Triodos Bank

The Corona Crisis

Some reflections by Kees Vendrik, 10 April 2020

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The outbreak of the COVID-19 virus in many countries around the globe is impacting societies profoundly. In the past few weeks, governments have proclaimed different restrictive measures from social distancing to an overall lockdown of social and economic activities with the aim – at least - to slow down the speed of spread of the virus. These containment policies are ultimately intended to avoid sudden and uncontrollable increases in the number of sick people and the demand for (intensive) care for people with frail health, which cannot be matched with adequate supply. Nobody knows if and to what extent these policies will be successful soon. A vital question is what level and intensity of social isolation is now requested: a total lockdown or a differentiated approach. Governments are setting policies almost daily.

In China and a few Asian countries like South Korea restrictive measures have been softened, enabling people and business to resume activities. These countries are an exception. In many countries public life as we know it has come to a standstill, with empty streets, trains and offices, closed shops and schools and social life that is increasingly taking place via digital channels. It feels like a 'Sunday-morning economy'. As the OECD recently said: 'These shocks bring a double whammy: a halt in production in affected countries, hitting supply chains across the world, and a steep drop in consumption together with a collapse in confidence.'

Indeed, global value chains of many manufactured goods have been instantly disrupted. Sectors like transport, hospitality, leisure, retail, culture and parts of agriculture face a sudden loss in turnover because of lockdown measures. This in turn leads to lay offs and stress among the flexible workforce and self-employed – as usual the first ones to experience the effects of economic relapse – attributing to lower aggregate demand and economic stand still. Equity markets are in a state of manic depression. Initially they plunged and showed very significant declines, expressing fear about future returns and economic prospects. Two weeks ago, a remarkable recovery took place at the stock exchanges, responding to government action, especially the two trillion programme adopted by Trump and the US Congress and the Pandemic Emergency Purchase Programme (PEPP) by the European Central Bank (ECB). This will probably be a temporary recovery. Valuations of companies as well as credit ratings are expected to go down. In many countries 20-40% of the economic activity is now locked and out of business. For 2020, an economic recession in many countries is the most likely scenario. An economic decline of 5-10% GDP might not be imaginary for many countries. Of course, the longer governments will see themselves forced to stick to restrictive corona policies, the more severe and longstanding negative economic effects will be.

Fragile systems, fragmented world

The corona crisis exposes structural weaknesses in the contemporary global social economic system. Although the world community embraced the global Sustainable Development Goals agenda in 2015, we are still far from meeting these global targets today. Climate change, global loss of biodiversity and deforestation fundamentally change the global ecosystem, enabling the wide spread of viruses in new environments. Globally, millions of citizens lack access to basic needs, including care. Many countries struggle with deep divisions, social exclusion and inequalities of income and wealth. This matters for how the crisis will unfold, as some people will be hit more severely than others or lack the resources to cope with the consequences.

National health systems are tested rigorously and, in some countries, might be inadequate to deliver the necessary care for all citizens in need. More than once, the World Health Organization (WHO) have expressed serious concerns about this. As Italy shows, it is not yet certain for rich OECD countries whether the current health systems are fit for the job, let alone what might happen in emerging markets or the least developed countries. The people that will be worst off are probably the millions of people in war zones like Syria, Yemen, refugee camps and places like Lesbos, where healthcare facilities are broken or almost non-existent. It will require significant global action and aid to avert the Dante's inferno there.

The quality and accessibility of healthcare systems and the overall management of the crisis are closely related to the general functioning of public systems and institutions. Three decades of free market thinking has been at the expense of strong and effective public organisations. It's remarkable that now the public workers turn out to be essential for society during this crisis. The populist governments in the USA, Brazil and Australia are not equipped to properly handle this kind of crisis. Their usual political agenda of fear, denial and exclusion is at odds with the type of public policy and strategy that is required now: a credible government that can operate quickly and effectively and can successfully appeal to public solidarity. Communities and a variety of social initiatives, supported by social enterprises, will probably be vital in many countries to contain the effects of the outbreak and soften the immediate consequences. Indeed, many remarkable and innovative initiatives take place spontaneously, which are proof of vibrant and initiative-oriented communities.

The outbreak has caused immediate and unavoidable economic pain. The disruptive effects are accelerated by characteristics of the current global economic system. Large parts of industrial production operate in global value chains and networks of finely tuned patterns of demand and supply. In many sectors, from cars to mobile phones, stocks of materials and goods are preferred not to be held or at minimum size for cost reasons. Since accession to the WTO in 2001, the Chinese economy has come to play a significant role in this global network economy, as 'the factory of the world'. The original corona outbreak in December in Wuhan and subsequent local measures already caused significant and immediate interruptions in global supply of semi-manufactured goods and the operation of assembly production. India has recently announced a lockdown. The situation in the USA is getting out of control. This will cause additional disruptive effects globally.

Another issue of concern is current high levels of private (households and business) and public debt. Although governments intended to control the rise of indebtedness after the 2008 financial crisis - especially in the EU where the mix of debt and equity in the economy should be changed - available data tell otherwise: global public and private debt has risen from USD 173 trillion 2008 to USD 250 trillion a decade after the financial crisis. The most indebted countries are the richer ones, indicating that financialization of the economy has intensified. The risks of economic shocks transferring into financial destabilisation or a 'financial pandemic' have grown.

Yuval Noah Harari recently wrote in the Financial Times: 'In this time of crisis, we face two particularly important choices. The first is between totalitarian surveillance and citizen empowerment. The second is between nationalist isolation and global solidarity.' Many global institutions, like the WHO, IMF and the World Bank, are important vehicles of international cooperation and have come up with analyses, plans and proposals to tackle the corona crisis. In the previous world order international cooperation was steered and supported by the United States. Not so this time, as the current president is only interested in his own country. Global cooperation, collective financial support for the worst hit people and countries, a common approach to this health crisis, free exchange of knowledge and patents, and global solidarity will require others, like the European Union, to show leadership. Time will tell if that will be the case. For now, it seems solidarity is revived within but not between countries.

Impressive policy response

Many governments and central banks have announced firm policy responses. Governments interventions consist of a threefold policy agenda, with direct expenditures in the order of magnitude of 1-4% GDP and public guarantees of private loans and investments of a larger size.

In the first place, in many countries authorities focus on direct income support for suddenly unemployed people. To that end existing social benefits schemes are used and opened for part time unemployment benefits and, if necessary, modified for (extra) support for flex workers and self-employed out of business, especially in sectors directly affected by mandatory closure by order of the government. Secondly, governments try to address emerging liquidity problems, by offering deferral of tax payments and freezing/abolition of tax fines and recovery interest rates to entrepreneurs and business organisations. Public guarantee schemes are set up or expanded for business and specific sectors like agriculture, to facilitate access to additional private finance meeting liquidity issues. In some countries, governments have decided to support companies affected by an acute drop in demand, such as airlines, with public money. Other governments are considering similar plans. Finally, many governments have created extra budgetary space for healthcare expenditures and additional emergency measures.

Central banks have been equally active with a range of interventions in recent days and weeks. Interest/credit rates have been cut, especially by the Federal Reserve (Fed) in the US. Capital requirements (for example for systemic banks) have been softened. Both the Fed and ECB launched new assets purchase programmes. Head of the ECB Lagarde echoed the famous phrase of her predecessor, saying 'we will do everything necessary within our mandate to help the euro area through this crisis, because the ECB is at the service of the European people'. In case of the ECB, the restrictions of purchasing programmes of sovereign bods have been lifted. That implies that the ECB can intervene in a more political way to 'manage the yield curve'.

The memory of the euro crisis of 2011-12 is still fresh. Many EU governments might face higher interest rates, as the recent fiscal response to the corona crisis evidently creates (higher) deficits in the near future. The inevitable economic downturn this year will also negatively impact the state of public finances in many countries. Recently, the spreads in the bond markets recently increased, in response to previous remarks from Lagarde, suggesting the ECB might have adopted a different position on controlling the spread (the difference between the German bond interest and other sovereign bonds). The latest additional ECB intervention has cleared the air: Frankfurt stands ready to intervene and safeguard countries like Italy from unfeasible refinancing costs of state debt.

The European Commission has launched the Corona Response Investments Initiative, which basically unlocks existing ESI funds in the short term to be spent by member states for corona related projects. Funding via the European Investment Bank has been enlarged. The regular commitment of eurozone states to gradually improve the structural fiscal position will no longer apply in these extraordinary times. The European Commission and the European Council of Ministers of Finance have decided that any one-off budgetary spending responding to the outbreak is excluded from the computation of the structural balance.

This package of monetary and fiscal policies will, at least partially, avert the worst of the economic effect of restrictive policies following the outbreak. It's pretty remarkable how quickly governments and central banks have decided to act, without much public discussion and with significant support from parliaments. The scale of the interventions is also striking. One would like just a small part of this kind of action and urgency to be employed when facing (other) planetary emergencies.

Unfinished business in the eurozone

This quick response from governments and central banks shows a mixture of urgency and experience. People's health has always been, and rightly so, top priority in politics and public administration. And the crisis of 2008 has provided authorities with recent experience and a richly filled manual on how to deal with the type of economic disruption we face today. Will it be enough?

Of course, the million-dollar question is how long the restrictive corona measures should be maintained. For sure, the economy has been hit, and the scale of the economic damage risks being larger than in 2008, because large parts of the real economy are impacted now. The quick response of governments and central banks will soften the immediate effects. As time goes by, the chance increases that a significant part of private businesses will, despite government and liquidity support, become insolvent because of long lasting loss of demand or persistent production restrictions; unemployment will rise substantially, fiscal balances will deteriorate and banks, especially the weaker ones, will enter the danger zone. We don't know whether the current steep decline in output will be followed by a quick recovery. It is possible that the recession will drag on for a number of years.

Then, as in 2010-2011, the resilience of the eurozone may be tested again. The fiscal position of some governments – like Germany and the Netherlands - is better than at the beginning of the previous decade and now allows significant additional government spending in order to support the economy. The sovereign debt ratio of these countries is below or around 60% GDP, the current ceiling of the EU Stability and Growth Pact. Others, most notably Italy, are worse off, with a national debt of about 130% GDP. Capital markets are now getting ready for a significant demand for funding of the emergency packages announced by governments.

In mid-March, the ECB announced the PEPP of EUR 750 billion, an attempt to prevent the heavily indebted countries in the eurozone from rapidly rising bond interest rates. Access to additional capital at affordable rates will be key to meeting the financing needs of more vulnerable member states struggling with the corona outbreak. Frankly, this should not be in the hands of the ECB but, first and foremost, requires political decisions and leadership. Here the picture becomes hazy.

It's unclear whether the European countries will agree on deploying the European Stability Mechanism (ESM), the originally EUR 700 billion fund (EUR 430 million currently available), which was set up and used in the aftermath of the euro crisis (for Greece, Cyprus and the Spanish banks). At first glance it makes sense to use the ESM, which has been set up for times of crisis. But complications arise here. The ESM was originally designed for 'asymmetrical shocks' afflicting one specific country and thereby not intended to respond to the type of crisis we witness today, hitting the entire eurozone economy. Moreover, all eurozone countries must agree to share the risk in case of extra funding via the ESM, which is basically a political decision of eurozone states about solidarity. Another problem concerns the likely conditions to get access to the ESM, which in the past were known to be pretty harsh. Without adaptation, countries will again have to adopt the type of austerity policies that have met significant social resistance during the years of the euro crisis and attributed to the rise of populism. Looking back, many agree that these policies have been socially unacceptable and economically unwise. Are these times different?

Maybe. During the euro crisis different options were tabled to tackle the then urgent sovereign debt crisis. One such option concerned the introduction of Eurobonds, but this idea was never carried out. It's now back and called 'corona bonds'. These bonds, to be issued by the eurozone member states collectively, could raise funding for public needs. Backed by all governments these bonds can serve as a sign of firmness, solidarity and burden sharing. Not surprisingly, this is, again, the subject of controversy. Twenty-nine years after signing the Maastricht treaty that created the euro, the eurozone leadership has yet to establish the common answer to fundamental questions of, and limits to, explicit transfers and solidarity within the currency zone. History might repeat itself. The people of the EU will most likely be involved in a political struggle to define the basic foundations and institutions of the euro project, while the crisis is knocking on the door.

If more credit is not the solution

Eurobonds and PEPP are options to facilitate access for eurozone governments to fund state debt at reasonable rates. Ultimately, it remains credit, adding to current high levels of (public) debt. The question arises whether increasing levels of debt are sustainable in the long run. The past decade's lower interest rates masked the direct economic effects of rising debt globally. Are we walking into a dead-end street here? Wolfgang Munchau, commentator in the Financial Times, is pretty clear: 'What is often oversold as a bazooka tends to come with awkward conditions in the small print. Much of the money is credit, not grants. (...) What the eurozone needs is cash, not credit.' As the initial policy response will ultimately add to the growing stock of debt in the global economy, even more credit might not be the solution. Given the probable size of the current decline and its aftermath, it's not easy to see whether a policy response based on credit can be sustainable in the longer term.

Here, another proposal from the time of the euro crisis is interesting. The adoption of 'unconventional monetary policy' (QE, or quantitative easing, putting extra cash into circulation via the financial sector by purchasing public and private bonds from the secondary market) by central banks around the world, has provoked alternative ideas about 'QE for the people'. These proposals include central banks directly financing newly issued state (or even corporate) debt or introducing 'helicopter money' to be handed over directly to citizens. One of the disadvantages of QE, as it was put into practice by the central banks since the financial crisis, was the advantage given to the financial industry. This included the steady rise of prices of financial assets and real estate, adding to existing inequality of wealth and locking major cities for lower income groups. Another point of critique was the implicit support by QE of fossil business, complicating the transition to a zero-emission economy, as the prevailing principle of 'market-neutrality' of QE led to the substantial purchase of corporate bonds of companies with a high carbon footprint, which can be considered as another implicit fossil subsidy.

In previous years the economic recovery has been facilitated mainly by cheap credit. Today, it's hard to imagine whether loads of additional credit on top of the current stock leads to a sustainable outcome, without returning to the austerity economics authorities attempt to prevent today. Even lower interest rates are likewise probably not feasible nor effective. QE for the people, a direct transfer of money to the people is an interesting way out here.

Supposing cash is king now, society and business could decide to operate in 'chains of solidarity'. Like the tax deferrals announced in many countries, enterprises with enough cash can do good by paying bills tomorrow instead of waiting until the end of the regular limit of 30 days. Why shouldn't landlords in possession of enough liquidity help tenants with postponement of the monthly rent? What about well-to-do citizens who bought a ticket for Bach's St Matthew Passion? Leave the money with the orchestras affected, without compensation if one can afford it. What will major clothing brands do with orders already placed in the Indian textile sector, now this sector cannot deliver due to the lockdown in India? Governments can also consider introducing a temporary 'corona tax', to shift money from the wealthy and business unaffected by the crisis to those parts of the economy that require support in cash now.

Avoid the 'doom loop'

And Big Finance? The European banking industry, which together with Wall Street, was the great pacemaker in the previous crisis, is in a different shape overall. Better capitalised, under stricter supervision and with improved risk management. As announced recently, the Dutch banking sector (including Triodos Bank) now promises a suspension of regular payment of interest and repayments for six months to benefit SMEs. This will add oxygen to the economic cycle and help business and economic communities to get through the crisis.

Although the banking sector has improved the soundness of its balance sheets, it's far from certain if this applies to all banks in Europe, and that matters a lot. The European economy still depends to a large degree on banking finance. Economic decline directly impacts the sanity of banks. The existence of weak or zombie banks in some countries might trigger the shortcomings in the current depository insurance schemes and the existing EU regime for resolution of failed banks. Ultimately, despite original intentions to come up with real European solutions, today, these emergency systems rest mainly on the shoulders of national authorities. In case of banking crises, to a large extent it's up to national authorities to put extra money on the table. That's problematic because this a recipe for repetition of the 'doom loop' – the deadly embrace between failed banks and weak states – that at the time deepened the euro crisis. The launch of the Single Supervisory Mechanism, the European supervision of the largest EU banks from 2014 is part of the answer, but more is needed.

The financial crisis of 2008 was initially addressed by a massive bailout programme funded by the taxpayers. This was a clear 'breach of contract' that created bad blood with many voters. Market economy rules had told the people for years that ultimately one's business goes bankrupt in case of failure. Not so for Big Finance, as it turned out. Although these interventions were inevitable to prevent a financial melt-down, this bailout lacked public legitimacy. Private gains and socialised losses appeared to be a toxic cocktail, which created momentum for populist parties in many countries. Building on this lesson, Robert Reich, former US Secretary of Labor, recently said: 'Bail out people, not corporations.' That requires an intelligent design of the public support programmes that are deployed now. For example, the new EU agenda for the Green Deal also offers leads for a support programme that includes the necessary transition to a net zero emission economy. The vital question will be which part of the economy do we take into the future.

Fear and altruism

The inevitable corona outbreak response has dramatically changed the perspectives of many citizens and entrepreneurs in a short period of time. Economic uncertainty and sometimes despair are widespread, and social life flourishes via the internet. Fear and altruism are everywhere.

The dominant neo-liberal approach that ruled mainstream policies and business operations for decades - built on the human image of the selfish 'homo economicus' - increasingly makes way for another view that emphasises the importance of public institutions and collective action and underlines the responsibility of all. Many public responses to the outbreak indicate that we now need people to behave in accordance with 'homo empathicus', people fully aware of public needs, the importance of communities and shared responsibility. It looks like many have eagerly waited for a different public conversation and atmosphere, in real life and on social media, in which other values are dominant. The recent statements of public support, like applause for healthcare workers, are an example of this, so are the entrepreneurs and economic communities that have started to produce face masks and respiratory equipment.

Yes, there is also fear that incentivises people to go out, hoard and leave supermarkets with empty shelves. Although very undesirable, it's understandable that some people behave in this way, because they – like us all – have no clear picture of the future.

It will matter a lot how we all respond to this crisis. The forces for good in communities of citizens, social enterprises and business, non-governmental organisations and sustainability networks can make a difference, offering alternative solutions to the politics of fear and exclusion.

Today, many try to cope with the immediate impact on everyday life of social distancing, being out of business and unemployed, with loved ones in hospital fighting for their lives, taking care of the kids and figuring out how to be a part-time teacher with no schools open, trying to apply emergency bandages to support the vulnerable ones and elderly nearby and in families, and becoming experts in the technology of webcast meetings and conversations.

The initial response of many is the desire to go back to normal as quick as possible and regard the corona crisis as an inconvenient but short interruption. That's probably not what lies in front of us. With a quick and probably huge recession on its way, our health systems being tested to the limit and governments exercising huge control of public life, these times will be different.

Change and transition

Otto Scharmer (MIT) wrote recently: "What if we used this disruption as an opportunity to let go of everything that isn't essential in our life, in our work, and in our institutional routines? How might we reimagine how we live and work together?"

We all do our best to be open to new perspectives and invite others to do the same. Triodos Bank is part of a large community of frontrunners promoting the transition to a sustainable and inclusive economy and society. The ambitious and extensive agenda this community of change bears is full of proposals that come in handy in these times, using the new momentum for strong and resilient communities and economies.

Today, naturally, everybody is busy with dealing with the immediate effects of the crisis, in hospitals, local communities and the broader economy. Tomorrow, let's see this crisis as a wake-up call for all.

It's time for a *reset* of the current economic system. The corona outbreak is a terrible event. But the global ecological degradation seems to be a fertile ground for this type of outbreak. The present crisis also shows the great vulnerability of our global economic system, excluding many people lacking resources and social protection. After all, its bad economics: the current costs in human, social and monetary terms should make everybody think. History shows it may take two crises to change. Maybe we have now arrived.

Let's *resist* the attempts, already visible, to postpone the climate and food transitions or to put improving social inclusion and reducing inequality on the waiting list. Let's *reject* actions of fear, blame, egoism and nationalism by offering tangible initiatives of cooperation, solidarity and humanity. The community we've served for the last 40 years has a lot to offer here.

National and international *recovery* plans should build on agendas like the European Green Deal, the *redesign* of the current food and agricultural system, to *reconnect* finance and real economy, and be based on markets steered by true prices and circular regulation, smart public investment plans and greening of tax systems, grants, financial regulation and trade regimes.

It's time to move beyond economic growth as the holy grail of economic progress. We need to *rebalance* social, ecological and economic values to ensure the promotion of broad welfare and inclusion. Let's *revalue* the ecosystems on which all human activity depends and start building a *regenerative* economy that respects planetary boundaries and restores the huge damage done in the past decades. The *resilient* economy of the future is based on stakeholder business models being the leading model of economic development, respecting mutual dependence in good and bad times and being connected to the communities they serve.

Let's use our heart, head and hands together.

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