

THE ROLE OF FISCAL POLICY IN MITIGATING THE COVID-19 CRISIS

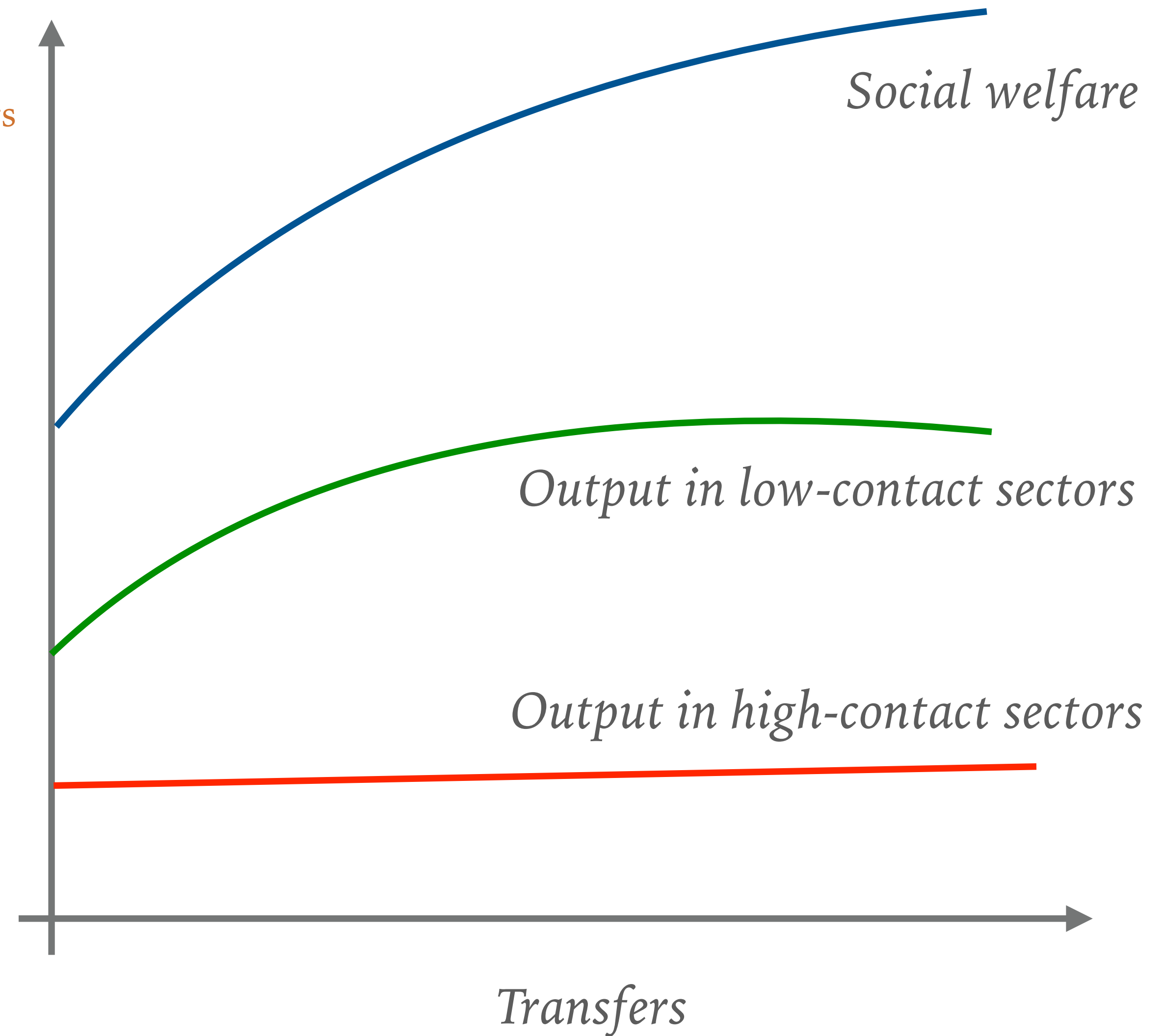
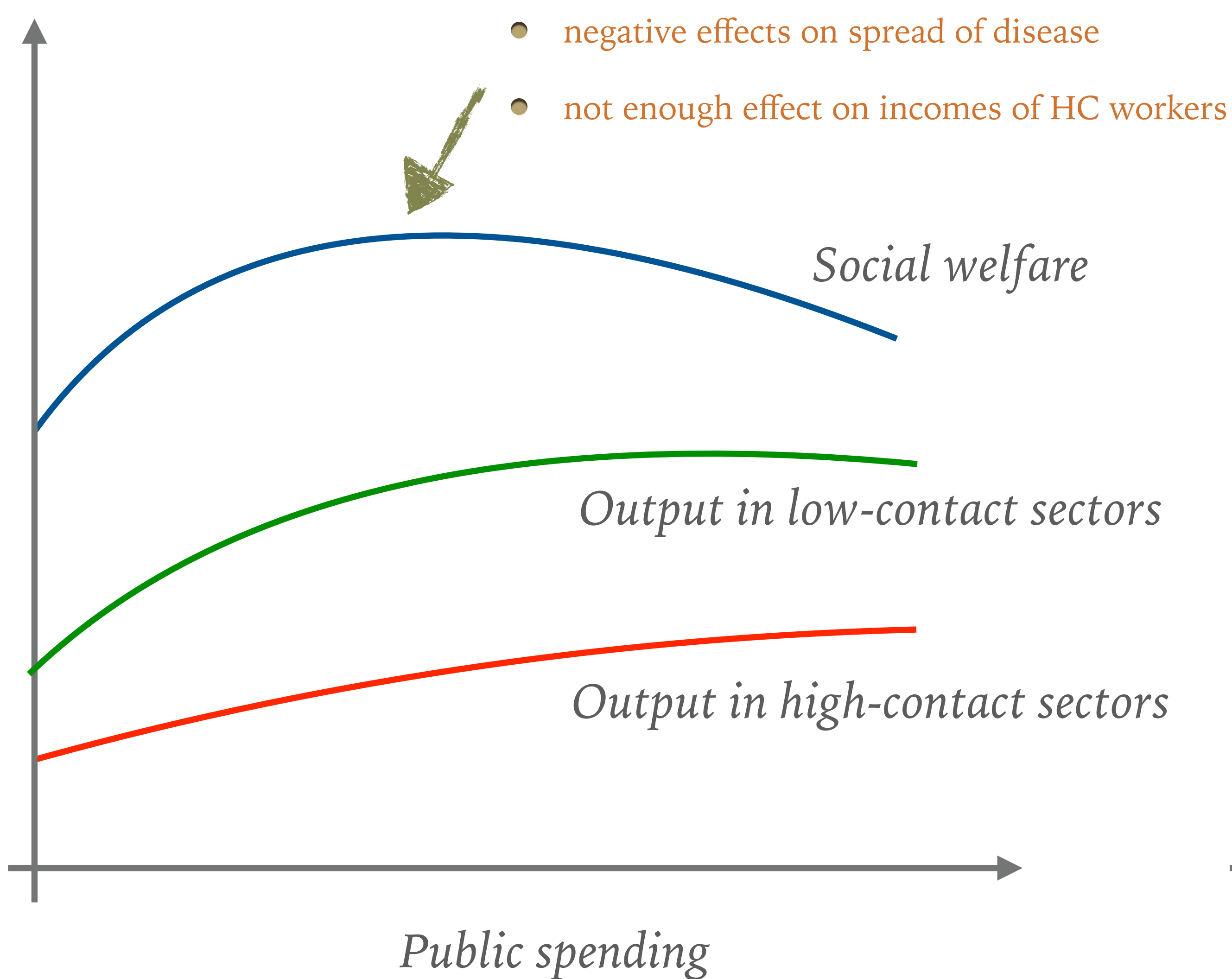
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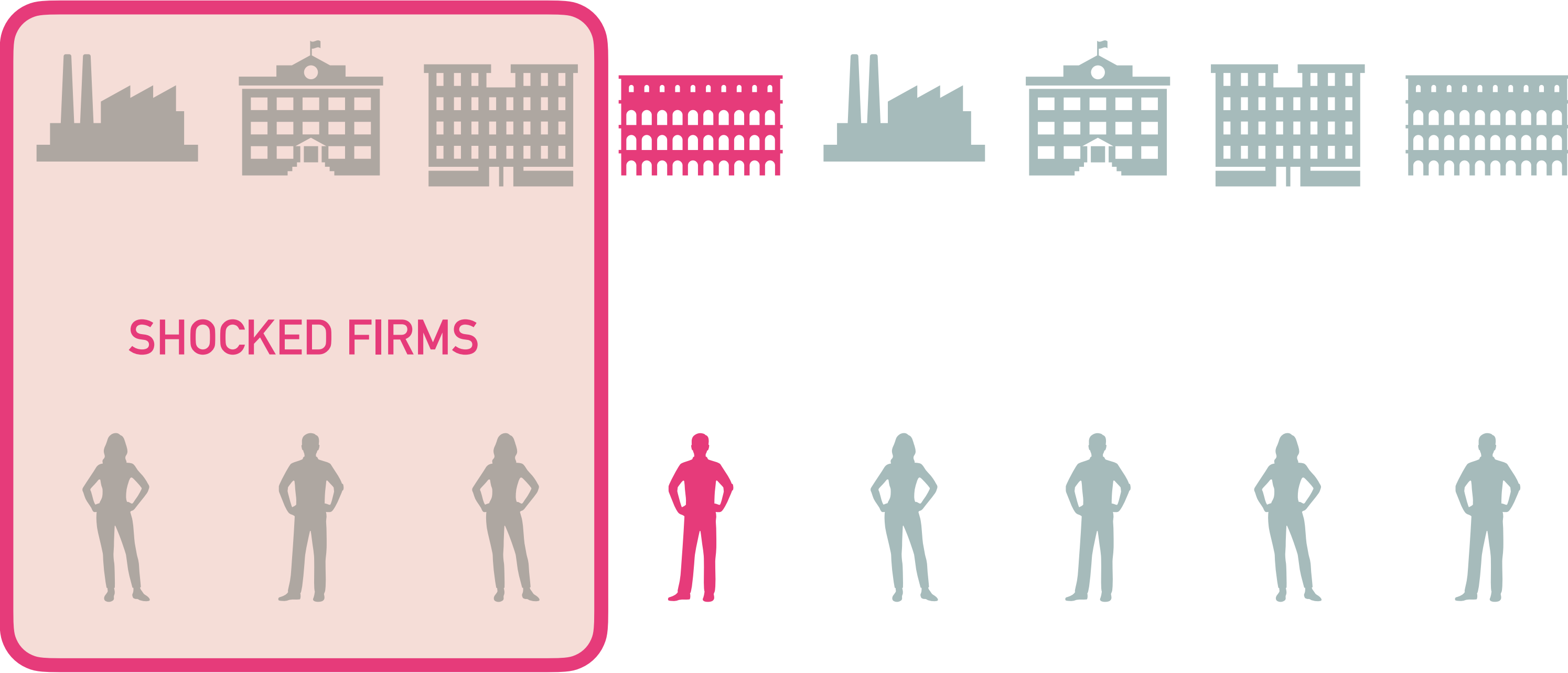
HOW SHOULD WE THINK ABOUT A PANDEMIC IN A MACRO MODEL?

- ▶ Defining feature of a pandemic: **asymmetric shock** hits directly high-contact sectors
- ▶ Reduction in activity in high-contact sectors is efficient → is stimulus beneficial?
- ▶ Yes if shock propagates to low-contact sectors through demand shortages generating inefficient employment losses (**Keynesian supply shock** in Guerrieri-Lorenzoni-Straub-Werning)
- ▶ However, conventional monetary policy and government spending are not the best tools: they do not reach most affected workers in high-contact sectors
- ▶ Key problem due to the asymmetric nature of the shock: **lack of insurance**
- ▶ → **targeted transfers** are the best tool (unemployment insurance, firm support, ...)

TRADITIONAL FISCAL POLICY VS TARGETED TRANSFERS

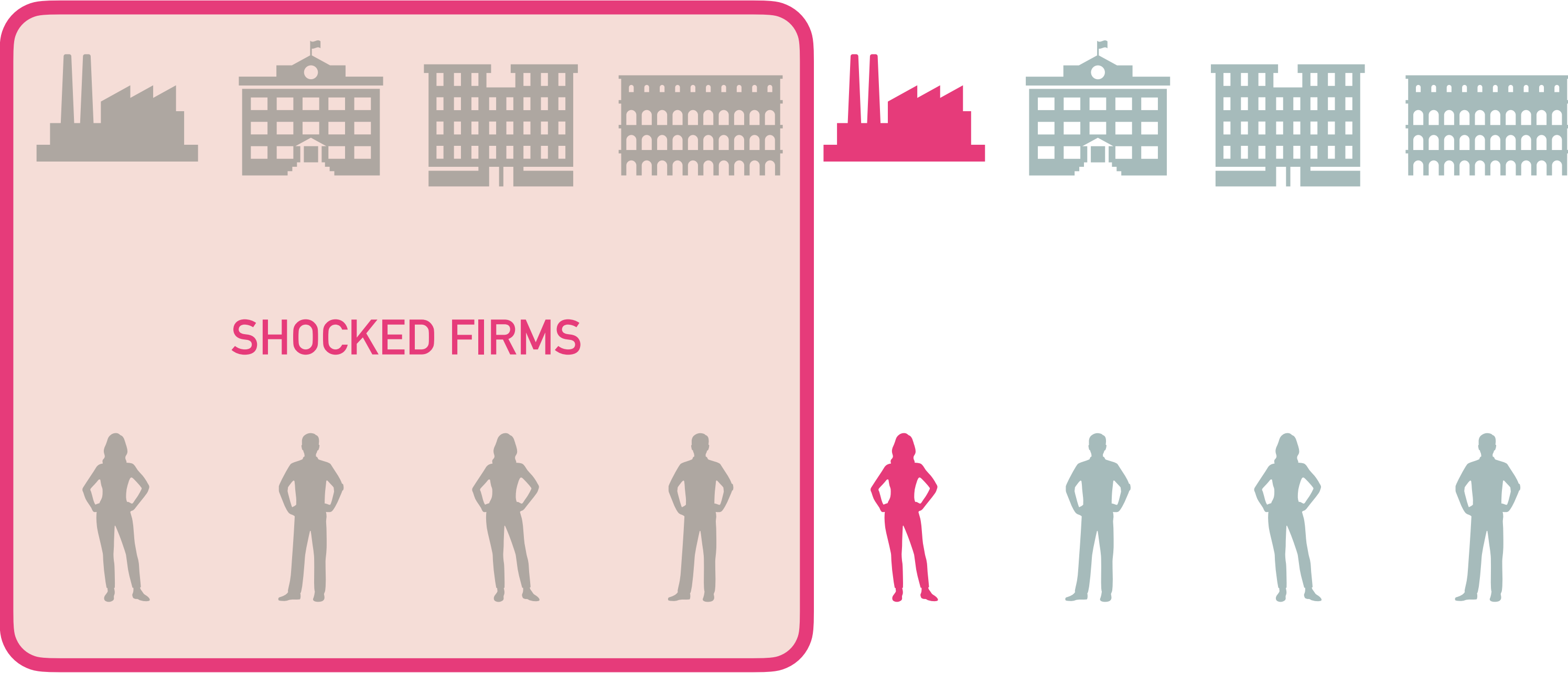


BUSINESS EXITS



Pandemic shock leads to business exits ...

BUSINESS EXITS



...business exit cascades

Role for
business support

FISCAL POLICY: THE PAST AND THE FUTURE

- ▶ **Looking backward:** initial fiscal response to COVID-19 both in US and Europe has been massive and successful, including different form of targeted transfers:
 - ▶ US: extended unemployment insurance, business support, ...
 - ▶ Europe: job retention schemes (Kurzarbeit style), business support, ...
- ▶ **Looking forward:** three main challenges:
 1. unconditional fiscal support cannot be sustainable for long
 2. uncertainty about the length of the pandemic shock makes it hard to decide when to roll back
 3. uncertainty about the persistence of the demand/productivity shock and about which businesses are viable in the medium run makes it hard to target business support

EURO AREA AND FISCAL UNION

- ▶ Three possible objectives of fiscal policy:
 1. stimulating demand during recessions (particularly important because of currency union and ZLB)
 2. providing social insurance
 3. public investments to foster growth
- ▶ Next Generation EU is an important step towards a fiscal union focusing on (3), but uncertainty on how effectively the funds are used in different countries (potentially generating political tensions...)
- ▶ Automatic stabilizers deliver fast counter-cyclical support focusing on (1) and (2). We should push the fiscal union also in that direction