

# We must mobilise as if for war



**FT series**  
Coronavirus: the economic cure

Higher public debt levels will become a feature and be accompanied by private debt cancellation, writes Mario Draghi

**T**he coronavirus pandemic is a human tragedy of potentially biblical proportions. Many today are living in fear of their lives or mourning their loved ones. The actions being taken by governments to prevent our health systems from being overwhelmed are brave and necessary. They must be supported.

But those actions also come with a huge and unavoidable economic cost. While many face a loss of life, a great many more face a loss of livelihood. Day by day, the economic news is worsening. Companies face a loss of income across the whole economy. A great many are already downsizing and laying off workers. A deep recession is inevitable.

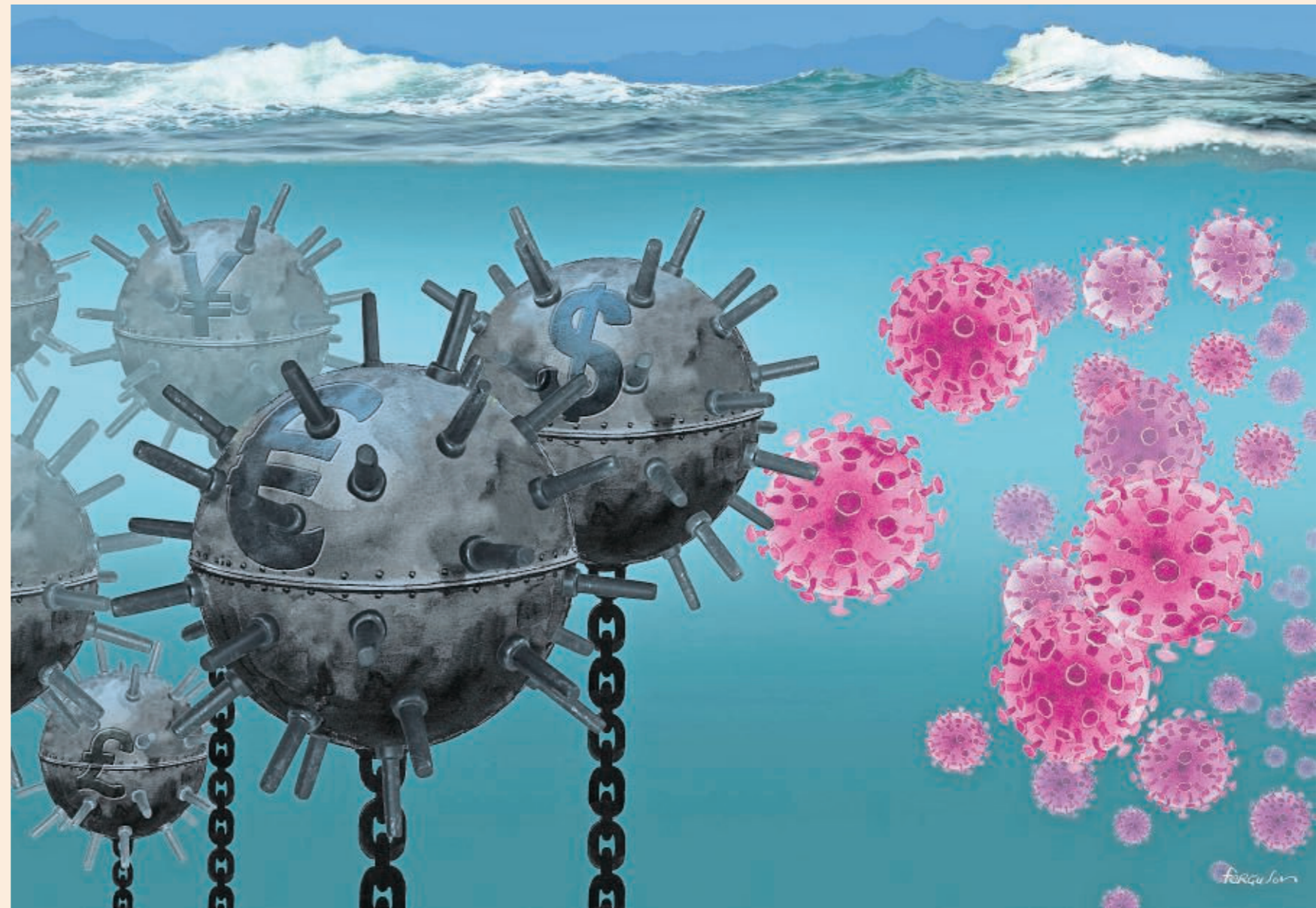
The challenge we face is how to act with sufficient strength and speed to prevent the recession from morphing into a prolonged depression, made deeper by a plethora of defaults leaving irreversible damage. It is already clear that the answer must involve a significant increase in public debt. The loss of income incurred by the private sector — and any debt raised to fill the gap —

must eventually be absorbed, wholly or in part, on to government balance sheets. Much higher public debt levels will become a permanent feature of our economies and will be accompanied by private debt cancellation.

It is the proper role of the state to deploy its balance sheet to protect citizens and the economy against shocks the private sector is not responsible for and cannot absorb. States have always done so in the face of national emergencies. Wars — the most relevant precedent — were financed by increases in public debt. During the first world war, in Italy and Germany between 6 and 15 per cent of war spending in real terms was financed from taxes. In Austria-Hungary, Russia and France, none of the continuing costs of the war were paid out of taxes. Everywhere, the tax base was eroded by war damage and conscription. Today, it is by the pandemic's human distress and the shutdown.

The key question is not whether but how the state should put its balance sheet to good use. The priority must not only be providing basic income for those who lose their jobs. We must protect people from losing their jobs in the first place. If we do not, we will emerge from this crisis with permanently lower employment and capacity, as families and companies struggle to repair their balance sheets and rebuild net assets.

Employment and unemployment subsidies and the postponement of taxes are important steps that have already been introduced by many governments. But protecting employment and productive capacity at a time of dramatic income loss requires immediate liquidity support. This is essential for all businesses to cover their operating expenses during the crisis, be they large corporations or even more so small and medium-sized enterprises and self-employed entrepreneurs. Several gov-



ernments have already introduced welcome measures to channel liquidity to struggling businesses. But a more comprehensive approach is needed.

While different European countries have varying financial and industrial structures, the only effective way to reach immediately into every crack of the economy is to fully mobilise their entire financial systems: bond markets, mostly for large corporates, banking systems and in some countries even the postal system for everybody else. And it has to be done immediately, avoiding bureaucratic delays. Banks in particular extend across the entire economy and can create money instantly by allowing overdrafts or opening credit facilities.

Banks must rapidly lend funds at zero cost to companies prepared to save jobs.

**Either states compensate borrowers, or they will fail and the guarantee will be made good by the state**

Since in this way they are becoming a vehicle for public policy, the capital they need to perform this task must be provided by the government in the form of state guarantees on all additional overdrafts or loans. Neither regulation nor collateral rules should stand in the way of creating all the space needed in bank balance sheets for this purpose. Furthermore, the cost of these guarantees should not be based on the credit risk of the company receiving them, but should be zero regardless of the cost of funding of the government that issues them.

Companies, however, will not draw on liquidity support simply because credit is cheap. In some cases, for example businesses with an order backlog, their losses may be recoverable and then they will repay debt. In other sectors, this will probably not be the case.

Such companies may still be able to absorb this crisis for a short period of time and raise debt to keep their staff in work. But their accumulated losses risk impairing their ability to invest afterwards. And, were the virus outbreak and associated lockdowns to last, they

could realistically remain in business only if the debt raised to keep people employed during that time were eventually cancelled.

Either governments compensate borrowers for their expenses, or those borrowers will fail and the guarantee will be made good by the government. If moral hazard can be contained, the former is better for the economy. The second route is likely to be less costly for the budget. Both cases will lead to governments absorbing a large share of the income loss caused by the shutdown, if jobs and capacity are to be protected.

Public debt levels will have increased. But the alternative — a permanent destruction of productive capacity and therefore of the fiscal base — would be much more damaging to the economy and eventually to government credit. We must also remember that given the present and probable future levels of interest rates, such an increase in government debt will not add to its servicing costs.

In some respects, Europe is well equipped to deal with this extraordi-

nary shock. It has a granular financial structure able to channel funds to every part of the economy that needs it. It has a strong public sector able to co-ordinate a rapid policy response. Speed is absolutely essential for effectiveness.

Faced with unforeseen circumstances, a change of mindset is as necessary in this crisis as it would be in times of war. The shock we are facing is not cyclical. The loss of income is not the fault of any of those who suffer from it. The cost of hesitation may be irreversible. The memory of the sufferings of Europeans in the 1920s is enough of a cautionary tale.

The speed of the deterioration of private balance sheets — caused by an economic shutdown that is both inevitable and desirable — must be met with equal speed in deploying government balance sheets, mobilising banks and, as Europeans, supporting each other in the pursuit of what is evidently a common cause.

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