

How to live in an indebted economy

Government policies have aimed to tackle both the pandemic and the economic crisis simultaneously. In the short term, this means taking on public debt, which markets are currently paying little attention to. But over the medium and long term, new measures will be required to ensure the stability of public accounts.



June 17, 2020

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Little by little, the world has been learning how an economy operates in a society shaken by the SARS-CoV-2 pandemic: steep declines in consumer demand, investment and exports; confinement, with a notable reduction in production and employment; loss of family income; lack of liquidity in companies whose payments have not been reduced at the same speed as

their incomes; interruptions in the supply chain; and enormous uncertainty about when, and how, a recovery will occur. On top of these economic worries, questions persist about infection duration, possible new outbreaks and the probability of finding an effective vaccine.

The public policy response

Governments have designed policies to combat both the pandemic and the economic depression using two alternative strategies: mitigation and suppression. The first involves tracing the virus and applying selective quarantines: test, track and treat. This requires medical resources that not all countries had access to when the virus struck, but the advantage is that their lockdowns, and subsequent economic fallout, were limited. Taiwan, Hong Kong, South Korea and Singapore followed this strategy, with variations.

Countries that opted for suppression did so primarily due to a lack of resources, experience, or medical technology. They relied on widespread confinement -- which comes with a much more acute economic impact -- and the hope of achieving a high degree of social immunity that would allow economic activity to resume quickly without too much risk to health. In fact, the strategy followed by almost all countries combines suppression with some mitigation.

In Spain, as in many other countries, containment plans were drawn up late, meaning that suppression was the strategy that needed to be employed, with extensive and rigorous confinement that accentuated the economic impact. This is why Spain's crisis has been referred to as a crisis of supply more than demand: it affected, first and foremost, the country's productive capacity, ahead of aggregate demand. If the latter collapses, it is mainly due to the paralysis of many productive activities.

Although Spain's shutdown of production only began in mid-March, the first quarter of 2020 saw GDP reduced by 5.2% compared to the fourth quarter of 2019. Over time, expectations for the whole of 2020 have become increasingly pessimistic, with GDP forecast to fall by more than 14% year over year. The rise in unemployment was initially moderate, as workers were furloughed under a scheme known as ERTE rather than counted among the unemployed. However, it is likely that unemployment will be over 24% by the end of the year, if those now furloughed are included.

The Spanish government's recovery strategy was based on the implicit assumption that the acute phase of the pandemic would be brief and that recovery could begin rapidly. What was needed, then, was a set of transitional measures to reduce the economic impact of the crisis. To this we should add a series of aggressive measures to revive production and demand as

soon as possible. Thus, the second half of 2020 should already feature noticeable economic recovery, granted there were no major spikes in infections.

The harm-reduction measures tried to avoid the closures of companies and permanent dismissals of workers; maintain companies' liquidity and families' purchasing power; reduce debt defaults and meet the immediate needs of the most vulnerable in society. The instruments were mainly direct subsidies, credits and guarantees, as well as moratoriums on payments.

If the acute phase of the economic crisis was short, the key to the strategy pursued was devoting the necessary resources to reduce the damage inflicted upon families and businesses. The idea was to prevent productive capacity from being permanently affected, which would cause the loss of physical, organizational, technological and human capital. This route required that the public administrations were able to invest the necessary resources; first, to avoid too steep a fall, and, second, to finance the recovery of demand and the reordering of productive capacity.

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