The EU must support the member at the centre of the COVID-19 crisis

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Why Italy became the center of the Covid-19 epidemic remains to be understood. Most likely, it was bad luck. But the medical situation today is dire.

Twelve days since the number of confirmed cases exceeded 100, the total number of active cases exceeded 12,000, compared with 6,000 in South Korea, 8,000 in China ex-Hubei. Per one million population the rate is 350 in Italy, 56 in China, 160 in South Korea and 150 in Iran (numbers from the WHO as of March 15). The number of deaths as of last weekend is half that of China (1,440 against 3,200) and 20 times that of South Korea.

The current constraint is the number of intensive care beds available for new patients: in Lombardy, this is now close to zero, although hospitals and the government are doing their best to increase supply.

As very clearly explained by Pierre-Olivier Gourinchas ('Flattening the Pandemic and Recession Curves', March 13) the containment of the pandemic is closely linked to the capacity of the health care system. In terms of hospitals beds per 1,000 inhabitants Italy (OECD data) is close to Finland, slightly higher than Israel and Spain but far below Japan, South Korea and Germany.

The first policy priority is to expand hospital capacity

The first policy priority is obviously expanding hospital capacity and containing contagion. The severe restrictions to people mobility imposed a week ago mirror those of the province of Hubei and are now being followed by other countries, e.g. France, Spain, Switzerland and Germany. The US misled by the Trump administration is a laggard. Italy did not send the army in the streets, but with a broadly admirable sense of discipline Italians follow the new rules very closely after an understandable stop and go start. Now almost nobody goes out except briefly for groceries.

Probably the new rules should have been introduced earlier since it takes at least two weeks for such restrictions to slow down contagion. Still, Italy has acted faster than other countries.

Containing the economic crisis

What about the policy response to the implied economic shock? The planned response of the Italian government was initially modest. However, it was rapidly raised: the total sum allocated on March 15 is about 1.5 percent of GDP which will raise the budget deficit to above 3 percent of GDP.

Presenting the decree, Finance Minister Roberto Gualtieri said: 'Nobody will lose their job because of the virus'. We would have added: 'And if someone loses her or his job, they will be guaranteed an income to support them until they find a new one'. In other words, it would have been preferable to announce an objective, not a number.

For two reasons. First, to avoid a negative shock to consumption you want people to be reassured that whatever happens because of the epidemic they will not lose their salary, whatever that costs. To limit the reduction in consumption, families must be given **a certain level** of certainties: they must be guaranteed that if the companies for which they work close due to the virus, their incomes will be guaranteed, whatever the type of company they work in, whatever their contract. And this must also apply to young people. We need decisive surgery: an aspirin could end up costing much more.

'No one will lose their income because of the virus' should be the analogous, mutatis mutandis, of Mario Draghi's 'Whatever it takes' which saved the euro. In Italy however, as in many countries, and for good reasons, the budget law does not allow Parliament to adopt bills that authorize unconditional spending. The bill about to be approved by Parliament, however, although it implies a number for the deficit, it is in practice unconditional, since the change in the unemployment benefits rules – which extend access to virtually all workers—are indeed unconditional and apply to everybody, even workers on temporary contracts.

What this means is that the government after a few months might have to re-finance the bill. In fact it has however has already announced a follow-up decree to be issue on April 1, thus indicating that the initial figure will be raised over time as needed.

Then there are firms, especially those in the tourism business (13 per cent of Italy's GDP) that will not see revenues for many months, possibly longer. Here the principle should be 'No firm must be forced to go bankrupt because of the Covid emergency' because a bankruptcy implies an irreversible loss. The ECB decision to restart the TLTRO program goes in the right direction as does the temporary suspension of tax payments.

Of course, the burden on the State will be high. But those who criticize the government decree because it is risky for public finances they underestimate the importance of signals and of the effect they have on the behavior of families and businesses. This is case in which promising to possibly spend more may lead to actually, in the end, spend less.

The national debt issue and a temporary budget relaxation

The emergency in which Italy finds itself shows, at our expense, what the cost of a high public debt is. If Italy had not accumulated a debt of over 130% of GDP, for no good reason, in years when the economy was growing, we could, and should, spend much more today, and the investors we are asking to finance us would not be worried, raising the spreads. All those who did not understand why being fiscally rigorous in in normal times was so important, now they have their lesson.

Having said that, after the peak of the corona virus passes, it is important that this unconditional deficit spending does not become a free for all for any kind of spending, for this or that politically useful constituency: when the government can spend the parasites rise their ugly head. If that happens the government will fail in a way which would be a monumental disaster for the Italian democracy. The stakes are very high.

Without excusing the mistakes Italy has made in the past, and hoping that they are nor repeated, this is not the time for the European Union to impose constraints. Despite the initial indifference and lack of foresight of France, Germany and other countries, which finally is changing (too late) the virus will come to them too. And then it can only be contained with a determined, credible and ideally joint European effort, ‘Whatever it takes’.

There are two options. Either each country is left to find the additional resources alone, or these are part of a EU-wide program. In the first case we risk a repeat of the 2010-14 euro crisis, as markets will start doubting the solvency of some countries. To avoid this the ECB could step in, for example expanding the size of the QE program and lifting, at least temporarily, the constraints on asset purchase (the capital key in particular). Alternatively, the additional spending could be part of a EU program. This is a ‘symmetric shock’: the occasion to create a European safe asset and turn the euro into a ‘normal currency’. When if not now?

Concluding remarks

Italy today is on the front line. This is the time for the EU to support Italy in every possible way, reassuring markets by saying that Italy will not be left on its own, as Ursula von der Leyen has said and Christine Lagarde has not, showing her inadequacy to her post. More generally EU institutions need to act at their best and fast: the populists everywhere are already using the panic created by the corona virus to damage even more the perception of the EU amongst citizens blocked at home, without anything to do other than commiserate their fate and blame someone, the EU in particular. Christine Lagarde’s ditching of Draghi’s ‘Whatever it takes’ has given populists ample latitude already.