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How to stimulate the economy after lockdown

A US-style 'helicopter money' stimulus of direct payments to individuals wouldn't be transformatory in Europe

With the progress made in vaccinating the population, now is the time to think about the measures required to stimulate the economy and enable a rapid recovery of the losses caused by the pandemic. Of course, special attention should be paid to those sectors — hotels, restaurants and the stationary retail trade — hardest hit by the lockdown, alongside many self-employed people: hairdressers, masseurs, artists.

Government stimulus programmes should take the three Ts into account: they should be timely, targeted and temporary. Increasingly, a fourth T is mentioned—transformatory. Three measures stand out because they are particularly targeted: consumption vouchers, an extended loss carry back and instant write-offs. The latter are also strongly transformational.

Heavily dosed

The new United States president, Joe Bidden, has launched a heavily-dosed recovery programme involving direct payments of $1,400 per person, sharply tapered for incomes above $75,000 for a single person and couples making more than $150,000. In Germany, this model was taken up by the Retailers' Association, which called for a payment of €500 per citizen.

But on the above-mentioned criteria general government transfers do not score well. The biggest weakness is targeting. Chastened citizens may simply save the money, so the intended consumption effect will fizzle out. But even if the money is consumed, it is far from certain it will arrive where it is most urgently needed.

The pandemic has led to a major upswing in online retailing — not least because many households previously sceptical of this sales channel have had surprisingly positive experiences. Government transfers might thus

be used for online purchases, leaving businesses affected by the lockdown largely empty-handed.

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With limited government funds, the aim should be better targeting. This can be achieved above all by giving citizens consumption vouchers, which expire if they are not redeemed. In addition, the vouchers may only be used at businesses directly affected by physical lockdown.

The timeliness requirement can be met by allowing the vouchers to be issued on a random basis for only one specific month in 2021. In this way, it is possible to avoid a run on the stores after the vouchers have been issued, resulting in unwanted crowds.

Successful example

A successful example already exists. In June 2020, the German university town of Marburg sent each adult a voucher for €20 by mail — even €50 for children. The so-called 'city money' could be redeemed in restaurants, cafés, shopping stores or at cultural events. The vouchers were limited to six weeks, and the money was to be spent promptly. Stores had to register via a merchant portal and were paid the voucher value directly by the city. A total of 75,517 vouchers were sent out.

So far, there has been no scientific evaluation of this model — the city administration assessed it very positively. But it is obviously a measure which helps those affected by the pandemic in a much more targeted way than a general transfer, such as is now being made to citizens in the US.

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Given the high savings rates of private households, one might of course ask whether there is any need for a government stimulus to consumption. But low-income earners are generally hardly in any position to save. They are also likely to be harder hit by income losses due to unemployment or short-time work.

Those companies and self-employed most affected have suffered serious losses as a result of the lockdown. While many previously enjoyed a successful business model, a return to 'business as usual' will not compensate for such setbacks. What is needed is a strong surge in consumption, which should help not least to reduce high accumulated inventories.

Simple measure

A targeted and administratively simple support measure is the loss carry back. For instance, if a company has made a profit of €1 million in 2019 and a loss of €1 million in 2020, it can offset these against each other. This would allow the company to recover the tax paid for 2019. The logic of this is simple: if the state shares in a company's profits, it should also share in its losses. In Europe, the instrument exists so far in only five countries — France, Germany, Ireland, the Netherlands and the United Kingdom — and it is limited to one year.

With the pandemic entering its second year in Europe, it would make sense to extend the loss-carry-back period to two years. In the US, the Coronavirus Aid, Relief and Economic Security (CARES) Act even allows losses in 2018, 2019, and 2020 to be carried back over five years. The risk of supporting zombie companies, chronically lacking a successful business model, however speaks against an overly long period. With a two-year carry back, companies could at least offset the losses of the two coronavirus years against the profits of 2018 and 2019.

With a generous loss carry back such as this, coronavirus-weakened companies would see their liquidity and solvency strengthened, enabling them to bounce back strongly once the pandemic subsides. European countries which do not have this facility should seriously consider it as a well-targeted instrument.

Investments required

The pandemic will have more than temporary effects on the economy, however. The pressure of digitalisation will make some business models obsolete or at least require major realignments. In most cases this will require investments which many businesses are unable to finance today. Their balance sheets damaged by the crisis, they will have a hard time getting loans from banks.

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In this context, immediate write-offs could play an important role. According to the tax rate, companies thus receive interest-free liquidity assistance. Here again the US can serve as a model, with the 100 per cent first-year 'bonus' depreciation which was part of the 2017 tax overhaul. It applies generally to depreciable business assets with a recovery period of 20 years or less — machinery, equipment, computers, appliances and furniture — and, with

restrictions, to property.

For most European countries, this measure would in principle come free of charge. An instant write-off of depreciation means lower tax revenues today but higher revenues in the future. This is effectively costless as governments can currently borrow at interest rates of zero or close to zero — even for Italy, the interest rate on ten-year government bonds is only 0.6 per cent.

One can reasonably ask whether generous aid to businesses is socially justifiable, rather than making transfers directly to citizens. In view of the much more limited room for manoeuvre of European states compared with the US, it seems however sensible to take targeted measures helping to ensure the survival of companies hit by the pandemic and the jobs they provide.

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Peter Bofinger
Würzburg

Peter Bofinger is professor of economics at Würzburg University and a former member of the German Council of Economic Experts.