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The Coronavirus Crisis: Economic Policy Recommendations

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Israel is not far from a complete lockdown. The policy, driven at the urging of the health system in an effort to contain the spread of the coronavirus, comes with increasing economic and social costs. As a result of the crisis, some 900,000 people have joined the ranks of the unemployed (including unpaid leave) and the numbers are increasing. At this time, with health authorities unable to predict when the pandemic will peak, there is a need for a cautious and integrated public health–economic policy that will allow a continued fight against the coronavirus while maintaining the socio-economic fabric in Israel, minimizing harm to the economy, providing economic breathing space over a period of time, and ensuring the ability to resume rapid economic growth once the crisis comes to an end. Therefore, continued lockdown measures should be weighed on a cost-efficiency basis that will take into account both short and long term economic aspects. The proposed measures, including differential testing, financial support enabling social distancing, and plans for when this policy is eased can significantly reduce the cost of the crisis to the state, maintain economic and social stability, and assist in creating a sound exit strategy.

This paper is part of a broad study focusing on efforts to balance public health considerations with economic and social considerations in dealing with the crisis and conceptualizing the next phase: life with the coronavirus.

Outbreaks of aggressive viruses such as COVID-19 cause an extremely rapid increase in infection rates and a high degree of uncertainty with regard to the disease and the effects of the pandemic. Economic literature shows that in this situation there can be three reasons for economic market failures that impair the operational ability of free markets and necessitate government intervention:¹

1. Lack of information: each individual does not know his own medical condition or that of individuals around him.
2. An individual who is a carrier of the virus causes negative externality insofar as he infects other individuals.
3. Uncertainty with regard to the scope and duration of the pandemic could cause over-reaction, even more than is justified by the virus, as we know from studies in behavioral economics.

Today's medical and technological capabilities enable the use of technological means, including wide-scale testing and other systems, that allow us to confirm the medical condition of any person in the public sphere. Thus, it is possible to narrow the spread of the virus at a significantly lower economic cost, while allowing most economic activities to function reasonably. For example, through intelligence and population monitoring it is possible to focus quarantine efforts and treatment of specific persons, while releasing others into the labor market, in order of economic priority, without confining the entire population to their homes. Such means have been used in various constellations by countries in the Far East (China, South Korea, Taiwan, and Singapore), and it appears this is the modus operandi now recommended by the World Health Organization. Laboratory tests for population mapping are performed in Israel, but increasing the scope of tests takes a long time. The lack of information requires the government to take collective social distancing measures, which come with a very high cost to the economy and over time could jeopardize social and economic stability.

As of the time of this writing, Israel is not far from full closure. Current policy is driven at the urging of the health authorities in the effort to slow the spread of the virus, and most of all, to prevent the inundation of the health system with severely ill patients requiring artificial respiration, which can lead to the collapse of the system. However, this policy comes with increasing social and economic costs. For example, as a result of the crisis, close to 900,000 people have lost their jobs (including those on unpaid leave) and the numbers are rising. At this stage, with health authorities unable to predict when the pandemic will peak, there is a need for a cautious and integrated public health–economic

¹ Martin S. Eichenbaum, Sergio Rebelo, and Mathias Trabandt, "The Macroeconomics of Epidemics," No. w26882, National Bureau of Economic Research, 2020, https://sites.google.com/site/mathiastrabandt/home/downloads/EichenbaumRebeloTrabandt_EpidemicsMacro.pdf.

policy that will maintain the state's basic socio-economic fabric, minimize harm to the economy, provide economic breathing space over the period of the crisis, and ensure the ability to resume rapid economic growth once the crisis comes to an end.

Proposed Policy Principles

There should be a phased and integrated approach to deal with the crisis. At this stage, the priority is to curb the spread of the virus at the expense of harming the economy. At the second stage, the priority is to move the wheels of the economy, while taking a risk of a renewed increase in the spread of the virus. Advance planning is required for the phase in which quarantine and social distancing commences are relaxed toward social and economic reconstruction.

1. First phase: economic support for social distancing measures as determined by the government, while narrowing the harm to the economy to the minimum. For example, resources should be allocated to support state systems during the crisis, with an emphasis on medical systems; increased resilience of households; and strengthened economic infrastructures, especially electricity, water, food, and communications, critical to most economic activities.
2. Second phase: use of medical and technological capabilities to minimize harm to the economy. A wide-scale testing, monitoring, and technological infrastructure is required to create a situational assessment of the evolution of the pandemic in order to formulate measures to relieve social distancing to the necessary minimum and to enable increased economic activity of essential branches of the economy. Consequently, personal and general risk of infection as a result of a lack of data will decline.
3. In both phases, it is important that the state assist the weaker links in the economy and society in a measured and focused manner. The state should not initiate relaxed payment schedules for contracts and signed agreements in the business sector indiscriminately (leases, payments to banks and suppliers, and so on). Banks and leasing entities also have an interest in ensuring that good customers do not collapse.
4. Risk management: controlled risks with regard to the scope of the lockdown – with increased enforcement of lockdown measures through various means of testing and electronic surveillance.
5. Reduction of uncertainty in the economy by determining ahead of time, and for as extended a period as possible, guidelines for many parameters involved in the business process, such as postponement of payments to the authorities, clear publication of the terms of assistance to the economy, and in particular the period of time for which they will be valid.
6. Controlled intervention in the economy that will not cause irreversible damage or long term difficulties, and at the same time keep in mind “the day after.” The

- intervention must be focused on the workers, companies, and industries affected most severely, based primarily on the damage to demand.
7. Professional information dissemination, in order to gain the trust of the population: consumers, manufacturers, and so on.
 8. Efficiency: achieving higher economic output at the same if not lower level of health risks via a policy that integrates the needs of the health system with those of the economic system.

Recommendations for Economic Policy Measures to Manage the Crisis

In our opinion, up to this point, the government has taken responsible measures² that overall have been sound.³ It is necessary to ensure controlled management of economic resources, subject to uncertainties from the health aspect (as of the time of writing, it is unclear when the crisis will end) and given that the Israeli economy is also suffering from the impact of the coronavirus crisis on the global economy.

What follows is a list of additional steps that we recommend be taken toward the transition to the second phase of return to economic activity while the coronavirus pandemic continues.

1. Increase the scope of work: Enable better management of the economy while the pandemic is ongoing; allow more public sector workers to work remotely; support private sector companies as far as is possible to expand remote work capabilities; and add safeguards to enable employees to work safely in workplaces where remote work is not possible.
2. Relieve cash flow difficulties of businesses that have a chance of surviving and moderate the damage to the purchasing power of employees who have lost their place of work. Actions can be considered to reduce fixed business expenses and encourage employment, such as deferring taxes, including municipal taxes for businesses, deferring pension deductions, and perhaps lowering minimum wages while compensating employees through negative income tax. The government must clarify to the public the time frame in which payment deferrals (tax payments, pension deductions, and so on) that have already been announced are valid. At this point, we recommend deferment until November 2020.
3. In the event that the state decides to provide capital (cash) assistance to large firms that have suffered extraordinary damages, it should take a portion of ownership

² Ministry of Finance Measures to Maintain the Stability of the Economy at https://www.gov.il/en/departments/news/press_16032020_b.

³ Some members of the team believe there is no need for broad support for export sectors as opposed to other sectors of the economy, Others believe that Israel should provide support for exports (some 30 percent of GDP) in order to protect Israel's place in the shrinking world markets for the period after the crisis has ended.

- (shares) in the company in return, as was the case with the rescue of banks and insurance companies in the United States and the United Kingdom in 2008-2009.
4. Provide clear and precise instructions to the economy at as high resolution as possible. In order to do so, the following is required:
 - a. Establish professional committees in each sector to formulate, with the cooperation of employers, regulations that will enable maximum activity with minimal risk. For example, on large manufacturing floors there is no need to restrict the number of employees to 10.
 - b. Prioritize essential and systemic sectors (the health sector, food, energy, electricity, water, and defense industries), sectors that have a large number of employees, and sectors in which a slowdown of activity will create systemic damage or other large risks. The public should be party to the considerations weighed in decision making and professional elements should be consulted. Presumably the more the public is convinced that the justifications are proper and proportionate, the higher will be the level of compliance.
 - c. Enforce and monitor regulations and assist in their implementation, and minimize the need for enforcement through law and judicial enforcement. Furthermore, use should be made of civil enforcement bodies with administrative powers (the labor sector, Ministry of Economy, and so on). These apparatuses can be enlarged in a short time. CEOs and owners of companies should be involved and made responsible for carrying out directives. Each company must prepare an internal enforcement procedure to implement government directives.
 - d. Establish a public information apparatus that uses concepts from behavioral economics. This is a step that could increase compliance.
 5. Take steps to diagnose and physically distance infected persons in order to enable the greatest possible number of employees to return to work – such as ongoing testing and monitoring at places of work, lab tests, cellular surveillance, and protective gear for employees. With the help of these measures, conduct differentiation through testing and enable “life to go on with the coronavirus” and with a suitable health context.
 6. **Population differentiation:** Populations that are more susceptible to the disease and contribute less to the labor market and GDP will be subject to more stringent social distancing and will not return to work places. In contrast, most other employees will return to work in line with Health Ministry guidelines to be defined, thus enabling the economy to continue despite the presence of the coronavirus.
 7. **Rapid mobility of employees:** The unpaid leave model comes at a very high cost to the state and does not provide flexibility for partial work, quick adaptation of employees to available jobs, retired employees, and new employees. For example,

- in a number of sectors there is increased demand for employees, such as the retail and delivery sectors. Employees on unpaid leave should be allowed to work elsewhere, but with the imposition of limits, such as 90 percent of their salary from their original place of employment. In the meantime, the Histadrut should examine whether flexible work arrangements can be established that will reduce the need to put employees on unpaid leave at least in some cases, including a temporary cut to the minimum wage.
8. **Public services:** It must be clear to the public which government and municipal services are operating, with steps taken to ensure that maximum possible service is provided.
 9. **Bank of Israel policy:** We support the steps taken by the Bank of Israel to stabilize the government bond market and the foreign exchange market. Furthermore, the decision to purchase NIS 50 billion of government bonds is important, and there is a need to examine whether the move caused a sufficient decrease in margins on the corporate bond market in order to prevent companies with high ratings from raising debt. At the moment it seems that margins are still high and we recommend weighing the purchase of corporate bond ETFs of companies with high ratings. In our estimate, cutting the interest rate will send a substantial signal as to the willingness of the BoI to maintain low interest rates over a long period. In addition, the steps taken by the BoI to relieve the banks and various borrowers are welcome; however there is a need to consider the possibility that the cost of credit to the banks will be reduced if the capital adequacy rates for loans to small and medium businesses and to households, including mortgages, are adjusted downwards as part of an anti-cyclical supervision policy. This policy was recommended following the 2008 crisis, and this is the right time to adopt it, when the banks' capital is relatively high in comparison to their credit portfolio.
 10. In anticipation of the stabilization of the pandemic, a detailed situational assessment should be undertaken for all sectors of the economy. Concrete plans should be developed to return the economy to routine activity, in accordance with the pace of decline of the epidemic. General plans should be prepared now.

Economic Exit Strategy

The goal is to put the economy back on track at maximum speed, subject to restrictions deriving from public health policy. The exit strategy should be part of decisions made as early as possible, in order to provide maximum certainty to businesses regarding the steps they should take in the next phase. Within the exit framework, health, technological and logistic mechanisms should be set up and the exit strategy implemented gradually while integrating health system measures with economic and social systems. Commencement of implementation on the ground should be subject to medical and economic assessments.

Principal Points of the Strategy

1. Controlled return of most of the workforce via the following means:
 - a. A suitable medical framework backed by extensive testing for employees and their families at their place of employment in order to create confidence and a sense of security for employees and to prevent a renewed rise in the rate of infection.
 - b. Use of technological means, such as those currently employed by Israel, and others. For example, China uses an app that presents an individual's medical condition so that it is possible to see whether people have recovered or have recently been tested and thereby move freely in the public sphere and the labor market without endangering the environment.
 - c. A strategic plan for the use of testing resources should be formulated with a national overall vision that includes considerations of essentiality to the economy. Priority should be given to medical teams and places of employment that are essential to the economy, and in order to enable broad employment.
 - d. The last sector to exit from the lockdown will be the population at risk for severe illness and high mortality, most of whom are not job seekers, and especially at-risk populations whose participation in the labor market is limited, such as persons over the age of 67 and people with pre-existing medical conditions. Schools and other such institutions remain closed.
2. Encouraging employment and increasing growth: During the exit from the crisis, employers' demand for employees may be different than it was before the crisis. There may also be significant friction in the process of matching employees to employers. Therefore, steps should be taken to ease the process:
 - a. Significant reduction of the bureaucracy for business activities, and especially for businesses in the services and trade sectors, which are those that have been hit hardest by the crisis. This should include reducing bureaucracy to set up and expand businesses.
 - b. Continued relief measures, such as deferred tax payments, including company tax and municipal tax, until the end of the year.
 - c. Continuation and expansion of loans for businesses for a number of years.
 - d. Increased budget of the Innovation Authority in order to support the hi-tech sector's exit from the crisis.
 - e. Expansion of professional training mechanisms on the basis of the 2030 Committee recommendations for all unemployed and those entering the labor market.
 - f. Commencement as soon as possible of large scale infrastructure projects supporting growth, in particular the Tel Aviv light rail, public transport

lanes, and so on, in order to balance the decline in the demand from the private sector while encouraging growth in the long term.

3. Debt and the state budget deficit

- a. The state should seek to return to previous ratio levels of debt to GDP. At the present stage we see an increase in the ratio to 75 percent (with a significant margin of error) by the end of 2020. Planning should be for a minimal increase in 2021 and commencement of a downward trend in 2022.
- b. Regarding the deficit, the plan should be that from 2021 the deficit will return to the range that enables the said decline. The goal in 2021 should be a deficit of 4 percent (significant growth is expected after the low levels of 2020) and 2.5 percent in 2022.

Conclusion

Thus far, some 900,000 people have registered as seeking employment (be they unemployed or on paid leave) and it is possible that we will see another wave in April to reach one million job seekers – approximately one quarter of the salaried employees in Israel prior to the crisis. Israel has never experienced a crisis of these proportions (in the global financial crisis of 2008, unemployment in some European countries reached 25 percent).

The Bank of Israel estimates that if the government continues with current measures (i.e., the recommendations outlined here are not implemented and there is no further tightening of the lockdown) the result will be a loss of some NIS 40 billion a month to GDP. The Bank of Israel estimates that in the event of a further tightening of the lockdown, the loss to GDP will increase to NIS 58 billion per month (namely a decline of 50 percent in GDP on a yearly calculation.)⁴

Therefore, the period before Passover should be used to organize for implementation of the measures recommended above. If these measures are adopted, and in particular if relief measures are expanded, the decline in GDP will be reduced to NIS 20 billion per month (as of May) and from mid-June additional relief measures will be possible, thus minimizing damage to the economy with the aim of returning to almost full functioning by August.

We recommend that continuation of the closure be examined on the basis of cost-benefit analysis that takes into account both short and long term economic aspects and narrows the health risks through an appropriate health framework. Implementing the steps proposed above could significantly reduce the costs of the crisis to the state (in relation to the assessments conducted by the Bank of Israel) and maintain social and economic stability, and thus assist in the exit from the crisis.

⁴ Bank of Israel presentation presented to the team on March 24, 2020 (not published)