

Pandemics, Capital Allocation and Structural Change

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Abstract

The economic effects of pandemics are often viewed through a Malthusian lens, which may not be applicable to modern economies. Unlike land, credit is the primary source of capital in modern economies, and it is mobile across regions. Therefore, pandemic-induced changes in capital allocation can have long-term negative effects. To empirically investigate this, we analyse the effects of the Spanish Flu on capital allocation within Spain from 1915 to 1929. As the deadliest pandemic after the Black Death, the Spanish Flu provides a unique case to study. Spain was neutral during World War I and had varying levels of industrialization, and it experienced a significant economic boom in the 1920s. We exploit the exogenous geographic variation in flu-induced mortality rates across Spanish regions and find that high-mortality regions experienced a decline in productive capital (credit). This flu-driven capital reallocation led to structural changes that boosted urban/rural GDP and reduced urban/rural inflation in low-mortality regions. Our results align with Krugman-type models that consider increasing returns and capital mobility.