

Europe struggles to pass the virus test

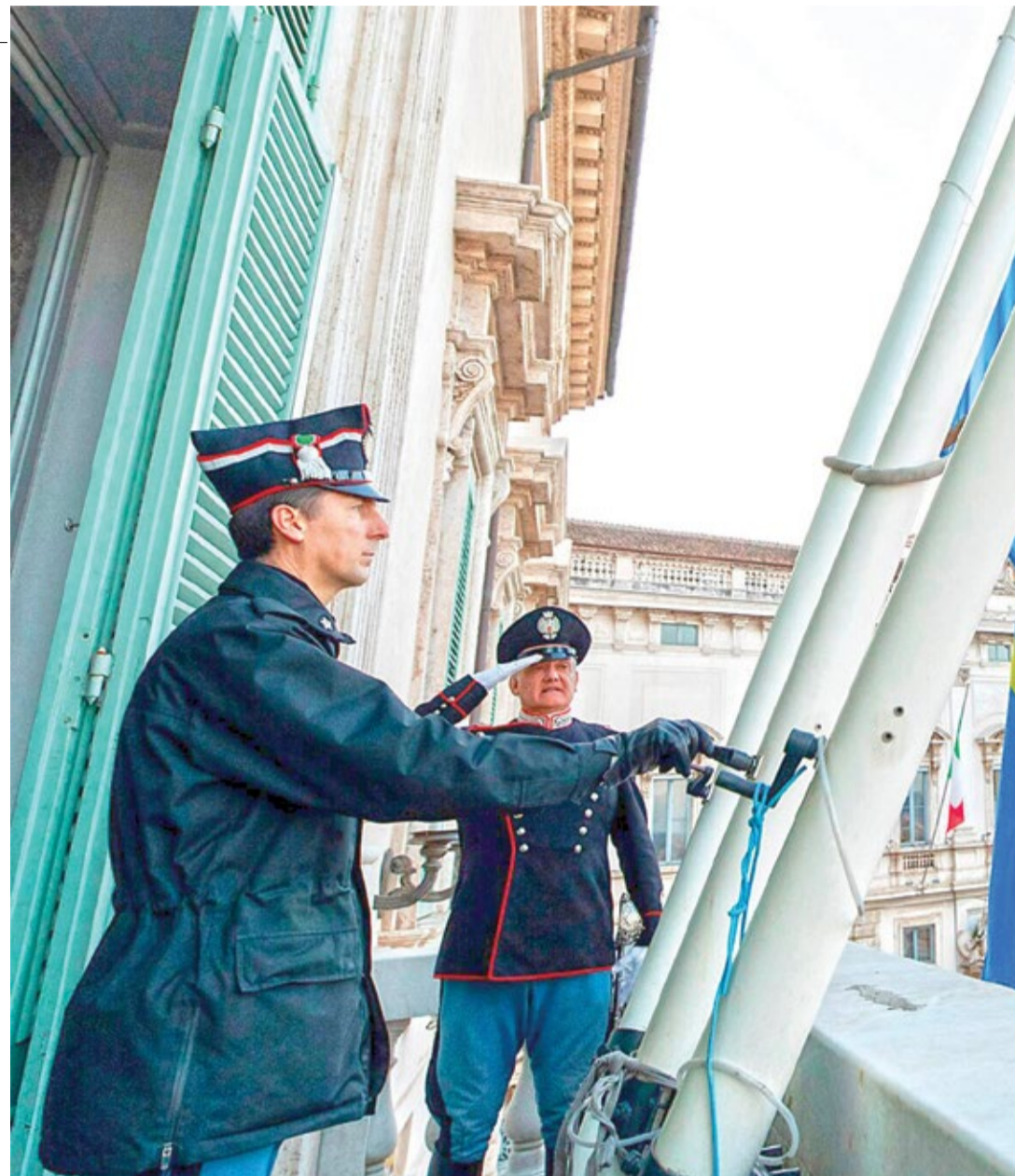
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The European Union has long been hailed as the guarantor of stability and peace in Europe; even its fiercest critics admit that the dissolution of the Warsaw Pact would not have been so smooth, had it not been for the EU's support and largesse.

Over the past decade the organization has had to contend with several adversities that shook it to its core. The eurozone crisis of 2012 left deep rifts between the economically weaker southern states and the more affluent north; the departure of the UK caused deep wounds and put into question the EU's very modus operandi, particularly its unyielding bureaucracy; Angela Merkel's decision in 2015 to admit about a million refugees flew in the face of previous agreements, and backfired not only in parts of Germany but in the Balkans too; and there are deep ideological divisions over tolerance and human rights between the more liberal original member states and later arrivals with a Warsaw Pact legacy such as Poland, Hungary, the Czech Republic and Slovakia.

COVID-19 has magnified these cracks in the EU's cohesion. The question now is whether it emerges from the pandemic stronger or weaker — or whether it will even implode.

The Schengen zone was built on the free movement of people across borders, but as the virus spread, the barriers went up. Many workers in border regions are employed in neighboring countries, some in medical and care professions, which heightens the care crisis. Confining hundreds of thousands of Eastern European agricultural laborers to their homes endangers the harvest of early vegetable crops, which may have ramifications for overall food security. Giant trucks carrying es-



Officers putting the flag of the European Union and the Italian flag at half-mast on the balcony above the main entrance to the

sential goods are still allowed to cross borders, but their drivers' access to food and hygiene is precarious; without them, supermarket shelves would remain empty and Europeans would go hungry.

EU member states also showed

a woeful lack of solidarity when it came to protective equipment such as masks, gloves and gowns; Germany and other countries have banned their export. Pictures of Chinese and Russian aircraft delivering desperately needed

medical equipment to Italy be ingrained in this generational collective memory. They will themselves, where was European solidarity when we need most?

So what should be done r

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The COVID-19 pandemic is a crisis like no other. It feels like a war, and in many ways it is. People are dying. Medical professionals are on the front lines. Those in essential services, food distribution, delivery, and public utilities work overtime to support the effort. And then there are the hidden soldiers: those who fight the epidemic confined in their homes, unable to fully contribute to production.

In a war, massive spending on armaments stimulates economic activity and special provisions ensure essential services. In this crisis, things are more complicated, but a common feature is an increased role for the public sector.

At the risk of oversimplifying, policy needs to distinguish two phases:

Phase 1: the war. The epidemic is in full swing. To save people's lives, mitigation measures are severely curtailing economic activity. This may be expected to last at least one or two quarters.

Phase 2: the post-war recov-

ery. The epidemic will be under control with vaccines/drugs, partial herd immunity, and continued but less disruptive containment measures. As restrictions are lifted, the economy returns—perhaps haltingly—to normal functioning.

The success of the pace of recovery will depend crucially on policies undertaken during the crisis. If policies ensure that workers do not lose their jobs, renters and homeowners are not evicted, companies avoid bankruptcy, and business and trade networks are preserved, the recovery will occur sooner and more smoothly.

This is a major challenge for advanced economies whose governments can easily finance an extraordinary increase in expenditures even as their revenues are dropping. The challenge is even greater for low-income and emerging economies that face capital flight; they will require grants and financing from the global community (a focus for a subsequent blog).

WARTIME POLICY MEASURES

Unlike other economic downturns, the fall of output in this crisis is not driven by demand: it is an unavoidable consequence of measures to limit the

spread of the disease. The role of economic policy is hence not to stimulate aggregate demand, at least not right away. Rather, policy has three objectives:

Guarantee the functioning of essential sectors. Resources for COVID-19 testing and treatment must be boosted. Regular health care, food production and distribution, essential infrastructure, and utilities must be maintained. It may even involve intrusive actions by the government to provide key supplies through recourse to wartime powers with prioritization of public contracts for critical inputs and final goods, conversion of industries, or selective nationalizations. France's early seizing of medical masks and the activation of the Defense Production Act in the United States to ensure the production of medical equipment illustrate this. Rationing, price controls, and rules against hoarding may also be warranted in situations of extreme shortages.

Provide enough resources for people hit by the crisis. Households who lose their income directly or indirectly because of containment measures will need government support. Support should help people stay at home while keeping their jobs (government-funded sick leave

reduces movement of people, hence the risk of contagion). Unemployment benefits should be expanded and extended. Cash transfers are needed to reach the self-employed and those without jobs.

Prevent excessive economic disruption. Policies need to safeguard the web of relations among workers and employers, producers and consumers, lenders and borrowers, so that business can resume in earnest when the medical emergency abates. Company closures would cause loss of organizational know-how and termination of productive long-term projects. Disruptions in the financial sector would also amplify economic distress. Governments need to provide exceptional support to private firms, including wage subsidies, with appropriate conditions. Large programs of loans and guarantees have already been put in place (with the risks ultimately borne by taxpayers), and the EU has facilitated direct capital injections into companies by relaxing its state-aid rules. If the crisis worsens, one could imagine the establishment or expansion of large state holding companies to take over distressed private firms, as in the United States and Europe

Economic Policies for the COVID

Policy options

Policies in support of households, businesses, and the financial sector involve a mix of liquidity and solvency measures.

	LIQUIDITY	SOLVENCY
HOUSEHOLDS	Suspension of mortgage payments, student loans	Cash transfers
	Tax and social security contribution deferrals	Unemployment insurance
		Meal vouchers for students who are away from school
BUSINESSES	Extension of loan maturities	Equity injections
	Tax and social security contribution deferrals	Subsidies for maintaining employment
	Purchase of commercial paper and bonds	Direct subsidies based on past sales (tax based)
	Direct credit provisions by central bank	
	Credit guarantees	
FINANCIAL SECTOR	Liquidity provision for financial intermediaries	Equity injections
	Actions to preserve market liquidity	Government guarantees

Note: Liquidity measures include loans or payment deferrals. Solvency measures include transfers, payment waivers, and non-refundable goods or services.

INTERNATIONAL MONETARY FUND