DISCUSSION PAPER

Saving the Economy from Covid-19:
A Preliminary Assessment of Government Rescue Plans

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Introduction

The Covid-19 pandemic has caused a major economic recession around the world. Governments are enforcing extensive social distancing measures and lockdowns to contain the outbreak, which have led to a sharp decline in aggregate demand, as well as disruptions in production and supply chains. Millions of people have lost their jobs and livelihoods, while many businesses in various sectors are facing bankruptcy. Needless to say, this environment exacerbates the human costs of the Covid-19 pandemic as more people find themselves in financial distress and face the psychological impact of long-term economic uncertainties as well as having to go to work and risk infection. Accordingly, alongside the pandemic, governments are being forced to fight a second battle. In the hope of mitigating the economic fallout of lockdowns, governments have introduced various economic countermeasures.

According to the IMF (2020), this may be 'the deepest' economic recession of modern economic history. But what is truly novel about the current crisis is not its depth but its nature. The standard economic advice against economic recessions involve various ways of activating the economy (incentivising businesses to make investments and households to consume) so economic growth and thus employment can recover. However, in the current environment, it is not certain how governments may be able to accomplish this, given that they are at the same time asking people to isolate at home (Meadway, 2020). In other words, the measures to fight the economic crisis contradicts and has to be aligned with the measures to fight the health crisis. This situation, while making governments' jobs more difficult, opens new horizons in economics discussions.

What shall governments do to shield the economy? The experience of the 2008 financial crisis informs the current policy discussions in many ways. Most economists agree that the rescue plan adopted after the 2008 crisis had many flaws, and ultimately failed to recover the growth rates (Basbay, 2019). This time, governments seem to be acting smarter and instead of throwing money at big businesses, they are trying to extend resources directly to workers and the self-employed so that aggregate demand can be sustained. Still, the unique nature of the Covid-19 crisis makes it difficult at this stage to judge whether this improved approach will help to mitigate the economic shock. Some economists claim it will not and we should try even more radical paths. Moreover, some think the current crisis may be an opportunity to transform economies towards a more environmentally sustainable and socially egalitarian structure, so they formulate rescue plans with that vision (Badré, 2020).

This paper critically discusses the rescue packages introduced by governments to counteract the economic consequences of the pandemic and explore the potential pathways governments can take in the near future in order to trigger sustainable and inclusive recovery. It concludes that in the likely event that the pandemic continues for a prolonged period, governments will have to come up with unconventional solutions beyond pumping liquidity or boosting demand in the short run. This may include a state-led reorganisation of the entire economy. While being a major challenge, on par with war-time economic efforts, this may also be an opportunity to transform economies towards a more favourable model.

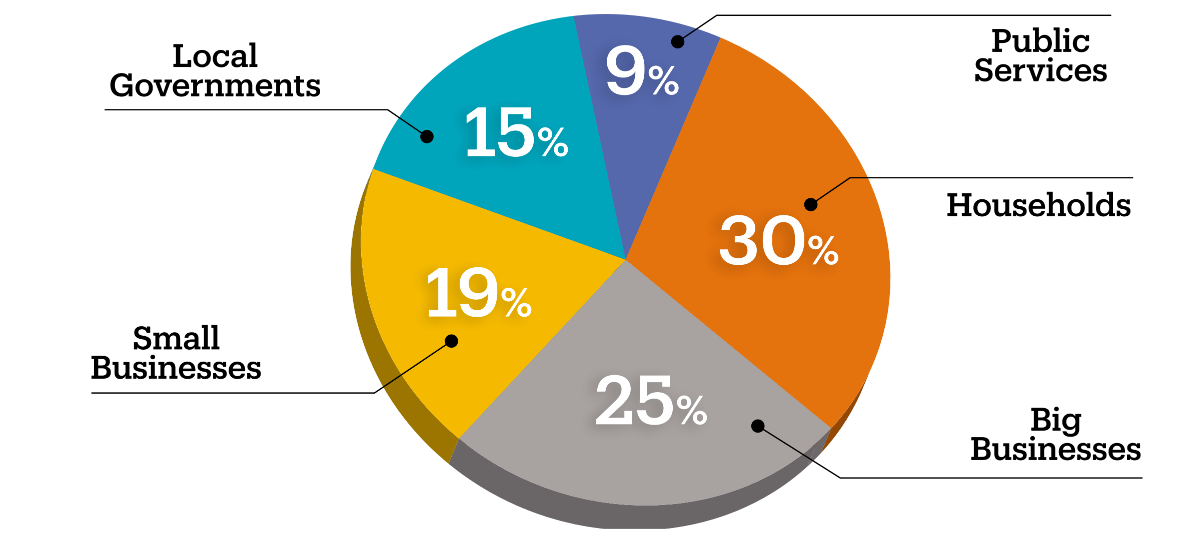
Past mistakes, new paths

Memories of the 2008 Financial Crisis are still fresh. In the aftermath of the crisis, the US government found itself in the bizarre situation of having to bail out almost all big businesses in the supposed heartland of liberalism. Three decades of preaching about government non-interventionism and free-market fundamentalism were quickly forgotten. In order to save the American economy, the government spent trillions of dollars of taxpayers' money to bail out companies, while the US Fed lowered interest rates to historic lows. This powerful liquidity attack did prevent a total collapse, but the government's action plan was nonetheless heavily criticised afterwards for it fell short of bringing about a strong recovery. Moreover, according to critics, it led to a major transfer of resources from the poor to the rich (Kuhn et al., 2018; Landy, 2018).

Indeed, after more than ten years of quantitative easing since the 2008 financial crisis, growth rates in developed countries were still sluggish when the Covid-19 crisis started. The mistake, according to many economists, was that while the government did commit enormous resources to activate the economy, it failed to channel them to the right place. Instead of boosting household demand and employment directly, liquidity was channelled to the big businesses which used these resources to secure their financial position, rather than to improve real investments and maintain employment. As Italian economist Mariana Mazzucato (2020) recently said: "*After the 2008 financial crisis, we learned the hard way what happens when governments flood the economy with unconditional liquidity, rather than laying the foundation for a sustainable and inclusive recovery. Now that an even more severe crisis is underway, we must not repeat the same mistake*".

Facing another major recession, lessons of the 2008 recovery programme overshadow the discussions surrounding the current rescue plans. Indeed, this issue was at the centre of US senate proceedings over the proposed rescue package. The Democrat Party insisted that the package should include specific limitations and conditions for cash transfers to corporations. They also managed to include in the bill a significant expansion of unemployment insurance. However, it seems that even without much pressure coming from the opposition, the Republicans were ready to adopt a different approach than the one the US administration did in 2008. Apart from its unprecedented size, the package is truly original in nature. Specifically, the senate had legislated a 2.1-trillion-dollar rescue plan which included, apart from conditional loans to big corporations, direct cash transfers to households, grants to small businesses, aid to local governments, and major spending on the healthcare system.

Figure 1: **US Rescue Package Composition**



Source: Denning, 2020

What the US rescue package aims to accomplish is that, instead of bailing out big corporations with the hope that this will save them from bankruptcy and thus their workers from being laid off, it extends funds to households and small businesses directly, which can, in turn, sustain aggregate demand and help businesses continue making a profit. In other words, the programme follows the reverse path; instead of supporting businesses in order to save workers, it supports workers to save businesses. In particular, the programme involves direct cash payments of $1,200 to all adult Americans, and 500$ for children, which is an idea that has long been discussed but never realised at this scale (Warner et al., 2020). Also, it provides extra funding for an enhanced unemployment assistance programme which is under enormous pressure after more than 30 million workers (a historical record), lost their jobs in less than 2 months (U.S. Employment and Training Administration, 2020).

European rescue plans are equally dramatic and revolutionary. The UK government, for instance, announced a £350 billion package, which commits to pay 80 per cent of all private-sector wages up to a maximum of £2,500 so employers do not lay off their workers. It also supports the self-employed (e.g. small shop owners, taxi drives) (Partington, 2020). Again, this approach is also truly novel and follows the same logic as the US plan. Similarly, the European Union also makes use of mechanisms which keep workers at their jobs even though their companies cut production. As long as firms remain at a standstill, governments pay most of the wage bill and company costs (Pisani-Ferry, 2020). Specifically, overall eurozone fiscal liquidity support for firms and workers amounts to 13 per cent of the Euro Area GDP. Germany alone has committed €822 billion to rescue businesses and help workers and the self-employed during the crisis.

Will the rescue plans work?

Given the novel nature of the ongoing crisis, it is still uncertain if the updated rescue plans will work. Arguably, there are different ways through which the rescue plans may fail. First of all, some of the plans fail to include the most vulnerable members of society. Before anything, rescue spending should target those who are in most need, such as the informally employed, immigrants, those in low-pay services, etc. These segments of society are losing their livelihoods in increasing numbers and are usually not protected by social safety nets. The informally employed, for instance, cannot receive unemployment assistance when they get fired. Unregistered migrants in the US do not qualify for federal cash assistance. If people at the lower end of the socioeconomic spectrum are not supported, the situation could easily culminate into a social crisis (Milanovic, 2020)

Secondly, all the measures taken so far are based on the assumption that the crisis will be short-lived and there will a strong rebound afterwards. Accordingly, governments and central banks are trying their best to keep businesses alive until the health crisis is over, and the lockdown measures are eased. For the time being, trillions of dollars spent in this effort are indeed worth it because if businesses fail, this will mean a tremendous loss of firm-specific capital, know-how, and expertise. Businesses cannot be built overnight and it takes time and a lot of 'learning-by-doing' to accumulate tacit knowledge needed for various businesses. Thus, the loss of companies is more than the loss of income to their stockholders. However, the big question is, what if the current situation continues for much longer, say over a year? In this case, governments will not be able to continue their efforts to freeze everything until the pandemic is over.

It is probable that governments will need to refocus their attention to transitioning to a new normal. This makes governments' job much more significant and difficult. They will have to figure out what the new normal will be and what is the least costly path towards it. According to Snower (2020), governments should divide all production and consumption activities between 'physically interactive' and 'physically disjointed'. Snower points out that there is a great mismatch between growing demand in the latter sectors and almost a complete collapse in the former. Namely, businesses such as Amazon or Netflix are thriving and looking for more people to employ, while others where people necessarily come in close contact, such as hotels, restaurant, airlines etc., are laying off their workers. Therefore, governments' role should be to smooth the transfer of workers and resources from the latter group of economic activities to the former.

Another line of criticism against the current rescue plans is that there is too much focus on liquidity. According to the former Greek finance minister Yanis Varoufakis (2020), the real problem is not that households and businesses do not have liquidity in the short run, but that they face insolvency. Then, regardless of whether the loan is extended to the firms or the households, money ends up being accumulated in the financial sector instead of circulating in the economy. Varoufakis defends government spending, not credit, because that is what will boost aggregate demand directly; otherwise, in essence, there is not much improvement from the post-2008 process. Governments "*must go all-in with stupendous fiscal expansion*" instead of extending loans to households or firms, he says. Although Varoufakis targets his criticism especially to the EU, his main point is relevant to other rescue plans and especially the US as well.

We are yet to see if the rescue packages will work but there is already talks of another wave of rescue packages. The UK has already extended wage guarantee for workers for another 4 months over the initially promised 3 months. So, 27% of all jobs in the UK, 7.5 million in total, are being paid by taxpayers over 7 months. The US Democratic Party has unveiled another relief plan that, if passed in the senate, will cost more than $3 trillion and become the biggest stimulus package in history (Foran et al., 2020). It seems that the ongoing situation will require governments to actively support the economy for some time to come, representing another source of fragility. Major economies around the world, including the US, the UK, and the Eurozone, had already had the longest quantitative easing in history after the 2008 crisis. How long governments can sustain pumping money into the economy is questionable. As famous economist Herb Stein once said, "*if something can't go on forever, it will stop*".

Does the situation present opportunities?

While governments are spending at an enormous rate, some economists are advancing the idea of spending on socially beneficial economic activities (Badré, 2020). Namely, governments can use this opportunity to channel resources towards truly transformative economic activities, which serve the dual purposes of boosting aggregate demand to help recover from the recession and moving towards a more egalitarian, sustainable, and inclusive economy (Birgel, 2020). For instance, governments can spend on climate change mitigation (e.g. renewable energy, forestation, green technologies), essential services such as education, healthcare provision or housing, and redistributive policies. Moreover, this may be the time to revise and restructure the domestic and global economic structure to make it more resilient to natural or human-made fluctuations.

Hepburn et al. (2020), for instance, surveyed high-status government and central bank officials from G20 countries, and concluded that spending on the following policies can contribute to climate change mitigation efforts positively while helping recover the economy: investment in clean physical infrastructure (wind and solar energy), building efficiency retrofits, investment in education and training, natural capital investment, and clean R&D. In developing countries, they report, rural support spending can be more significant while clean R&D may be less important. They claim that these measures create more jobs and work better as short-term stimuli for the economy than tradition fiscal spending programmes while helping long-run structural transformation towards climate-friendly economies.

Mazzucato (2020) claims that the ongoing crisis exposes the structural fragilities of the current economic paradigm. The world is facing not only a health crisis but also the prospects of a financial crisis and a climate change crisis, all of which are teaching us a lesson about governments' role in the economy. According to Mazzucato, the Covid-19 crisis once again proved that governments' active involvement in the economy is not a luxury, but rather a necessity for having a more inclusive, sustainable, and dynamic economy. For instance, as recently manifested in the vaccine-development discussions, we need governments to facilitate and contribute to innovation and R&D of new technologies in all socially beneficial fields, which include not only pharmaceuticals but also artificial intelligence, renewable energy, public health and many areas of infrastructure. Public-private relations in the entrepreneurial processes should be looked at from this perspective.

Lastly, it has been argued that this is also the time for developed countries to lend a helping hand to developing countries. This is crucial for containing the pandemic globally and limiting the economic damage. The overwhelming majority of the world's poor live in developing countries. Unless they are supported financially, developing countries do not have the fiscal capacity to support their populations under lockdown. Then, poor people in such countries will face the choice of starving at home or risking infection at work. Under these conditions, Covid-19 could potentially cost millions of lives across the crowded cities of the developing world where health provision is substandard, which will prolong both the pandemic and the global recession for years. Even if developed countries can contain the outbreak, most other parts of the world, where the majority of the population lives, will still be dealing with the pandemic and do not have the option of going back to an economic normal.

It has been suggested that international financial institutions, such as IMF and the World Bank, as well as developed country governments, can channel resources to developing countries via extending loans and grants or relieving sovereign debts. Badré (2020), for instance, says the IMF and multinational development banks should mobilise funds for developing countries to be used for building an environmentally sustainable infrastructure. He points at the fact that developing countries currently account for most of the world's carbon emissions (63% to be specific). So, according to him, this would achieve the triple objectives of helping developing countries to overcome the health crisis, recover economically, and reduce carbon emissions. Therefore, there is a strong case for including foreign aid and sovereign debt relief in rescue packages of developed economies as this will help not only recipient countries but the donor countries as well.

Conclusion

The Covid-19 pandemic has triggered a simultaneous supply and demand shock of unprecedented intensity. Governments are doing their best to mitigate the economic impact of lockdown measures. Such efforts involve huge rescue programmes to help households and businesses survive the economic storm until the pandemic is contained. In particular, governments are extending loans and grants to businesses, one-time cash payments to households, paying a big share of the private sector wage bill, and spend more on capacity building in healthcare provision. The question is how effective these measures will be in shielding economies from the adverse impacts of the pandemic and what paths further rescue programmes should take.

Economic administrations around the world learned a lesson from the 2008 financial crisis. When governments use rescue funds to bail out big businesses, it does not help to sustain employment and value-generating economic activities. The money mostly gets siphoned out of the real economy and works to financially secure the owners of those big businesses instead of saving the businesses themselves. In the end, workers lose their jobs anyway, inequality rises, and aggregate demand collapses. Because the problem of weak demand continues, full economic recovery cannot be accomplished either. This time, governments are channelling more resources towards vulnerable households directly.

However, this is still an elaborate process. Some economists claimed that even this smarter approach may fail if the lockdown measures or social distancing protocols stays in place for a prolonged period. Beyond trying to maintain the current economic structure, governments may also need to take the responsibility of actively facilitating the transition to a new normal. This new normal will probably see some physically interactive sectors shrink or even disappear while physically disjointed ones will flourish. Moreover, some claimed that regardless of where it goes, pumping liquidity into the market may not suffice to revive the economy; instead, governments should consider getting involved in fiscal spending directly rather than distributing money.

According to some economists, increased government involvement in the economy may also be an opportunity to transition economies towards a more environmentally sustainable, egalitarian and inclusive structure. The government can build capacity in green technologies, infrastructure, public services (healthcare especially) and channel more resources towards innovative and socially beneficially R&D activities. This would not only help recover the economy from the recession but also contribute to a structural transformation towards a better economic model with long-lasting positive effects on societal well-being.

Furthermore, the ongoing crisis offers us a moment of reflection about the interconnectedness of the global economy. Developing countries with limited fiscal space cannot impose lengthy lockdowns, and with underdeveloped healthcare provision, they are unlikely to able to contain the virus as quickly as developed countries. Countries that have been successful in containing the disease will have the risk of other waves coming from poor developing countries. In other words, unless pandemic is contained everywhere, it is not contained anywhere. The same is also true for economic recovery. Accordingly, some have suggested that this is a perfect time for developed countries to help developing countries financially.

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