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Government support and the COVID-19 pandemic

The economic consequences of the COVID-19 pandemic call for urgent policy responses to support households and firms alike, but how this support is designed will be critical in ensuring that it does not result in enduring global market distortions.

Support packages that are time-limited, targeted, cash-based, and consistent with longer-term objectives are the basis for ensuring a sustainable recovery.

Transparency of support packages is critical for public trust, but also once the crisis is over in order to foster accountability and enable governments to learn from what worked best.

There is a critical need for government support for vulnerable individuals and firms

The economic consequences of the COVID-19 pandemic call for urgent policy responses to keep the economy afloat and enable people to retain their jobs and incomes. Most of the measures envisaged at present are macroeconomic in nature, focussing largely on the provision of emergency liquidity by central banks. Fiscal measures that have been announced at this stage include broad-based tax relief (e.g. VAT reductions and deferred payroll charges), wage subsidies, unemployment benefits, the deferment of utility bills and rent payments, mortgage relief, lump-sum payments to households (i.e. so-called 'helicopter money'), loans and loan guarantees to businesses, as well as equity investments by governments in distressed companies.

These measures all proceed from the urgent need to prevent a catastrophic economic collapse that would have dire human, social, and health consequences. While the trade impact of these measures may not be a prime concern of governments at present, experience from the crisis of 2008-09 suggests that poorly designed stimulus packages can have negative, long-lasting consequences for global trade and national

welfare. Although there is an urgent need to deploy measures quickly, **care should also be taken to ensure that today's stimulus does not sow the seeds of enduring trade distortions**, including excess capacity, by relying excessively on "beggar-thy-neighbour" industrial investment, support that results in windfall gains for particular firms, and duplicative infrastructure projects. Emphasis could more effectively be placed on **measures that benefit smaller businesses**, including those operating in services sectors, as well as on investments in **strengthening broader healthcare and social safety nets** from which everyone benefits to kick-start final demand after the immediate crisis, reduce excess savings, and rebalance the global economy.[1]

Support is most beneficial when it is transparent, time-limited, proportionate, and non-discriminatory

One way to ensure that necessary economic stimulus does not end up distorting trade and global competition is by making support measures **time-limited**, e.g. through sunset clauses or other similar mechanisms.[2] This will help mitigate the risk that temporary support becomes entrenched and outlives its purpose

Another is to favour measures that are **targeted** at those companies and sectors that experience the most disruption as a direct result of the pandemic, with a view to avoiding windfall benefits or rescuing firms that would also have failed absent the pandemic.[3] This will help minimise the risk that stimulus spawns a new cohort of corporate zombies or national champions that could restrict competition, dampen domestic productivity growth, distort international markets, and impede the economic recovery and, in some cases, aggravate economic disparities.

Who gets support also matters for trade. On the demand side, governments should favour, where possible, **measures that benefit final consumers directly and leave them free to decide how to spend the cash they receive**. This is in contrast to measures that tie support to the consumption of specific goods or services (e.g. fossil-fuel subsidies or subsidised purchases of locally made products), which can distort relative prices, send inaccurate signals to producers, and reduce consumer choice. In terms of support to firms, much depends on how large and trade-exposed recipient companies are, and whether they are part of complex supply-chain networks. **Support for MSMEs** – which are generally least able to cope with large economic shocks – is unlikely to distort global trade very much, while offering the biggest "bang for the buck" in terms of employment and social stability.[4] This is in contrast to stimulus tools that put large domestic producers (and state champions in particular) at a competitive advantage over domestic and foreign competitors, which benefit the few at the cost of the many and lead to longer term distortions.

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[1] Some large stimulus packages in 2008-09 may have partly fed industrial excess capacity and could have been directed towards strengthening social safety nets and boosting consumption. See, for example, www.imf.org/external/np/g20/pdf/2019/060519b.pdf (accessed 26 March 2020).

[2] For instance, the EU Temporary Framework for State aid measures, which facilitates member states' support for firms affected by the coronavirus crisis, runs out, unless decided otherwise, end of December 2020. See https://ec.europa.eu/competition/state_aid/what_is_new/sa_covid19_temporary-framework.pdf.

[3] The expectation of a bailout for failing firms might lead to moral-hazard problems. This concern could be mitigated if it is made clear that support only targets those companies that are experiencing difficulties directly tied to the effective shutdown of whole economies in the pandemic context. Germany's state-owned bank KfW, for instance, guarantees loans up to 90% for companies which were financially sound before 31 December 2019, meaning they were, among other things, not an 'undertaking in difficulty' according to EU regulation No. 651/2014, had no unsettled payment arrears of more than 30 days and no deferment agreements or covenant breaches. See www.kfw.de/PDF/Download-Center/Förderprogramme-(Inlandsförderung)/PDF-Dokumente/6000004517_F_Ergänzende_Angaben_Coronahilfen.pdf (in German; accessed on 1 April 2020

[4] The *OECD SME and Entrepreneurship Outlook 2019* notes that "[a]cross the OECD, SMEs account for 99% of all businesses and between 50% and 60% of value added. Almost one person out of three is employed in a micro firm with less than ten employees and two out of three in an SME".

Lastly, policies need to apply objective, transparent criteria for determining firms' eligibility – in particular, **to distinguish between transitory liquidity problems at which assistance should be targeted and existing structural issues in relation to corporate solvency or performance.**

Governments could reap additional benefits **by aiming for support measures that achieve "double dividends"** and help ensure that **longer-term policy objectives** are not sacrificed for short term economic stimulus. Climate change remains a concern even as countries struggle to contain the COVID-19 pandemic and its economic and social consequences. To the extent possible, efforts should be made to align stimulus measures with climate and environmental objectives more widely, or at a minimum ensure that such measures do not compound or exacerbate existing problems. More broadly, support for businesses could contribute to **sustaining innovation efforts and existing productive capacity** at a time when depressed activity might lead many companies to cut into their spending on R&D and staff training. This can help minimise the damage that short-term shocks could impose on long-term growth potential (a phenomenon known as "hysteresis").

Support provided through the financial system will play a critical role, but needs particular scrutiny

Many of the policy responses announced to date appear to include the **provision of financing on preferential terms** – partly because such support **can be deployed and utilised by recipients faster** than budgetary instruments such as grants and tax concessions. This can involve, for instance, bridging loans to businesses by public investment banks and government agencies, government equity injections, or government loan guarantees. A key difference with the financial crisis of 2008-09 is, however, that emergency financing by governments will likely affect a larger share of economic activity, with non-financial corporations (e.g. airlines, manufacturers, and utilities) benefitting more than their financial counterparts. This has greater implications in terms of when and how to roll these programmes back.

In addition to the immediacy of direct public financing, **governments may need to step in due to ensuing market conditions**. Crisis conditions can dramatically reduce the availability of private finance. Heightened economic uncertainty may push banks to be more selective in their investment decisions or to charge unusually high margins to now risky borrowers. This may starve firms of financing when it is needed most, especially MSMEs that do not have enough cash on hand. Government intervention is essential to fill in the gaps left by private financial institutions, but care should nevertheless be exercised to **ensure that idiosyncratic, firm-specific credit risks are distinguished from the more systemic risks that stem from the crisis.** This is important to prevent too much capital from being misallocated.

Governments may also have to invest in firms directly in crisis times, with several having already announced their willingness to inject equity in struggling companies should it be required. **Governments have also raised the possibility for states to acquire shares in companies they rescue** as a way of fostering accountability, sharing in the financial downsides and upsides equally, or as protection against foreign takeovers. Cost estimates for some of the capital injections provided during the 2008-09 financial crisis suggest that there might have been more cost-effective options at the time, such as bail-ins and orderly liquidation facilities.[5] The current crisis is different in nature, however, and cost-benefit analyses need not be the same. Where capital injections are desirable in order to prevent greater harm to the economy, governments need to have **a clear exit strategy**. When these equity positions are prolonged beyond their initial purpose, they have **long-run effects on competition and effective resource allocation**, creating persistent market distortions. This is due to the fact that government participation can prove harder to dial back than subsidised loans or budgetary grants. Should continued state participation be necessary, steps need to be taken to ensure **competitive neutrality**, such as requiring firms to achieve market-consistent rates of return.

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[5] Lucas, D. (2019), "Measuring the Cost of Bailouts", *Annual Review of Financial Economics*, Vo. 11:1, pp 85-108.

Policy transparency is fundamental at all stages of the crisis response

Perhaps the most important aspect of implementing government support in a crisis is for governments to be transparent about the measures they choose to adopt. **Transparency is valuable *ex ante* for many reasons**, including managing business expectations and providing a focus to guide action by economic actors. Transparency regarding who benefits from support programmes also contributes to **public support** domestically, as citizens can see that taxpayers' money does not only help big multinationals but also MSMEs, as well as how support for firms compares to other public investments in the crisis. Finally yet importantly, being transparent also **enables countries to know and exchange information** on what each government is doing to stimulate the economy, thus defusing potential trade tensions present and future, enabling countries to learn from each other's experiences, and paving a way for further international co-operation. In short, **transparency is a key ingredient in building the trust that governments** badly need at home and abroad in troubled times.

Transparency has other benefits that may become especially relevant as the crisis subsides. As countries emerge from the COVID-19 pandemic – hopefully sooner rather than later – there will be a need for governments to scrutinise the measures they have introduced in order to either phase them out completely, or ensure that they do not have unintended market effects that can harm the economic recovery underway. In the course of this ***ex post* review process**, policy transparency should enable **greater government accountability and oversight** of the measures they have adopted – including by allowing for impartial third-party analysis. Detailed information on policies put in place and funds mobilised can help assess the true cost of government support and provide lessons and insights into its effectiveness. Indeed, lessons learnt from the last downturn have already helped inform decisions made today. Further transparency and *ex post* analysis should likewise help governments learn from current policies in order to better prepare for the future

Further reading

Lucas, D. (2014), "Evaluating the cost of government credit support: the OECD context", *Economic Policy*, Vol. 29/79, pp. 553-597, http://dx.doi.org/10.1111/1468-0327.12034.

OECD (2019a), "Measuring distortions in international markets: the aluminium value chain", *OECD Trade Policy Papers No. 218*, OECD Publishing, Paris, https://dx.doi.org/10.1787/c82911ab-en.

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OECD (2018), Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices, OECD, Paris, https://www.oecd.org/corporate/ca/Ownership-and-Governance-of-State-Owned-Enterprises-A-Compendium-of-National-Practices.pdf.

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