



ACCADEMIA NAZIONALE DEI LINCEI

Covid-19 and the economy

Statement by the Lincei Committee on Covid-19

For the first time, Italy, Europe, and the world at large have been hit by four simultaneous crises: health, economic, financial and social. Crises that intertwine in various ways with the pre-existing environmental and political-institutional crises. The four crises have very different impacts across geographical areas, social classes, industries, and age groups. Their novel aspects make it difficult to predict with sufficient precision their evolution in terms of spread, intensity, duration. They require immediate large-scale interventions, to be coordinated at the various decision-making levels (international, national, and local).

The economic crisis has a global scale and magnitude comparable to that of the Great Depression of 1929; and larger than that of 2008. Its effects will be felt for years, certainly longer than the health crisis we are experiencing. There are clear risks of dismantling social coexistence, as well as seriously damaging the economic system and European and global political system. In the EU, there is the risk that the crisis will bring about further divergence between areas and regions that adopt the euro.

With respect to the previous crisis, we can count on a wider toolbox of economic policy instruments and on more openness to its use. The EU has already agreed to invoke the general escape clause of the EU fiscal framework, effectively suspending the Stability and Growth Pact for this year. The EU has a strong safety net: the European Central Bank (ECB), the Multiannual Financial Framework (MFF), the European Investment Bank (EIB), the European Investment Fund (EIF), and the European Stability Mechanism (ESM). Other instruments are being added, including the *Recovery Fund* under discussion in recent weeks.

This economic crisis has several sides that deserve attention. Poverty is quickly spreading, with new characteristics: in addition to the traditional areas, we must add the families of victims that have lost their source of income, those who have lost their jobs, new forms of unemployment, several strata of autonomous and self-employed workers and small entrepreneurs, as well as those employed in the grey economy. While several forms of inequality are widened: territorial and economic inequality, due to the different impact of the crisis on the various sectors (the negative impact on

tourism and the positive impact on pharmaceutical companies), as well as those related to culture and education (for example, the differentiated effects of school closures).

The supply shock, with the suspension of the production activity of many companies, due to the lockdowns, and the difficulties caused by the interruption of the global supply chains, is added to the strong demand shock that is generalised in the short run, but differentiated across sectors in the long run. The crisis that so many companies are facing also brings difficult problems for the banking system. The fall in tax revenues, greater health expenditures and the costs of supporting families and firms imply, in the long run, possible problems for public finances. Furthermore, a large-scale financial crisis could arise from tensions in the euro area, such as the repercussions of the economic crisis on the banking and insurance sectors, as well as tensions in the international financial and currency markets. These different aspects must be considered and dealt with separately, with measures tailored to the specific problem that is being addressed, albeit within a single framework of reference.

In addition to the measures to address the health crisis, governments and EU institutions have launched several initiatives aimed at tackling the economic crisis. After some hesitation, the European Central Bank has adopted large innovative interventions that have brought under control the financial markets, especially the markets for sovereign debt; these measures provide plenty of liquidity for the banking system.

Several governments have moved separately, but in similar directions: measures to guarantee bank loans to ensure that this liquidity reaches companies so that they are able to overcome the most difficult phase of the crisis and continue their business. In several countries, these guarantee measures and other subsidies to businesses have been made conditional on maintaining employment levels; this has slowed down the growth in unemployment, which is exceeding the reasonable level in countries characterized by more flexible labour markets, such as the USA. Some countries have added further conditions, which allow only companies that are not based in tax havens to be eligible for public guarantees.

The Italian government has adopted a number of measures aimed at alleviating and reducing poverty and at legalization for migrants currently working in the country; these are welcome, but measures aimed at the transition from undeclared work to legal contractual employment, would also be needed in order to provide the necessary help and safety net for all workers.

In this difficult and complex situation, we deem it necessary to lay down some basic principles:

1. In the face of a crisis that hit the whole world and in particular all European countries, albeit to a different extent and in (rapid) temporal succession, a strong European response is needed. Financial help for the single countries, especially those most hardly hit by the pandemic must be accompanied by a deepening of the European Union, with the adoption of new rules aimed at ensuring greater unity also in terms of tax laws and regulations, an expansion of the EU budget, closer cooperation in the fields of education and research, in the construction of infrastructures, in environmental protection, and in the development of common norms regulating the promotion of direct investments. European public investments in these sectors, financed by an expansion of the EU budget and other sources, such as the leverage of institutions such as EIB, could play a key role. An industrial policy at the EU scale should tackle the issue of de-globalization of supply chains to ensure the supply of essential goods, so as to preserve the economies of scale and the productive specialization of EU countries, avoiding pressures towards national autarchy.
2. In the face of a global crisis and in light of the UN Sustainable Development Goals, the EU must set up a large aid plan aimed at the poorest African countries, financed by the EU budget and possibly involving the EBRD, in order to involve other countries and ensure a multiplier effect. Such solution is not only called for by the growth in migration flows, but by economic logic itself. In the post-World War II period, the financial aid of the US Marshall Plan was directed not only towards the reconstruction of European countries, but also at insuring the that US productive system had a steady flow of demand even if war efforts were over. Today, confronted with a decline in demand, the European productive system has unused productive capacity that could be used to jumpstart productive development in the least developed countries. The EU and its Member States are the world's largest contributor to development aid, but there is not enough coordination which, especially for Africa, would be crucial.
3. Within Italy, measures to sustain the economy and society must be enacted urgently, but gradually. Attention must be focused on concrete efficacy, correcting the single measures where the aims are not adequately reached, and balancing the resources allocated to the various emergencies. It is necessary to understand which sectors will suffer from long-term, if not permanent, effects of the crisis. Beside liquidity crises, some firms may suffer from solvency crises, and it is necessary to plan how to deal effectively with them. There is a race to demagogically announce "big

numbers”, which may have little and unbalanced practical effects today, and which risk leaving a heavy legacy for the future of public finances.

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