Generous Wage Compensation & Corona Loans:

Why and How the Swiss State Should Bear Most of the Economic Cost of the Corona Lockdown

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Our economic engine is currently being artificially throttled in the face of the rapidly spreading corona virus. In order to save human lives, we are all temporarily giving up consumption and leisure activities, and many of us are condemned to economic inactivity for an uncertain period of time.

This economic coma state causes enormous private economic costs. Sales collapse in many industries, and the companies affected run short of money to pay wages and other fixed costs.

There is broad agreement that these threatening payment shortfalls should be prevented. Almost daily, the media report calls for ever larger relief funds. What is all too often forgotten is ***the question of why and to what extent it is up to the State to intervene, and how to distribute the money most intelligently so that incentives and externalities are taken into account.*** The speed and the strength of the recovery will depend first and foremost on the efforts and creativity of individuals and entrepreneurs around the country, and it is thus critical to introduce policy schemes that will not only facilitate but also incentivize those efforts. This is what we discuss in this paper.

An important basic principle here is that no one is to blame for the outbreak of the epidemic and that the economic burden should therefore be shared as widely as possible. ***The logic is similar to that of building insurance***: compulsory premiums paid by all property owners insure against negative exogenous events which affect some more than others, through no fault of the victims. The otherwise so important principle of personal responsibility is therefore, exceptionally, less relevant here. And one cannot expect most companies to have insured themselves against such a once-in-a-century event (this is only the third time that Olympic Games cannot be held, and the first time not because of a world war!)

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Compensation of corona costs through the public purse: efficient and fair

Everyone is now looking to the State: it should step in to fill the corona-induced gaps in the accounts and wage payments of the companies that are forced to halt their activity. ***Governments around the world have done the right thing by responding to these calls, for efficiency as well as equity reasons.***

Government compensation of private-sector corona costs is efficient for a number of reasons. In the current exceptional situation, State aid is largely free of the usual negative incentive effects: the epidemic is spreading independently of Swiss economic policy. Moreover, a wave of bankruptcies risks slowing down the economic recovery after the end of the corona crisis significantly. There is thus a negative externality (strain on aggregate recovery and growth) of entrepreneurial decisions (individual bankruptcies) - a textbook example of a situation that calls for corrective public policy. Moreover, it is important to preserve not only productive capacity but also demand for after the lockdown. Consumers and firms burdened by debt are less likely to spend during the recovery. Finally, the state enjoys better credit conditions on international capital markets than private borrowers. A debt burden pooled with the State is thus cheaper for Switzerland as a whole.

From an equity perspective, too, much speaks in favour of a strong commitment by the State. If we leave the economic bridging of the lockdown to individual companies and individuals, those whose livelihoods depend on exposed sectors and who have little financial cushion will be particularly hard hit. However, the industries mainly affected by the corona lockdown - hotels and restaurants, personal services, non-food retail, private media, etc. - are no more or less to blame for the crisis than the industries less affected, such as the public sector or agriculture. Why should the costs be borne by companies that are exposed through no fault of their own? Compensation of the victims by the State also has the advantage that the financial burden is thus borne by the whole of society, with a burden-sharing algorithm called the tax system – transparent and shaped through the democratic decision-making process. If we are serious about broad burden-sharing, then the State is the obviously appropriate source of funding.

Why the public purse should not cover 100 % of the costs

So, while the State should bear the bulk of the corona costs, we do not advocate 100% compensation. The main reason for this is that even in the current exceptional situation, ***certain "moral hazard" incentive problems remain***. For example, a full wage replacement would take away the financial incentive for many workers to look for jobs in sectors that expand during the lockdown, for example in health care or logistics. Companies that could open up new areas of activity during the corona crisis - think of restaurants that could offer home deliveries - would have little incentive to do so. And, looking ahead to when the lockdown will be gradually eased, ***workers able and allowed to return to work should have an incentive to do so***, while their quarantined peers should continue to receive financial support.

The loss of wages caused by the corona lockdown also means more (albeit constrained) leisure time and cost savings (e.g. for external childcare) for the affected workers, which can justify a certain wage cut. ***The Swiss solution via short-time work and income compensation thus seems exemplary to us: up to 80% of the lost wages, fees, salaries, etc. are compensated by the State.***

Financial aid for capital costs is still insufficient

The situation is quite different with regard to the cost of capital (rent, maintenance costs, storage costs, depreciation, interest, etc.). These account for an estimated 40% of the value added by Swiss SMEs.6 So far, only repayable loans have been earmarked for this purpose.7 The implicit public compensation here is therefore very close to zero. This is neither efficient nor fair.

The inefficiency of a pure loan policy is due to the fact that ***a repayable loan equivalent to several weeks' or even months' turnover is likely to be a major burden for many companies.*** Companies with tight margins and thin capital cushions may well be forced to file for bankruptcy in the face of such a debt burden – repayable within a maximum of seven years. This phenomenon would affect an increasing number of companies as the lockdown were to persist. In view of the high external costs of a wave of bankruptcies, zero compensation of the cost of capital is therefore inefficient from a macroeconomic perspective.

The policy under consideration is also questionable from an equity perspective: Why should the owners of affected companies have to bear the loss of income themselves? They are no more or less to blame for the crisis than owners of businesses that happen not to be affected (e.g. food retailers or certain IT companies). ***The insurance logic outlined above therefore also applies to the production factor capital.***

What might a practicable solution look like? Again, efficiency considerations do not speak in favour of 100% public compensation of revenue shortfalls due to the crisis. Companies that still have a certain sales potential during the lockdown should not have an incentive to be completely dependent on the government's drip. In addition, companies that are already ailing should not be kept alive artificially.

An efficient and fair non-repayable compensation of capital costs of affected companies should therefore be in the same percentage range as for wage replacement measures, i.e. up to 80%. The compensation rate could be set higher or lower as the duration of the lockdown increases and depending on how a company is affected. These payments could be initially issued as loans by commercial banks, as is currently the case. ***The difference to the measures so far adopted by the Swiss government would be that such "corona loans" would from the outset be linked not only to a State guarantee but also to a promise that in the future a portion of the loan (up to 80%) would be forgiven and covered by the public purse***. The

[6] Siegenthaler, Michael and Tobias Stucki (2015) Dividing the Pie: Firm-Level Determinants of the Labor Share. *ILR Review*, 68(5), 1157-1194.

[7] Federal ordinance on the granting of credits and solidary guarantees as a consequence of the coronavirus (COVID 19 Ordinance on solidary guarantees) " of 25 March 2020.

precise discount would be determined after the crisis, depending on the duration of the lockdown, on the severity of the impact on different sectors, and on individual companies' cost structure. There would be sufficient time for such an examination after the crisis (as opposed to immediately, before granting any bridging loans).

Student loans as a model?

An intermediate form between the fully repayable loans currently planned and ex post non-repayable grants would be ***loans that could only be repaid if business were to be profitable in the future*** - comparable to student loans in in the U.K. or U.S., which must be paid off by graduates in later life only if they earn sufficiently high incomes.

Such conditionally repayable loans would probably considerably reduce the risk of bankruptcy compared with the simple loans currently on offer. However, it could still appear unfair that companies in lockdown-affected industries would have to concede medium-term profit losses, from which unaffected companies would be completely spared. It would also be important that the repayments would not eat away the entire profit, as otherwise incentives for innovation would be impaired.

Profit-related conditionally repayable loans seem particularly appropriate for firms in sectors with relatively low competitive intensity and thus high profit margins. Despite all the theoretical arguments in favour of equal treatment, State aid to companies that pay out large profits and bonuses in subsequent years would be politically difficult to justify.

The situation is similar for companies operating in sectors where global risks are a permanent threat and should therefore also be factored into their profit margins. This is the case, for example, in the aviation and travel industries, where events such as 9/11, the subprime crisis, Icelandic volcanoes, SARS, etc. imply temporary losses, and should thus be to some extent priced in. However, as the impact and extent of the corona pandemic was hardly foreseeable, a certain amount of government support also seems justified for these sectors.

What could a practicable rule for "corona loans" look like? Non-repayable grants could be reserved for those sectors that cannot, or only to a very limited extent, make up for lost revenue during the lockdown by deferred demand - think of the catering, personal services or florists. Other sectors, such as furniture stores or construction companies, have greater potential to catch up on lost sales after the crisis, which means that profit-driven or even fully repayable loans could make more sense there. It would be important to develop and publish such sector-specific criteria as quickly as possible in order to keep the financial uncertainty of the borrowing companies to a minimum. The interest rate on such loans could be that currently applied to the existing fully repayable government-backed bridging loans, i.e. 0% for loans up to CHF 500,000 and 0.5% for larger loans.

Whatever it takes

For reasons of both efficiency and fairness, we therefore recommend generous State compensation for the shortfalls in sales resulting from the lockdown. How large should the total amount of these compensation payments be? In the famous words of Mario Draghi: “Whatever it takes”. ***Switzerland has an internationally enviably low level of government debt, which is currently paying negative interest. Even an expansion of the federal debt by a three-digit billion amount would not put our public finances under serious strain.*** Moreover, it is more efficient, more democratic and fairer to manage corona debt through the federal budget than to have the virus randomly allocate the economic burden across private-sector workers and firms.