Free Lunch **Eurozone economy**

How Europe should design a 'coronabond'

The eurozone needs mutualised spending more than it needs mutualised borrowing

Martin Sandbu YESTERDAY

It is clear that the coronavirus crisis will bust government budgets in a way they have not been busted since the global financial crisis, and quite probably more. This has raised worries in the eurozone, where several governments already have large debt burdens, and memories from the sovereign debt crisis are still raw. Italy, in particular, is both highly indebted and among the most affected by the virus.

What is also back, naturally, are the discussions about mutualised debt issuance. Nine governments, led by France, are proposing a "coronabond" — borrowing jointly guaranteed by all the member states. Others think this is going too far, but have been willing to discuss using the European Stability Mechanism (the eurozone's rescue fund) to provide finance to governments in trouble.

What is missing, however, is a clear-eyed discussion about what problem these solutions are supposed to solve. All eurozone countries currently face low borrowing rates and could take on the extra debt. If the worry is that bond yields could soar like in the debt crisis, the European Central Bank can intervene — indeed its new Pandemic Emergency Purchase Programme is designed to do exactly that. Italian bond spreads have narrowed after the programme was announced. Even if there are still doubts about whether the ECB would do enough, the ESM is there, ready to be used the day borrowing costs really become unaffordable.

Alternatively, the worry could be not about borrowing ability, but

by what adding to already high debt burdens would do to state capacity in the future. Would Italy or other high-debt countries suffer permanent low growth as a result of the extra debt needed to address the economic damage of Covid-19? But if this is the problem, an ESM loan would not help, nor would borrowing through a common coronabond. Those funds would, after all, have to be paid back.

The only thing that would make a difference would be common borrowing, raising funds to give — give, not lend — to governments. A coronabond would fill a eurozone (or EU) "Common Covid Fund", which would function as catastrophe insurance, covering the increase in the national government deficits of all member states that was due to spending on combating the virus and the economic fallout. This could be calibrated to the swing in 2020 national income growth from pre-crisis forecasts, or a proportion of the swing in the deficit, whichever is bigger. (That proportion could be, say, 50 per cent or 67 per cent, but not 100, to discourage governments from taking the opportunity to add non-crisis related spending at other countries' expense.)

A reasonable guess is that 2020 national income growth will deteriorate by 10 percentage points on average. Deficits may deteriorate by more. That implies coronabonds and a fund upwards of 10 per cent of eurozone national income, or about €1.2tn, that would be given as grants to countries according to the same formula. Such a solution would eliminate any worries about borrowing costs or about future debt sustainability.

But would it not amount to the "transfer union" dreaded in some northern countries? It would involve transfers only in the sense that insurance involves transfers — to those most hit by catastrophe from those spared its worst effects. But there is, sadly, no reason to think northern countries will face milder suffering from the pandemic or its economic consequences. Their deficits may well

swing more into the red. We just do not know yet. What we do know is that the common coronabond debt may have to be serviced by a supplement to the EU budget in the future, ideally over the very long term or even perpetual bonds as proposed by Francesco Giavazzi and Guido Tabellini. Debt service costs would presumably follow current budget contribution rules, roughly proportionate to national income. It is quite possible that when all the accounts were settled, Italy would have ended up subsidising a northern country's big crisis.

If that is so, one might ask, why bother at all — why not just stick to national borrowing for national purposes? The answer is that the Covid-19 pandemic is not just the biggest economic shock to hit Europe since the second world war, it is also a common shock that at the same time has exceptionally large spillovers between countries. Even if the virus only affected the nationals of one country, and only one country had to shut down its economy, that would have enormous effects on its neighbours and Europe as a whole. That is as strong an economic reason as you can get to mutualise the spending (and not just borrowing) needed to address it. Even more stronger is the political reason: to find the willingness to address a common threat together.

Other readables

- The readables this week are all about policy ideas to tackle the economic impact of the Covid-19 crisis. Start with my FT Big Read last weekend on how the speed of the crisis is sweeping away policy taboos. "Helicopter money" is now being discussed seriously, both in the sense of monetary financing and universal cash handouts to individuals. Even the OECD's chief economist is now proposing monetary financing of government deficits.

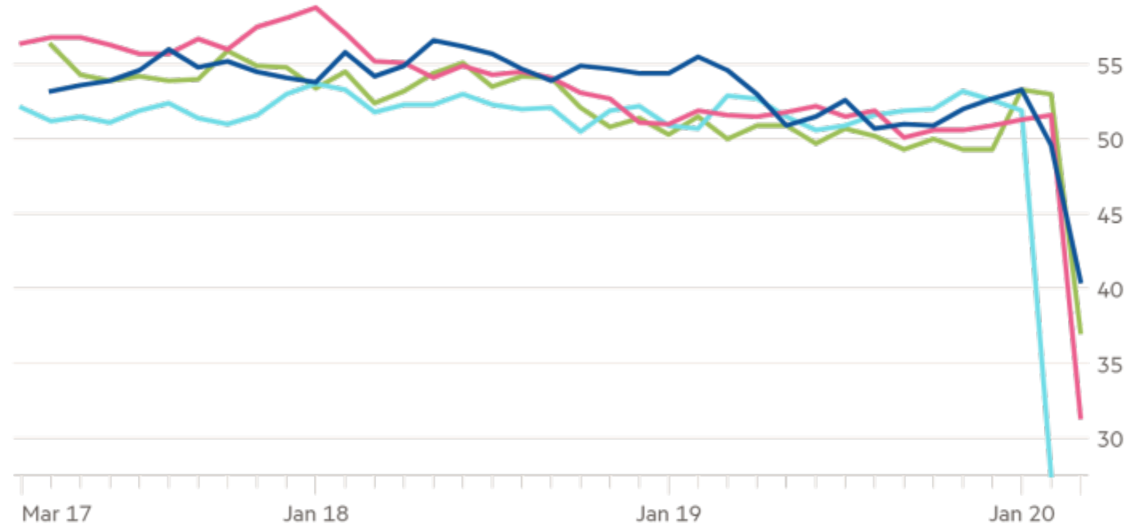
- Another big policy question is how to protect the incomes of those who are hit by the economic shutdowns governments have adopted to arrest the spread of the disease. As Christopher Pissarides, the

economics Nobel laureate, points out, a key challenge is to protect the self-employed as much as those in regular employment. The Resolution Foundation has just issued a report on the UK's policy efforts and where they fall short, which is conceptually useful for observers from countries with other systems.

• Yet another question is how to help crisis-hit businesses without unnecessarily bailing out those who do not need it — in particular shareholders who have extracted a lot of value from their companies, leaving them without cash piles that could otherwise have cushioned the blow. Some very clear-headed thinking comes from Thomas Philippon at NYU, David Wilcox at PIIE and Carsten Jung at IPPR. The overall message is: be willing to write down investors; demand conduct in the public interest; secure a government stake. On the last point, the IPPR has also published a discussion paper by Eric Lonergan and Mark Blyth proposing that aid to companies could seed a sovereign wealth fund.

Numbers news

• The data have started to come in on how the lockdowns implemented around Europe and the US are affecting economic activity. In a word: things are awful. Survey indicators such as purchasing managers' indices are in many cases at their lowest-ever levels.



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