

**Webinar:**  
**What it will take to save the  
economy from COVID-19**

**WITH OLIVIER BLANCHARD**  
SENIOR FELLOW, PETERSON INSTITUTE

Monday, April 6, 12:00 PM ET  
Pre-registration Required



**Introduction: MARKUS BRUNNERMEIER**

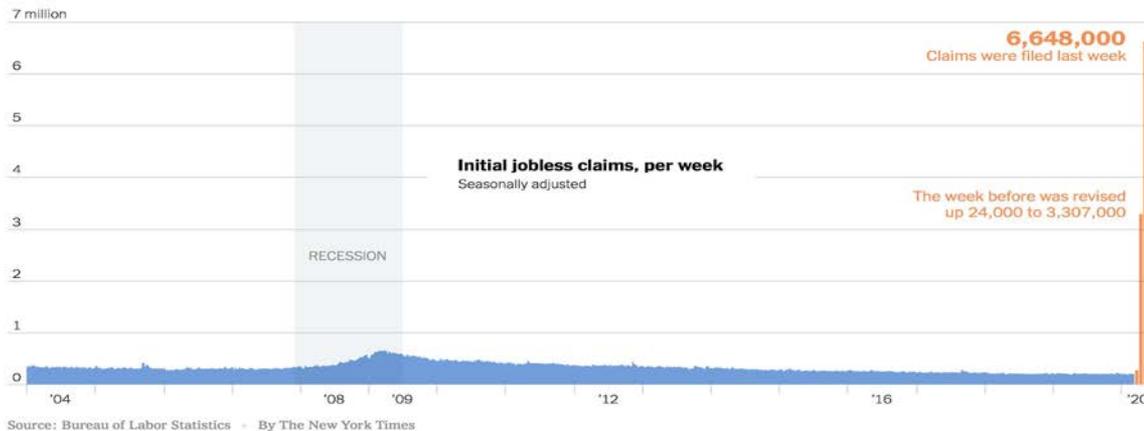
*Twitter: @MarkusEconomist*

*Website: [bcf.Princeton.edu](http://bcf.Princeton.edu)*

# Mo/Fri Lunch Webinars

- From Paul Romer's webinar

Another 6.6 million joined the U.S. unemployment rolls last week.



Testing model

Bring  $R(0) < 1$

- Speakers coming up + more

Tyler Cowen, Agnus Deaton, Penny Goldberg, Hyun Shin, Joe Stiglitz,



# Fiscal policy

- Health crisis
- Monetary policy at negative rates already
  - Exchange rate depreciation not very helpful
    - In case of lock down (no global demand)
    - All countries are weakened
- Fiscal policy
  - Tax revenue collapse
  - Gov. expenditures skyrocket

*One key question:*

What will happen with interest rate?

# Fiscal policy & Interest Rate

- Interest rate during shift from risk-on to risk-off regime
  - $i \searrow$  for Safe asset issues (US, Germany, ...)
  - $i \uparrow$  for Non-safe asset issues (EME)



# Fiscal policy & Interest Rate

- Interest rate during shift from risk-on to risk-off regime
  - $i \searrow$  for Safe asset issues (US, Germany, ...)  
*THE BIG DIVIDE is getting wider*
  - $i \uparrow$  for Non-safe asset issues (EME)

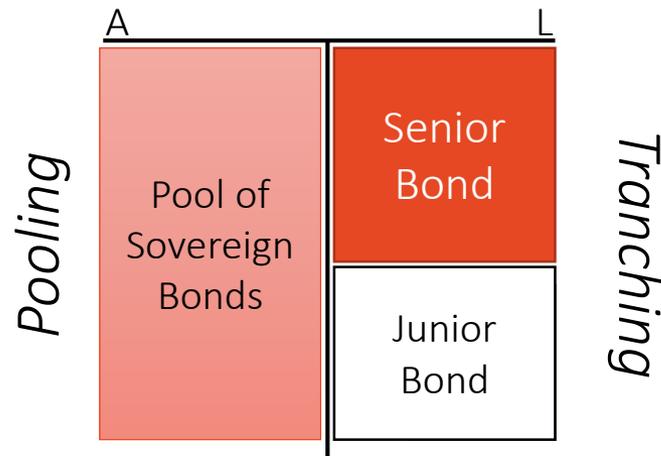


# Fiscal policy & Interest Rate

- Interest rate during shift from risk-on to risk-off regime
    - $i \searrow$  for Safe asset issues (US, Germany, ...)
    - THE BIG DIVIDE is getting wider*
    - $i \uparrow$  for Non-safe asset issues (EME)
- 
- Flight-to-safety*
- Characteristics of a safe asset ( $\neq$  risk-free asset)
    - Good friend analogy: “valuable and liquid when you need it”
    - Safe asset tautology: “safe because it is perceived to be safe”
      - Multiple equilibrium/bubble feature
        - Brunnermeier & Sannikov

# Safe asset for EME

- New Element for Global Financial Architecture
- GloSBies (based on ESBies/SBBS idea)



# Designing Fiscal Policy in response to the Covid-19 Crisis

**Olivier Blanchard, April 6, 2020**

Economic policy : Second fiddle to pandemic dynamics  
Virologists > Economists

Main economic tool: Fiscal policy.

More generally: Role of the state versus markets in response to very large shocks.

Focus of the talk: Mostly normative

Comparative disadvantage in keeping track of actual policies

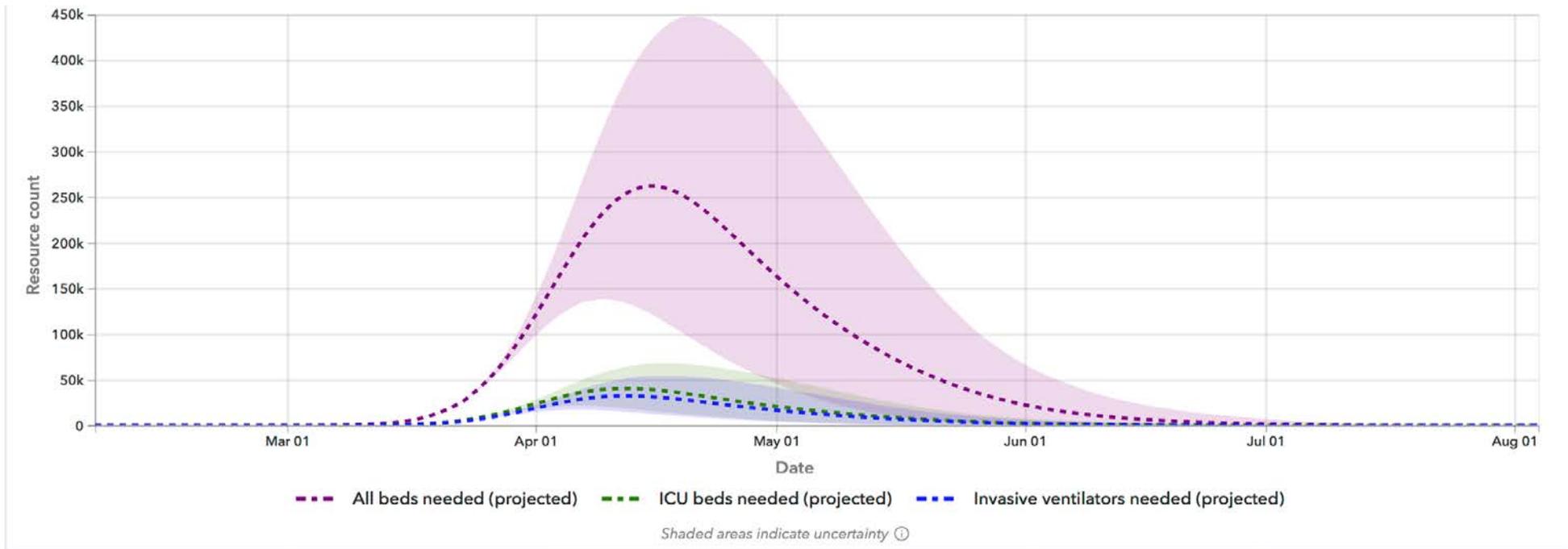
Caveat: One-man team (with a lot of friends/colleagues)

Gone are the good old Chief Economist days...

# Epidemic. Phase 1. Decreasing the infection rate (AEs)

Largely baked in. Relatively little uncertainty about timing, more about height.

Estimates with 95% CF for US (as of Friday) (not the only model)  
Heterogeneity across countries, states. Initial date, lockdown intensity  
Peak hospitalization needs: April/May. Down by June/July



## Epidemic. Phase 2. Keeping the infection rate low (AEs)

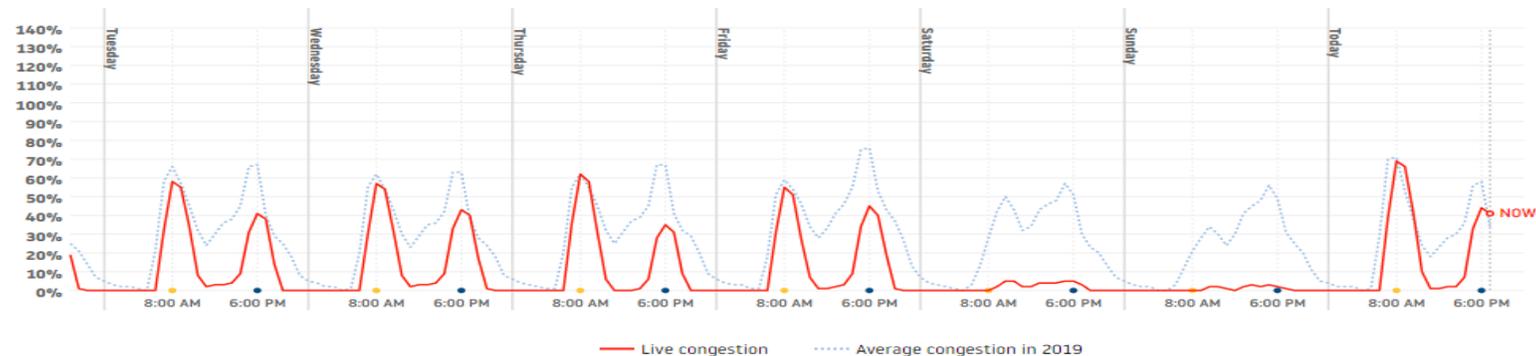
Much more uncertainty about length and required degree of lockdown.

Good and bad news. Beijing traffic:

### CONGESTION LEVEL

LAST 48 HOURS

LAST 7 DAYS



Depends very much on availability of tests,

Likely to be progressive. Rankings:

People: Immunized, negative, others by age.

Type of work: in person, telecommuting

Sectors: From more to less essential (schools/manufacturing/planes...)

(Work for economists: Converse analog to bombing choices in WWII...)

## Epidemic. Developing and emerging market countries

Poorer health system.

Harder to impose lockdown

Example of Nigeria

So far, few reported cases. 0 on March 16, 200 on April 3

But 0.5% bed per 1000 people (US: 2.3%)

169 ventilators (for subset of states accounting for 80 million people)

600 tests performed as of March 30

Higher likelihood of herd immunity dynamics

Much larger number of deaths.

Perhaps small short run economic cost.

(Pandemic of 1918, Eichengreen, Correia et al )

Map of Africa/coronavirus. [https://csis-prod.s3.amazonaws.com/s3fs-public/200404\\_COVID\\_42.pdf](https://csis-prod.s3.amazonaws.com/s3fs-public/200404_COVID_42.pdf)

## The three roles of fiscal policy (AEs)

1. Infection fighting
2. Disaster relief. People, firms---eventually financial institutions?
3. Aggregate demand management.

In normal recessions, just the third. Here the first two dominate.

Each of the three with its own challenges, and its own time dimension

# 1. Infection fighting

Phase 1. Physical constraints and non fiscal measures dominate: Lockdown.

Phase 2. Give incentives to produce tests, explore drugs, find vaccines.

How to give the right incentives to the private sector? (Kremer 1995)

Trade-off tests/lockdown

The P Romer computation. Argues that:

Daily tests of 7% of population (22 m if US) =>  $R < 1$   
with no confinement measures

Potential cost: 200 billion (likely seat of the pants)

Production cost : Currently cost of virus test: 50. (antibody test: 10)

Assume cost down to 25. Daily cost: 0.6b

If increase in output of 20%: 10b a day

Useful as discussion starter. Reality check : Abbott's production 100,000 a day. Roche: 60,000. Total tests in the US todate: 1.2m.

In any case, realistic cost very large, but small by macro standards <1% of GDP

## 2. Disaster relief

Provide funds to liquidity constrained households/liquidity constrained firms.

Challenge: Trade-off speed/targeting. (more so than in normal recession)

Initially, poor. Better over time. Makes sense to have bridge programs.

Different approaches: US : Unemployment offices, plus checks, tax breaks

France: Through firms/banks/fiscal backstop, tax breaks

Less different than it looks. SBA loan/grant conditionality

Need to err on the generous side (cash payments in the US, replacement rate in France)

Grants or loans? To be assessed ex post? Risky ex ante.

Can do better over time. Do it for two months and improve

Upper bound on the cost? Decrease in output: 35% of baseline under lockdown.

Assume 2 months at lockdown. 6 months at half lockdown

Liquidity constrained: 40%. Replacement rate: 80%. All grants: 5% of GDP.

### 3. Control of aggregate demand

Distinguish between phase 1 and phase 2.

Phase 1. Lockdown implies potential output down by 35%. Cannot produce more.

Could disaster relief lead to too much demand? It could (Werning et al)

Not a major issue however

Spending on food, repaying mortgage. No supply constraints.

And if rationing, some inflation, not a major issue

Phase 2. As lockdown is relaxed, will private demand go up or down?

Pent up demand, may dominate at the beginning

But also, precautionary saving and uncertainty and low investment?

Bottom line: Contingent commitment (No major investment plan for example)

# Debt sustainability

Is debt sustainable?

If the crisis leads to an increase of say, 30%-40 of GDP?

Answer for AEs: Yes (Hedging a bit: Unless the virus wins)

Back to the pre-crisis discussion of  $R < G$ . (Now two competing Rs.  $R_0$  and  $R^*$ )

$R^*$  was low before the virus crisis

Likely to be even lower after:

Precautionary saving.

Uncertainty and investment

What about the effect of higher public debt on  $R$ ?

2-4bp per 1%: so 60bp-160bp.

Still lower than or close to  $G$

Lower  $G$ ? 2020 for sure. Thereafter?

## The important fiscal role of central banks

Discussion about monetization of deficits: Largely confused.

Monetization at zero interest rate has no effect (to a first order)

Two nearly identical assets, paying zero

What matters is what central bank will do if and when  $R^* > 0$

Increase  $R$  and pay interest on money:

Then money = debt

Keep  $R=0$ , and allow for overheating and inflation

But important role of central bank in avoiding multiple equilibria

“Good equilibrium:” debt sustainable at the safe rate

“Bad equilibrium:” worries, higher rate, debt unsustainable

Maintaining the good equilibrium: yield curve control

Prologue: Italian yields and the ECB.

Risks in the future: If and when “good equilibrium” looks less good.

## Back to EMDEs

### Similarities

- Fighting the same virus
- Same three goals for fiscal policy

### Differences

- Not equipped to fight the virus.
  - Risk of catastrophic immunity herd dynamics
- Large capital outflows due to repatriation of liquidity
- FX denominated debt, and steeper demand curve for gvt bonds
- Drop in commodity prices, tourism

### So much more limited fiscal space

- Existing debt may have become unsustainable
- Additional borrowing may not be available.

Put another way: Liquidity issue and solvency issue.

# The role of central banks and international institutions

Dealing with the short run: (Debt service: 2018. 3.6 tr. Outflows in March: 100b)

Provide liquidity. Extension of swap lines, size and reach.

Allowing private creditors an out? (Argentina redux)

Capital controls on outflows?

Finance infection fighting through grants, not regular loans.

World Bank IDA. IMF concessionary loans (RCF).

SDR allocations, with gifts from AEs.

Dealing with medium run:

Uncertainty and debt sustainability. Too early to tell for sure.

A clear case for a debt standstill

Usual problems of coordination between creditors

CACs not sufficiently prevalent.

How much conditionality to impose in programs?

## Role of coordination?

Coordination in mobilizing and getting funds to EMDEs

Coordination in sharing information about pandemics and fiscal measures

Coordination in determining size of fiscal programs ?

Not obviously. Different from 2009.

Infection fighting; disaster relief. Spillovers not relevant.

An issue which will become a source of major tensions:

Fighting for tests, vaccines. (Today, fighting for masks. US/France/China)

If let markets decide, rich countries will get the tests/vaccines first

Ideally, agreement both to subsidize and to allocate across countries?

Highly desirable/highly unlikely...

## Sources

US epidemic dynamics.

[https://covid19.healthdata.org/projections?fbclid=IwAR3mQK1I2WFGfAlr\\_noujPQXtx1gFr5p5xp93U6VfM1SABhg7Mts69T6NWM](https://covid19.healthdata.org/projections?fbclid=IwAR3mQK1I2WFGfAlr_noujPQXtx1gFr5p5xp93U6VfM1SABhg7Mts69T6NWM)

Traffic statistics. [https://www.tomtom.com/en\\_gb/traffic-index/beijing-traffic/#statistics](https://www.tomtom.com/en_gb/traffic-index/beijing-traffic/#statistics)

Source for coronavirus statistics in Africa: <https://www.csis.org/programs/africa-program/covid-19-coverage>