Comments on Prof. Eckstein’s Presentation

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Responding to the economics crisis

- Larry Summers argues that the COVID crisis is costing the U.S. economy about $80 billion a week.

- Israel’s economy is about 2.5% as large as the U.S.

- So as a rough guess Israel is losing $0.025 \times 80\text{ billion} = 0.2 \text{ billion a week}.$

- The economic crisis won’t end until the health crisis ends.

- Almost any feasible investment that we make in measures to deal with the health crisis is worth it.
10 Year Bond Spreads

2015m5 2016m5 2017m5 2018m5 2019m5 2020m5
USA DEU

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Bond markets could be wrong

- How should we think about debt sustainability?

- Standard framework:
  - Compare growth rate of economy \((g)\) with real (natural) interest rate that the government can borrow at real \((r^*)\).

- Debt/GDP is stable
  \[ g > r^* \]

- Debt/GDP explodes if
  \[ g < r^* \]
Stability of debt/GDP

- $r^*$ has been falling across the world for a long time

- Consensus estimate for the U.S. is about 0.5%
  - For Israel let's suppose it's about 1%.

- What's the real growth of the Israeli economy:
  - Before the COVID crisis, $g^{Israel}$ clearly exceeded 3%

- So how much room do we have in terms of the deficit?
  - Summers: interest rate on government debt goes up 2-4 basis points per percentage point of debt/GDP.
Stability of debt/GDP

- Israel has lots of room to increase the deficit if sustainability is the key issue.

- But if we incur a persistent increase in the deficit it needs to be for reasons that makes $g$ as high possible.

- Zvika focused on new reforms that would raise $g$ compared to pre-COVID crisis.

- Equally critical: make sure the COVID crisis make sure $g$ doesn’t fall it’s pre-COVID level.

- Invest in programs that preserve human capital and productive firms allowing for sectoral re-allocation.
On building a bridge over the COVID crisis

- The bridge is expensive but has a very high social rate of return.
  - Because of its past fiscal responsibility, Israel has the capacity to build the bridge.

- Which risk do you want to take: building the bridge too short or too far?