

March 9, 2020

On Pandemics

Since January, the world has been dealing with the COVID-19 virus, a new coronavirus that has been spreading around the world. Because this situation is still evolving, it is too early to determine the overall impact of this specific virus. We update our views on COVID-19 regularly in our Daily Comment report.

In this report, we will examine the general geopolitical consequences of pandemics. We will start with a broad description of pandemics. From there, we will discuss the key problem facing policymakers, how to create the proper response to such events. An analysis of the impact on social and economic conditions will follow. As always, we will conclude with market ramifications.

What is a Pandemic?

To define a pandemic, it makes sense to define the stages before a disease reaches that category.

1. **Sporadic:** This is a disease that occurs infrequently and irregularly. An occasional case of polio or measles that doesn't spread would fall into this category. It usually doesn't require a policy response.
2. **Endemic:** This is a disease that is constant or has usual prevalence within a specific geographic area. Annual influenza would be an example.
3. **Epidemic:** This is a disease that shows a sudden and large increase in infections within a specific area.

4. **Pandemic:** This is an epidemic disease that spreads to a wider geographic area.

Occasionally, an endemic disease, such as the annual influenza, takes on characteristics of an epidemic. This usually occurs when the influenza strain is unusually virulent. If the virus spreads beyond its geographic region, it can become a pandemic.

The impact of pandemics can vary. In modern times, the economic and social impact usually lasts three to four months. Pandemics such as the 1957 Asian flu, 1968 Hong Kong flu and the 2009 swine flu are all examples of such events. The 1957 event was coincident with a recession, but there is little evidence to suggest that the downturn was caused by the outbreak of the flu. Instead, a decline in investment, likely caused by overly exuberant investment in 1955, was the proximate cause of that recession. There was no obvious economic impact from the 1968 Hong Kong flu. The 2009 swine flu occurred during the recession (December 2007-June 2009) associated with the Great Financial Crisis. Although the pandemic was simply another calamity in that historic recession, the pandemic was not the cause of that downturn.

This discussion doesn't mean to dismiss the impact of these pandemics.

Pandemics	# infected	Fatalities
Asian Flu, 1957-58	250mm/1.0 bn	1.0mm/1.5 mm
Hong Kong Flu, 1968-69	250mm/1.0 bn	0.8mm/1.0mm
Swine Flu, 2009	10mm/200mm	106k/396k
Endmic Flu	340mm/1.0bn	290k/650k

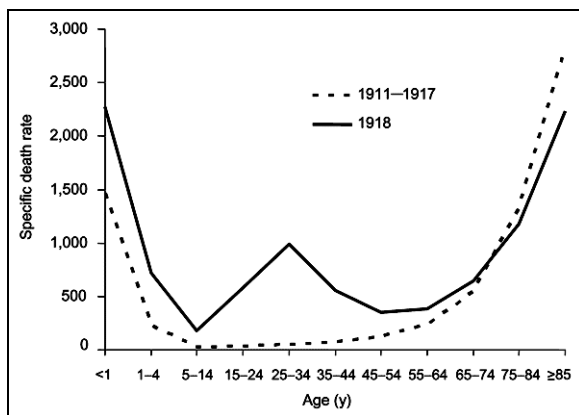
(Source: [Wikipedia](#))

In addition to statistics on the aforementioned pandemics, we also include

the impact of the seasonal flu. In any given year, nearly 300k to 650k persons will die globally from the illness. So far, the fatalities from COVID-19 are a fraction of what we usually see from the annual flu. Of course, we are still in the early stages of this event, so the potential for more fatalities remains.

At the same time, some pandemics are catastrophic. Two primary examples are the bubonic plague (14th century, although there were subsequent plague events as late as the late 17th century) and the Spanish influenza of 1918. Exact death tolls from the bubonic plague are non-existent, but estimates suggest that 50% to 60% of the European population perished in the mid-1300s.

The Spanish influenza is estimated to have infected 500 million with 10 million to 100 million fatalities. One of the factors that distinguished this variant of the flu was that it killed young adults; usually, influenza is most deadly to young children and the elderly. On the chart below, the broken line is the usual fatality rate for the seasonal flu. The solid line shows the 1918 pandemic. Note that it was unusually deadly for people in their 20s and 30s; it was also less deadly for the elderly (although it did clearly cause high death rates in that group). It was also unusually fatal to children.



(Source: CDC; right-hand scale is deaths per 100k)

The Problem for Policymakers

Government leaders of all types face the problem of crafting the best response to potential pandemics. The goal is to react with enough vigor to protect citizens but avoid an overreaction that triggers panic or severe economic and social disruption. Leaders strive to make the determination of the sort of pandemic they are facing. The policy responses to pandemics such as the Hong Kong flu, the swine flu or the Asian flu should be different than that of the Spanish flu or the Black Death. Unfortunately, policymakers have to make these decisions in advance of knowing with certainty the level of disease they are facing. Underreacting to a major threat would be seen as inexcusable; overreacting to a minor threat would be seen as excessive.

The textbook case of overreaction was President Ford’s response to the threat of a swine flu outbreak in 1976. In February 1976, a soldier named David Lewis died of a new form of influenza. David Matthews, the Secretary of Health, Education and Welfare, announced that this new flu was likely to become an epidemic by autumn and it would be a [variant similar to the Spanish flu of 1918](#). In the face of the threat, President Ford ordered a massive vaccination program. It turned out that the variant was nowhere near as deadly as the 1918 version, but problems with the vaccine caused around 450 people to develop [Guillain-Barre syndrome](#), a neurological disorder. The entire policy response was later dubbed “[a fiasco](#)” by the paper of record. Ford was clearly worried about not taking aggressive steps in the face of a new Spanish flu epidemic. His experience shows the risk of overreacting to a lesser disease.

What about underreacting to “the big one?” We only have one example of an infectious pandemic in recent history, the Spanish influenza. One of the reasons this event was

named the “Spanish” flu was that Spain was neutral in WWI and did not have press censorship. Thus, the [Spanish press reported on the emerging influenza and the common belief was that it originated in Spain](#). Although there is some dispute about the disease’s origin, there is [evidence to suggest it originated in Kansas](#). The flu hitched itself to mobilizing troops and was carried to the European theater. It was then returned to the U.S. after the war ended. Policymakers didn’t react to it because it was concealed from the public due to wartime censorship. By the time public health measures were deployed, such as quarantines, the pandemic was raging. However, because of the war, political figures were generally spared from criticism.

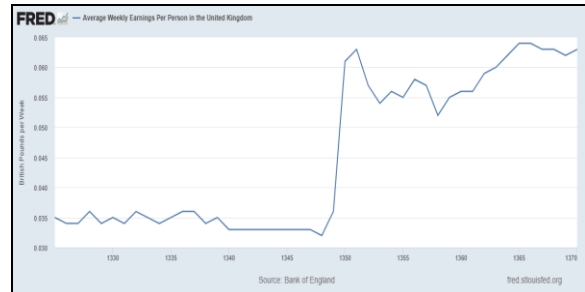
Social, Economic and Political Consequences of Pandemics

Pandemics are human tragedies. The fatalities that occur from widespread infectious diseases have ramifications that affect history. We are going to focus on four observations that have occurred from either pandemics or the reactions to them.

First, one of the questions that is circulating in the West is how does society reduce inequality? Walter Scheidel examined this issue in his 2017 book.¹ Scheidel’s exhaustive historical study of inequality suggests that only four events reversed it—mass mobilization war, revolution, societal collapse and plagues. Although pundits and politicians offer plans to address inequality, Scheidel’s analysis offers little hope that the “haves” will give up their gains in the absence of a crisis.

¹ Scheidel, Walter. (2017). *The Great Leveler: Violence and the History of Inequality from the Stone Age to the 21st Century*. Princeton, NJ: Princeton University Press.

One of the effects of the Black Death was that it killed so many people that wages jumped.



This chart shows average weekly earnings per person in the U.K. from 1325 to 1370. From 1347 to 1353, wages nearly doubled. The population fell from 4.4 million to 2.5 million over that time frame.

At some point, the “big one” will occur, a deadly pandemic similar to the Black Death or the Spanish influenza. One of the changes that could follow would be a reduction in inequality, sadly, due to a sharp drop in available workers which changes the relative power of capital compared to labor.

Second, pandemics, even mild ones, do affect the economy; the impact might not lead to recession, but it can lead to weaker growth for a three-to-four-month period. If such events occur in an election year, they could affect the political distribution of power.

Third, the saga of President Ford’s overreaction to the swine flu was noted above. It is notable that the political class often “over-learns” such events. So far, the reaction in the U.S. to COVID-19 has been rather modest. Perhaps the Trump administration fears overreacting could cause more problems than the virus itself, a reflection of the Ford administration’s experience. The best evidence we have to date is that COVID-19 will probably not be the “big one” and thus extreme measures are

not warranted. However, the risk is that the virus mutates and potentially leaves the U.S. underprepared for the event.

Fourth, there are some who argue that the [current anti-vaccine movement got its start due to the illnesses caused by the swine flu vaccine which proved more dangerous than the influenza](#). By undermining confidence in the government's response, vaccines themselves have become suspect.

COVID-19

China's reaction to COVID-19 was initially slow due to the pervasive censorship that exists in China. But, aggressive actions have followed the slow initial reaction. Beijing quarantined major cities and effectively shut down much of the Chinese economy. Unfortunately, their actions were unable to contain the virus to China; widespread global travel and the ability of the virus to infect new victims means that it has already easily spread around much of the world. The good news is that it doesn't seem unusually deadly (so far) and should dissipate in the coming months. At the same time, until a vaccine is developed (and people accept it), we may have a "flu and COVID-19" season in the coming years.

Ramifications

With regard to pandemics, there are two issues that affect markets. The first is how policymakers react. If policymakers fear the pandemic will be significantly fatal, draconian reactions, such as widespread quarantines and restrictions on travel, are justified. However, these actions will have an adverse impact on economic activity. If the virus turns out to be less lethal than feared, then the actions taken to prevent its spread may be more costly than the virus itself. In a sense, policymakers face a question—[contain or continue](#)? China has clearly leaned toward contain. What we have seen so far (although this position is

subject to change) suggests their policy response may have been an overreaction.

The second issue was raised by a [prominent market strategist](#), Scott Miner, who suggested that COVID-19 was "possibly the worst thing I've seen" and worried that the virus could end globalization as we know it. Regular readers will know that our house position, for some time, has been that globalization was in danger due to growing American disinterest in maintaining hegemony. In our opinion, based on hegemonic stability theory, globalization depends on the existence of a global hegemon that provides the public goods of worldwide security and a reserve currency. Given that the American public has become increasingly jaded about providing these public goods, globalization has been in danger for some time.

However, there is an interesting element to Miner's comment. As noted above, Walter Scheidel has stated that one of the factors that can reverse inequality is a pandemic. If a global disease disrupts economic linkages enough and undermines their reliability, it could lead to a reversal of globalization. However, we have doubts that COVID-19 will be that significant of an event. Even the Spanish influenza didn't end globalization; it was already collapsing due to the steady erosion that began with WWI. At most, the Spanish influenza was a contributing factor. Miner's thesis cannot be rejected out of hand but we doubt COVID-19 will be "[the big one](#)." At the same time, the case for reducing exposure to global supply chains has already been building—U.S./China trade relations are strained, security isn't guaranteed, and, now, a widespread virus exposes the risk of long supply chains. This virus probably won't lead to the end of globalization as we know it, but it is "another brick in the wall."

Finally, although epidemiologists are, in a sense, paid to worry about “the big one,” in reality, a [pandemic on a scale of the Spanish influenza is less likely in today’s world](#). It should be noted that viruses hadn’t been discovered yet so doctors in 1918 didn’t exactly know what they were dealing with. Antibiotics hadn’t been discovered yet, either. Although antibiotics don’t work on viruses, and thus are useless against the flu, they can thwart secondary infections that are often bacterial. It is unclear how many

flu victims in 1918 died of bacterial pneumonia, but descriptions of deaths suggest many probably succumbed due to secondary infections that would be addressed today.

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