



# A user guide to Covid-19

## *part iv – policy options*



European Research Council  
Established by the European Commission

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*Financial support from the European Research Council and the Wheeler Institute is gratefully acknowledged.*

## *Part IV – policy options*

### What we do

- Present different (non-mutually exclusive) health and macroeconomic policy options
- Discuss policy priorities, with emphasis on cash disbursements to firms and families
- Highlight the unprecedented scale of the policy challenge, both in terms of fiscal-monetary mix and global coordination

### What you learn

- Understand the policy objectives that central banks and governments are aiming at
- Evaluate which policies are best suited to achieve the stated policy goals
- Form an opinion on whether the nature/scale of the crisis warrant an unprecedented global coordination of fiscal and monetary policy

## Direct and Indirect Effects on the economy

- Round 1: supply side disruptions and large death toll generates heightened uncertainty and panic for households and businesses
- Round 2: heightened uncertainty and panic leads to drop in consumption and investment.
- Round 3: large drop in demand dries up corporate cashflows, triggering firms' bankruptcies
- Round 4: layoffs and exiting firms generate sharp rise in unemployment
- Round 5: Labour income fall significantly and non-performing loans spike up, which weakens demand and increases uncertainty further. Back to round 2 for another loop!

Indirect effects 2-to-5 potentially very large but not unprecedented by historical standards.

Major macroeconomic cost is associated with the suppression strategy to solve the health crisis.

## Flattening the recession curve

- Short-run trade-off between flattening the epidemic curve and the size of the recession. Slowing down the peak of infections is likely to prolong the time that the economy is not at full capacity
- Economy is complex, made of interconnected agents (suppliers, customers, consumers, workers, banks)
- Individually rational decisions can cause a catastrophic chain reaction:
  - i. Consumers not spending because self-isolated
  - ii. Firms cut costs and reduce workers, default on loans and suppliers
  - iii. Banks with non-performing loans will cut lending

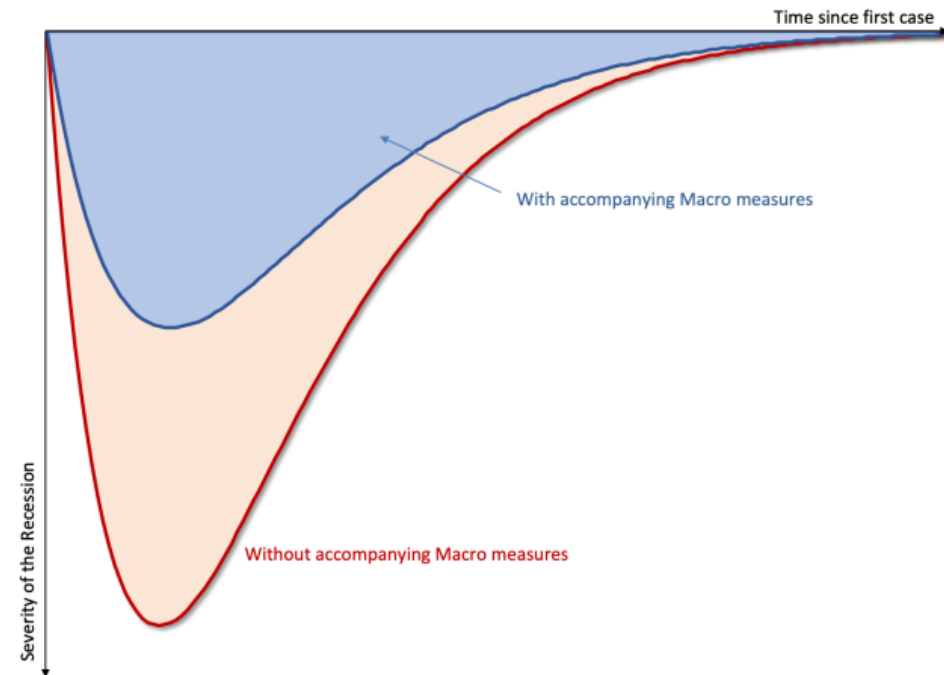


Figure 2: Flattening the Recession Curve

For health, isolation has positive externalities.  
For the economy, isolation has negative externalities.

Source: Gourinchas: "Flattening the Pandemic and Recession Curves", 13 March 2020

## Economic costs of a suppression strategy

Assume only a temporary drop in economic activities: 50% for a month and 25% in the two following months. Then, GDP drop of almost 10% of annual output! (Gourinchas, 2020).

Make the countries lock down longer and add the supply/demand downward spiral, then the actual costs (without policy interventions) could exceed 15% of GDP!

Output loss associated with the Great Recession was about 4.5% and still unrecovered.

Output loss associated with the Covid-19 crisis likely to be permanent. A global recession in the advanced world is inevitable and a recession in China seems now likely already in 2020Q2!

## Health policies and health expenditure

- At the FIRST sign of a highly contagious disease, isolate immediately the more vulnerables (e.g. the old) and test 'at random' representative samples of the population to identify the most contagious groups. More on next slide.
- Those who test positive need to self-isolate, independently of the symptoms.
- Trace the positive case and keep testing and isolating (more on next slide).
- Expand intensive care capacity (both beds and equipment) by building new units or convert available estates (e.g. hotel, barracks, etc). Recall retired medical personnel.
- If the contagion is geographically concentrated, spread non-pandemic-related intensive care cases to other regions.

## A simple policy proposal

### Random testing, statistical analysis and surveillance

1. Test a representative sample of the population (independently of symptoms), recording socio, economical, demographic and locational characteristics at the household level
2. Use standard statistical methods to infer the household characteristics most likely to predict whether someone is infected or not in the whole population
3. Develop surveillance strategies based on the information revealed in 2: nation-wide contact tracing, targeted social distancing

Collecting the right data and extensive statistical analysis can save MANY lives!!!

## What macroeconomic objectives?

1. Ensure households delay mortgage/rental payments and have cash-on-hands.
2. Ensure workers receive paychecks even in quarantine or if temporarily laid off.
3. Ensure firms have enough cash flows (to pay workers and suppliers), especially small and young businesses, and can avoid bankruptcy.
4. Support financial system to avoid the health crisis becomes a financial crisis.



## What macroeconomic policies?

- A. Government spending on public health sector.
- B. Tax relieves, tax cuts, tax holidays, tax incentives.
- C. Tax rebates and temporary universal income to households; cash grants to firms.
- D. Cut interest rates, launch QE programmes and lending schemes.

All would help but (C) most likely to stop immediate economic collapse.

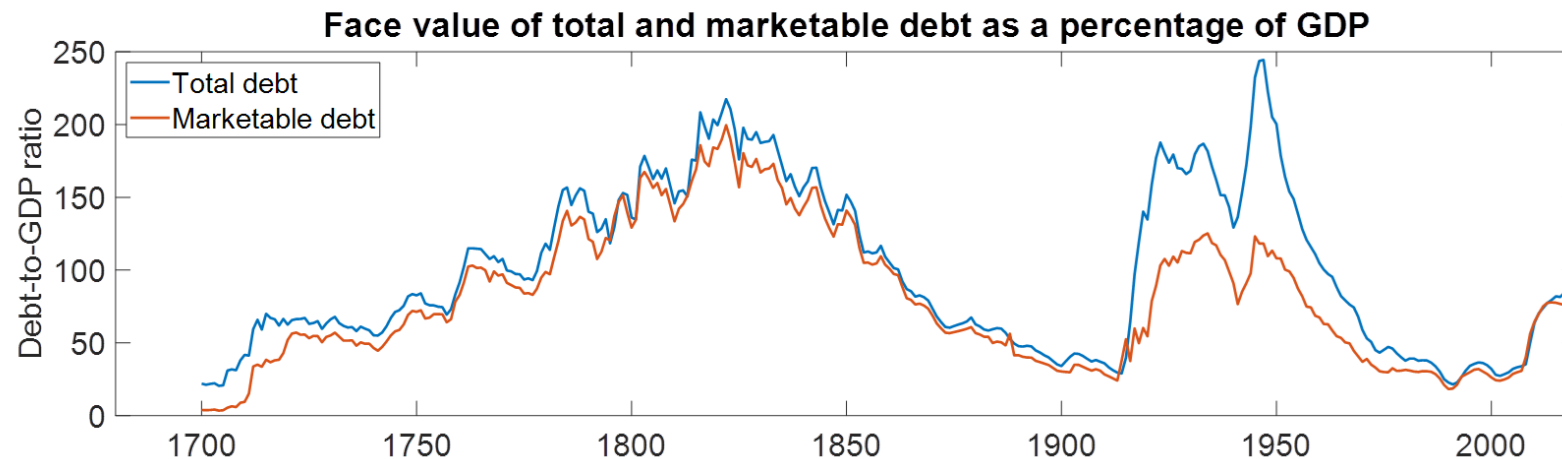
## Whatever mix is chosen, policies need to:

- i. be **now and** be **massive**, of the same order of magnitude of the output loss. UK announced a package worth about 15% of GDP. Unprecedented!
- ii. start from **health expenditure**: invest in testing and expansion of supply. Too late now for the first peak but still time to contain the second peak in the Fall of 2020.
- iii. be about **cash disbursements to households and businesses**. Tax incentives or cuts, emergency loans and borrowing on better terms, by their own, are unlikely to prevent a collapse in aggregate demand.
- iv. use a **coordination of fiscal and monetary interventions** to maximize and multiply impact and provide financial backing to each other policy.
- v. be **global**: interconnected society and economy requires global coordination.

## How to finance these macroeconomic policies?

Debt is attractive, especially given the ultra-low interest rates. But guaranteed by whom?

UK/US governments have sufficient credibility to afford it without too much sovereign risk but would still require coordination with the central bank (more on next slide)...



Source:  
Ellison-Scott  
(2020, AEJM)

But Italy can't! Lack both government credibility and independent national central bank.  
An Italian problem? Not really. Just timing is different: "Europeans are all Italians"

## A Governance Crisis in the EU. Again!

Common shocks require common policy.

von Der Leyen: “We will give Italy all it asks for”

Question is how? A few options:

A) Eurobonds via (an empowered) ESM

B) Coordinated sovereign debt issuance, ‘coronavirus bond’

C) Helicopter money

All require ECB backing by some form of government debt monetisation: the last taboo of economists! So far, ECB very disappointing: Lagarde’s “We are not here to close spreads”

## Summary

- With little or no government interventions, economic costs will be immense!
- Government priority should be on health expenditure but need a strategy to flatten the contagion curve that may spike back in the Fall of 2020.
- Simple proposal: 'random testing' to identify individual treats that predict being infected and then targeted testing and surveillance on the 'most likely' infected.
- Government spending should be **now** and as large as the predicted economic costs, focusing **directly** on cash disbursement to firms and households.
- Central banks should provide financial backing to the government, not just through their own reserves but also by printing money if necessary.
- Global shock needs global response. No country has fiscal capacity to stand alone.

*Full set of slides available at <https://sites.google.com/site/paolosurico/covid-19>*

**Thank you!**

