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# A recession is a public health necessity – let's keep it short

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The threat posed by the pandemic cannot be addressed simply by relying on Keynesian demand stimuli. This column explores the notion of using public spending to build a bridge for businesses during this unprecedented period. The EU needs to be open to a variety of new policy measures to meet the challenge head on, perhaps even turning to Eurobonds to deal with lingering fiscal sustainability concerns going forward.

Life in a number of European countries has largely come to a halt. Bars, restaurants, schools, and universities have shut down and senior citizens are being asked to stay at home in Italy, Spain, France, Belgium, the Netherlands, and a growing number of other places. As policymakers ponder how to respond to the coronavirus crisis (Gopinath 2020, Horn et al. 2020), it is important that they keep in mind that the threat posed by the pandemic cannot be addressed by relying on Keynesian demand stimulus.

In a 'normal' recession, the optimal policy involves raising aggregate demand through a combination of fiscal and monetary policy. Consumers and firms use the additional cash, and more readily available credit, to increase their spending. Full employment is restored and no resources are left idle, or so the story goes.

The situation we currently face is of a different nature. While significant sectors of the economy have, or will, come to a standstill, our immediate priority should not be to get them up and running again. It is important to provide support to households that face significant income loss, but the point is not simply to stimulate the economy. In fact, the battle against the pandemic requires that certain activities not be carried out at all. As we have said elsewhere, a recession is a public health necessity (Hamilton and Veuger 2020a). In this context, the median worker can only do 6% of their job from home (Mas and Pallais forthcoming). Many activities simply cannot proceed as they normally do, and 'pumping up' demand will not change that fact. Think of the financial support as serving to bridge a period of inactivity, rather than as stimulus.

Meanwhile, many businesses will lose money hand over fist. In order to ensure that these businesses continue to exist when the public health threat recedes, governments need to provide them with the means to bridge the coming months as well. That way incumbent workers will not find themselves out of work, and new entrants into the labour market will avoid the scarring effects of a recession to the greatest extent possible (Kahn 2010). In addition, we would preserve firm-specific human capital and avoid years of debt overhang.

In Denmark and the Netherlands, this has taken the form of government commitments to pay large shares of the salaries of employees at affected firms, as well as a number of other dramatic measures. France and Spain have focused heavily on providing liquidity to their companies. However, in the most heavily affected industries (bars and restaurants, some retail, aviation, the hotel industry), even those actions may not suffice. In effect, what governments will need to consider is to plug revenue holes, not just provide wage subsidies. Governments could do this by facilitating loans that make up for lost revenue. The repayment would be waived if firms do not reduce their payroll throughout the crisis. We outline a more detailed version of a plan along these lines in Hamilton and Veuger (2020b).

A worrisome aspect of the implementation of a policy like this in the euro area is that large new expenditures will resurrect concerns about the sustainability of the public finances of certain member states. While member states can mutually agree to effectively suspend Fiscal Compact rules, such an agreement will not necessarily placate markets or serve to avoid sovereign debt overhang issues in the medium run (Blanchard 2020, Garicano 2020). As the EU has made only limited strides in setting up mechanisms to deal with asymmetric countercyclical policy, lingering fiscal sustainability concerns could easily turn what will hopefully be a short and sharp downturn into years of fits, starts, and half-measures.

The most straightforward way to address these concerns is through the issuance of 'Eurobonds', with joint and several guarantees by all euro area countries. These have been discussed for many years (e.g. European Commission 2012), but we believe that their moment has now finally come. There is both an extraordinary circumstance that warrants extraordinary cooperation, and sound economic logic that justifies their deployment. Targeted use of this kind of financial instrument would be a helpful innovation that deals with the immediate problem, as well as a powerful symbol of European unity in the face of a once-in-a-generation challenge.

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