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Capital in the Corona Crisis*

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The shutdown of entire industries during the corona crisis represents a completely new and huge challenge for economic policy. Particular attention is being paid to limiting the loss of income for people affected by unemployment and to ensuring the existence of businesses affected by closures and demand shortfalls. So far, the Federal Government of Germany has responded to these challenges with rapid and comprehensive measures. In particular, the aid programs for companies, which consist of tax reliefs and government-backed emergency loans, are designed to mitigate liquidity shortfalls and to prevent insolvencies. These programs are supplemented by direct transfers to smaller companies and self-employed workers.

In the current situation, these unconventional measures are appropriate and urgently needed. As in "normal" recessions, companies are free to adjust their labor and capital inputs. However, such adjustments are costly: If, for example, workers are laid off, new workers will have to be recruited and trained after the end of the crisis. Such costs can be avoided, or at least reduced, by cutting working hours or resorting to temporary layoffs, and this is precisely why the provisions of short-time work schemes are currently being loosened in Germany.

Capital liquidations must be avoided

More problematic, however, are the adjustments of the capital stock, i.e. buildings, equipment, and machinery. The only options here are to either sell or rent out parts of the capital, or to liquidate the entire company. Again, the following applies: In normal times, these transactions are quite usual and, in some cases, desirable reactions to firm-specific or aggregate shocks.

During the corona crisis, however, such capital adjustments are to be avoided for good reasons: First, the decline in production is necessary for health reasons. As a result, there are currently no markets on which, for example, the facilities of hotels, restaurants or fitness centers could be sold at adequate

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prices or on which commercial premises in the shopping district could be rented out. Second, the shock is temporary which means that the very same capital will be needed in exactly the same places after the crisis.

Therefore, de- and reinstallations of physical capital, in the case of business closures even linked with losses of firm-specific human capital, are completely inefficient and hence must be avoided. References to the "cleansing effect" of recessions, as recently put forward by Robert Holzmann, Governor of the Austrian National Bank, are for this reason misplaced. Similarly, the concerns expressed by some economists that the government would keep so-called "zombie firms" alive through its liquidity programs are misleading.

The current aid programs are important to enable companies with high revenue losses to pay their ongoing capital costs and to resume operations immediately after the lockdown. However, they have one serious drawback that will become the more relevant the longer the shutdown lasts: If companies make use of the emergency loans, they will be burdened with a large amount of debt at the end of the crisis. In the best case, this debt can be paid off over the next years, but hinders future investments. In worse cases, insolvencies are only postponed and the debt will have to be assumed by the government. The fear of high debt will already deter some companies from using the emergency loans in the first place, which will then result in undesirable liquidations. Direct transfers to companies are also limited in scope and will only be able to cover the ongoing cost of capital for a very short time.

The instrument of "temporary capital layoffs"

For this reason, I would like to argue for a new policy instrument that is only intended for this particular crisis, which could be labeled "temporary capital layoffs". By analogy with temporary layoffs of workers, companies should be allowed to close down their capital provided by rent or lease, as far as it cannot be used due to state-ordered closures, and they should be exempted from payments to the capital owners in proportion to their revenue losses. In line with short-time work schemes, the government could step in to support capital owners, e.g. the landlords of commercial real estate, if they get into economic difficulties due to the implied losses of capital income.

The use of this instrument should be restricted to those companies that verifiably suffer from massive revenue losses because of the corona crisis and it must be limited to the period of the lockdown. For instance, a large clothing retailer that continues to generate sufficient sales online may not be eligible. The instrument would help smaller companies, though, which have no other options to make up for their revenue losses.

The main advantage of temporary capital layoffs is that the costs arising from the corona crisis are already shared more widely ex-ante. It is difficult to justify that only the tenants of commercial property should bear the risk of the corona crisis, which is clearly not a normal business risk, while the landlords are fully relieved through the aid programs and, in the end, by the taxpayer. In fact, the capital owners benefit directly from these liquidity programs which enable businesses to remain solvent. In the absence of these programs, capital owners might even be willing to make payment concessions in order to keep the businesses alive.

As a consequence of immediate cost-sharing with capital owners, the total amount of debt, which either the government or the companies affected by the lockdown have to take on, is reduced. It could be argued that capital owners should be spared during the crisis, for example, to avoid possible distortions on capital or real estate markets. Instead, in the coming years, they could contribute to a larger share of public debt repayments via higher capital or wealth taxes. While this might be a viable option, it is unclear whether such tax increases would be politically feasible when the crisis is over.

A limited and one-time waiver – no expropriation

The instrument of temporary capital layoffs would imply a substantial interference in existing contracts and would, therefore, need to be legally reviewed. But everyone in Germany knows (or at least should know) Article 14 of the German Constitution (Grundgesetz), which lays down the obligation of property for the common good. The proposal outlined here does not aim at expropriation, but rather at a very limited and one-time waiver of capital income, to preserve the productive potential of the economy, and to keep the long-term economic damage as small as possible.