectors.* The sectors of the US economy that have suffered greater loss of employment and GDP, on average, over the past five recessions—accommodation and food service, retail, and manufacturing—are also the ones experiencing the greatest economic impacts from the COVID-19 crisis. The regions with the greatest exposure to those sectors are again experiencing the pains of procyclical exposure. For instance, Nevada's economy is 4.0 times more specialized in accommodation and food service than the overall US economy is, and Hawaii's and Florida's are 3.0 times and 1.5 times more specialized,

[2] "Cash is king: Flows, balances, and buffer days: Evidence from 600,000 small businesses," JPMorgan Chase, September 2016, institute.jpmorganchase.com.
[3] André Dua, Kweilin Ellingrud, Deepa Mahajan, and Jake Silberg, "Which small businesses are most vulnerable to COVID-19—and when," June 2020, McKinsey.com.
[4] Maikel Pellens et al., *Public investment in R&D in reaction to economic crises—a longitudinal study for OECD countries*, ZEW discussion paper, SPINTAN Series, number 18-005, January 2018.

respectively. The three states are among those with the highest unemployment rates.[5]

States with an average or lower concentration in vulnerable sectors, such as Maine and Utah, saw unemployment rates nearly 10 percent lower than the overall US rate. That underlines the importance of reimagining the economy in a way that can break such patterns. How can states and cities reimagine their least resilient and productive sectors while also diversifying into more resilient and productive sectors?

— *The depth and importance of the digital divide has been exposed.* Seemingly overnight, access to digital infrastructure became a basic requirement for doing business in the face of the pandemic. Yet the variations in access across communities are still stark—sometimes a more than 30-percentage-point difference in the rate of access between counties, even within the same state.

  Around 24 million American households lack access to reliable, affordable, high-speed internet, and 80 percent of those households are in rural areas.[6] Suburban adults in the United States are 12 percent more likely than rural adults to own desktop or laptop computers, which are critical for remote learning and working from home. As technological innovation continues and accelerates, the expectation of digital access as the key means of doing business is only expected to continue.

— *The future role of megacities is in question.* Megacities (12 cities composing close to a quarter of the total US population) captured a disproportionate share of economic benefits in the two decades leading up to the COVID-19 crisis. Global connectivity and crowding in public spaces made them viral hot spots early in the pandemic. Many have adapted, closing off streets to allow outdoor dining and successfully pushing public norms around wearing face coverings and other physical-distancing behaviors. Nevertheless, the crisis has left US homes on the market for longer, with a greater increase—at 35 percent—in time on the market for urban areas, versus a 30 percent increase in suburban areas and a 25 percent increase in rural areas.

  Even before the crisis hit, questions were being raised about the future of megacities. Some have pointed out that rapid and concentrated development in them has negative effects, including growing urban–rural inequality and a lack of affordability for workers who are not benefiting from the cities' economic growth. A talent-attraction scorecard for 2019 from labor-market-analytics company Emsi reported that eight of the ten most populous US counties were not home to superstar cities, suggesting that workers were moving to smaller high-growth hubs or other niche cities in which housing and costs of living are more affordable.[7] Still, megacities continue to serve as major centers for foreign immigration and gateways to the American dream. In the wake of the pandemic, will cities continue as productive engines of opportunity? And if so, which cities will be best positioned to capture those benefits?[8]

The COVID-19 crisis has exacerbated existing divides, cut into the productive potential of the most vulnerable segments of the working population, slowed the pace of productivity enhancements and

[5] Financial-resilience ranking prior to the COVID-19 crisis measured by number of days a state could run on rainy-day funds; Steve Bailey, Airlie Loiaconi, and Mary Murphy, "Rainy day funds in 2019: Are states ready for the next recession?," Pew Charitable Trusts, October 1, 2019, pewtrusts.org; Unemployment rates are the May 2020 unemployment rates, as reported by the US Bureau of Labor Statistics.
[6] Broadband, US Department of Agriculture, usda.gov.
[7] Richard Florida, "Talent may be shifting away from superstar cities," Bloomberg CityLab, November 18, 2019, bloomberg.com.
[8] Christopher Mims, "Where you should move to make the most money: America's superstar cities," *Wall Street Journal*, December 15, 2018, wsj.com.

limited the diffusion of their benefits, highlighted constraints in provision of essential digital infrastructure, and exposed opportunities of the future as open questions. The stakes are high for state and local economic leaders to get it right as they reimagine the economy. That imperative is underlined by the wide disparity in recovery rates that states attained following the Great Recession, which left top-quintile-performing states with roughly 30 percent more GDP than bottom-quintile performers after a decade of recovery (exhibit).

Laying foundations for a reimagined economy

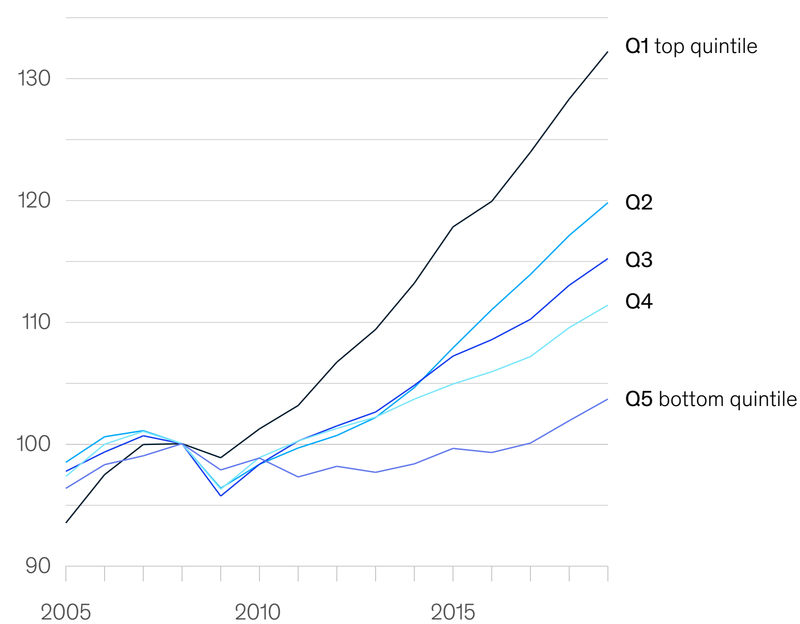
Fundamental to building a robust, reimagined postpandemic economy is keeping in mind the simultaneous and often self-reinforcing objectives of productivity improvement and inclusion. Nebraska, North Dakota, and Utah, for example, all had top-quintile GDP growth in the decade after the Great Recession, and all had top-quintile income equality as of 2018.[9]

To deliver on the dual mandate of productivity growth and broad-based income growth, public leaders at the state, regional, and city levels may find it helpful to prioritize seven areas of focus as part of their recovery and reimagination plans. Together, those levers aim to increase aggregate supply through greater productivity and innovation while unlocking latent demand to deliver growth.

Exhibit

Economic recovery among US states after the Great Recession has been uneven.

Real GDP recovery after the Great Recession by state quintiles,[1] % change



[1]Quintiles defined by 2008–19 real GDP compounded annual growth rate.
Source: Moody's Analytics

[9] "Gini coefficient as a measure for household income distribution inequality for U.S. states in 2018," Statista, September 2019, statista.com.

There are three levers that address supply:

— *Embrace and accelerate productivity enhancements.* Many trends and disruptions may accelerate in the wake of the COVID-19 crisis. Of them, automation and a shift of activities to online channels could be among the most relevant accelerating developments across many sectors. Some traditional sectors and occupations may be in decline, as a result, while newer ones may be generated. The economies that embrace and plan for those accelerating trends rather than resisting their impacts will most likely be the ones that outperform in the reimagined future.

  Public-sector leaders can incentivize the technology and skill investments needed for companies and workers to adapt to accelerated automation and digitalization. For example, the UK government, in collaboration with the manufacturing industry, launched a £20 million Made Smarter North West pilot to help SMEs navigate and adopt digital tools, including robotics and automation.

— *Find new openings to build resilience through 'health proofing' and diversifying economies.* Many sectors will be facing fundamental changes in how business is conducted in the postpandemic world, with a renewed emphasis on health. Hotels and airports are investing in contactless technology. New physical-distancing requirements will require numerous businesses to rethink. As such changes shake up businesses, policy makers and economic planners could take the opportunity to consider how to build back better, with healthy products and services.

  In addition, the current economic disruptions may also prompt policy makers to consider how to make their local economies more resilient through diversification of their economic activities. For example, New York City's diversification away from finance toward tourism, business service, and the arts allows the city to withstand market volatility better. With its diversified base in education, research, and technology, Austin was able to add jobs during the Great Recession.[10] Texas diversified by investing nearly $3 billion in cancer research and treatment in the first decade after the Great Recession, a move that helped boost its residents' health outcomes and the state's life-science ecosystem.

— *Invest in innovation ecosystems.* Building and strengthening innovation ecosystems—from state, business, and academia-led R&D to commercialization, start-up, entrepreneurship, and VC—will be critical in building a strong postpandemic economy and gaining global share of the innovation economy. Coordinated investments in R&D, talent, capital, place, and inclusion are all needed to strengthen regional innovation ecosystems. For example, the New York City metropolitan area anchored its innovation ecosystem in financial services and research universities, and that approach helped the area foster a robust tech sector and helped increase total VC investments more than five-fold from 2008 to 2017.

There are four levers that both expand productive capacity and broaden demand and inclusion:

— *Invest in inclusive growth and unlocking the maximum productive potential of all people in communities.* The widening disparities in access to opportunity are growing starker, as are the disparities in outcome across race, ethnicity, gender, and income. Research has shown that equity-enhancing measures can boost

[10] Kris Hartley, "Flexible economic opportunism: Beyond diversification in urban revival," New Geography, May 31, 2015, newgeography.com.

Leaders could be well served by planning projects that make their cities and regions more connected, equitable, sustainable, safe, and attractive.

economic growth in the long run. For example, achieving gender equality could add $4 trillion to the US economy, and closing the Black–white wealth gap could add a further $1.5 trillion.[11]

Solutions need to be targeted and long term, and they will require targeted investments to ensure equity in income and wealth across demographic groups. Such investment areas could include expanded childcare, accessible public transportation and other essential public services, available early-childhood education, improved K–12 outcomes, better public health, affordable housing, and affordable banking for underserved populations, among other strategies.

— *Lead a skill and talent revolution.* The long-term trends toward more automation and more digitization are now compounded by a shift to remote work and changing health and safety standards. It is likely that workers will need both digital and knowledge-based skills to ensure that they have a place in the postpandemic economy.

Initiatives that could help achieve that goal include strengthening education on problem solving, science, technology, engineering, and mathematics at all levels; incentivizing workers and companies to reskill themselves through tax credits and training subsidies; and scaling up apprenticeship and internship programs dramatically through education-industry partnerships—the types of programs that states such as Colorado and countries such as Germany and Switzerland have pursued. Public leaders at all levels could have an important role to play in helping workers reskill to attain new and better jobs.

— *Invest in digital-infrastructure access to close the divide.* Digital infrastructure, among other public infrastructure and services, has been exposed by the COVID-19 pandemic as part of the realization that public good is not shared equally across US regions. Investments in public digital-infrastructure projects—particularly those that support access to data and enable cloud and 5G technology—can create jobs, support workforce development, and attract business investment. For example, Government Technology Agency, Singapore's public-sector information- and technology-services arm, is increasing its spending by 30 percent in the wake of the COVID-19 crisis, and that move is expected to help kick-start more digital-infrastructure spending within the government and throughout Singapore.

— *Invest in making cities citizen-centric.* Megacities face a battlefield of competing for workers who are increasingly mobile. Recent and future projections of employment growth highlight growing preferences for alternative high-growth hubs, such as Austin, Denver, and Raleigh, over their larger, more expensive peers. Cities may want to consider their value propositions, such as their ability to offer efficient and high-quality public services, updated public infrastructure, and more affordable housing. By making the right investments, state and local leaders could be well served by planning not just for shovel-ready projects but also for those that make their cities and regions more connected, equitable, sustainable, safe, and attractive.

[11] "The power of parity: Advancing women's equality in the United States," McKinsey Global Institute, April 2016, McKinsey.com; Nick Noel, Duwain Pinder, Shelley Stewart, and Jason Wright, *The economic impact of closing the racial wealth gap*, August 2019, McKinsey.com.

Implementing new ways of organization to enable changes

The scope of the challenge in reimagining the US economic future is daunting, but the stakes have never been higher. To unlock latent demand and execute the vision, governments could consider adopting new ways of working and organizing, such as the following:

— *Organize for success within government.* Within government, neither the economic-development organization nor the treasury department alone can deliver growth. Leaders will need to convene a broad-based group within government that cuts across economic development, treasury and budget, transportation, energy, higher education, K–12 education, labor, and other departments. Close involvement of the governor's or mayor's office and sponsorship by the governor and mayor are likely to be of critical importance as well.

— *Ensure broad civic engagement.* Beyond government, a broad-based, multisector task force, including private and not-for-profit leaders, can be built to maximize the number of ideas from all sectors of the economy, secure buy-in, and ensure that all expertise and implementation resources are brought to bear.

Policy makers could consider positioning Black, Latinx, and Native American communities at the center of designing and delivering inclusive plans. That could help those communities identify with, advocate for, and lead the work to bring in more sustained long-term investment. As an example of broad civic engagement, the Netherlands launched the Voor je Buurt (For Your Neighborhood) platform in 2013 to crowdsource and crowdfund civic projects; it has been implemented in more than 40 cities and provinces.

— *Introduce better success metrics.* The implementation challenge will likely be particularly high when a task is as bold as economic reimagination. It is therefore critical to maintain discipline, energy, focus, and momentum throughout a multiyear period. Each initiative will need metrics, targets, milestones, and owners. Outcome metrics and targets should be identified in some long-term, measurable performance areas, such as GDP, productivity, median income, improvements in income for underrepresented groups, income distribution more broadly, VC investment, and number of businesses started. Metrics and targets should also be identified for some short-term areas, such as consumer spending and job placement.

The current crisis provides an opportunity to reevaluate traditional metrics of success, such as by giving greater consideration to the quality of new jobs, in addition to their number. Some novel approaches pointing the way include new

The crisis provides an opportunity to reevaluate metrics of success, such as by giving greater consideration to the quality as well as quantity of new jobs.

models being embraced in the Netherlands, New Zealand, South Africa, and the United Kingdom. For example, New Zealand released the world’s first-ever well-being budget in 2019.

— *Implement funding.* The unprecedented demand for government expenditures has put immense fiscal pressure on state and local governments. Governments will need to pursue the full set of resources available to them to fund the reimagination of the economy: leverage federal funding, reform state and local tax policies, issue debt, monetize government-owned assets, and establish public–private partnerships to crowd in private capital.

  As government funding is squeezed by lower sales and income-tax receipts and if stock indexes continue to soar, then public–private partnerships and other mobilization of private capital might offer the largest pools of funding and financing for economic reimagination. The challenge will be to unlock that private investment. Inviting private-sector players to the table early in the planning can certainly help.

— *Diagnose context-specific challenges.* Public leaders should consider making a retrospective assessment of the performance, assets, and vulnerabilities of their regions’ economies before the COVID-19 pandemic and recession. Those can provide baselines for evaluating the potential impacts of the crisis. It is critical for forecasts to include a number of scenarios at the macrolevel and at the microlevel, including postpandemic macrotrends, to understand exactly where challenges and opportunities are likely to spring up and where there will be urgent calls for reimagination.

— *Design challenge-specific solutions.* Policy makers may find it helpful to make an inventory of the solutions proven effective in dealing with expected barriers to determine which ones to pilot or scale up. Such an inventory could include excellent programs that are already designed but are operating subscale, best practices that other regions have pursued during the current crisis and past crises, and new initiatives that respond to new trends and challenges. Ultimately, a set of initiatives should emerge that balances cost, ease, impact, time horizon, and responsible actors. It is often better to have fewer higher-impact initiatives than too long a list of fragmented initiatives that is likely to fall victim to overly dissipated energies.

— *Execute with accountability, sustainability, and agility.* Implementation is where governments and multisector task forces most often fall short.

The individual resilience of businesses and workers during the unique and devastating COVID-19 crisis has been inspiring. To help efforts add up to more than the sum of their parts and to have flexibility and resilience in the long run, leaders in government and across sectors can take advantage of a major opportunity—one that is unprecedented in recent years and could serve them well in this crisis and in future crises. That opportunity is to reimagine not just their economies but also how they could work together to become far more than just the sum of their own parts.

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