ILO brief

Research Brief

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Macro policy options to stimulate pandemic-hit economies[1]

Policy challenges to address a crisis without precedent

The COVID-19 crisis is without precedent, both in terms of its speed and its depth. As we approach the fourth month after having been declared a pandemic, labour markets around the world have lost millions of working hours. By the end of the second quarter of 2020, global working time was estimated to have lost 10 per cent compared to the end of 2019, the equivalent of 400 million full time jobs.[2] Current scenarios indicate that these losses will only be partially compensated by the end of the year, even under an optimistic scenario. The situation is particularly dire for populations that were already vulnerable before the virus outbreak and that have limited or no access to social protection systems.[3]

Three challenges have arisen from the crisis simultaneously: Depressed or restricted supply, a significant fall in demand and a substantial rise in uncertainty due to the unknown nature of the virus, its spread and long-term consequences. To address this simultaneous health, supply and demand crisis, countries have responded using three broad macro policy approaches:

- setting up targeted support to the health care sector in terms of medical equipment, care provision and medication;
- providing economic stimulus through monetary and fiscal policy interventions, as well as through automatic stabilizers and expansion of social protection;
- relieving companies from current payments through deferrals of interest payments or tax and social security contributions, as well as through job retention schemes;
- finally, issuing (loan) guarantees and capital injections to companies.

The timing, size and composition of these different measures varies widely across countries, mostly owing to the extent of the health crisis they face and the fiscal space they dispose of. Moreover, the policy space to coordinate monetary and fiscal policy for maximum impact varies significantly between countries, partly owing to pre-crisis vulnerabilities resulting from financial and external imbalances. Importantly, cross-country differences in their institutional set-up influenced how quickly and well-targeted the support measures would reach those most in need. This research brief will look at these different dimensions and how they vary across countries. It concludes with a tentative summary of lessons learnt from the measure taken so far.

[1] This research brief was prepared by Ekkehard Ernst (RESEARCH) and benefited from valuable comments received by colleagues from the following departments: Research, Employment Policy, Enterprises, Sector, DDG/P office as well as the Bureaux for Employers and Workers Affairs. All remaining errors are mine.

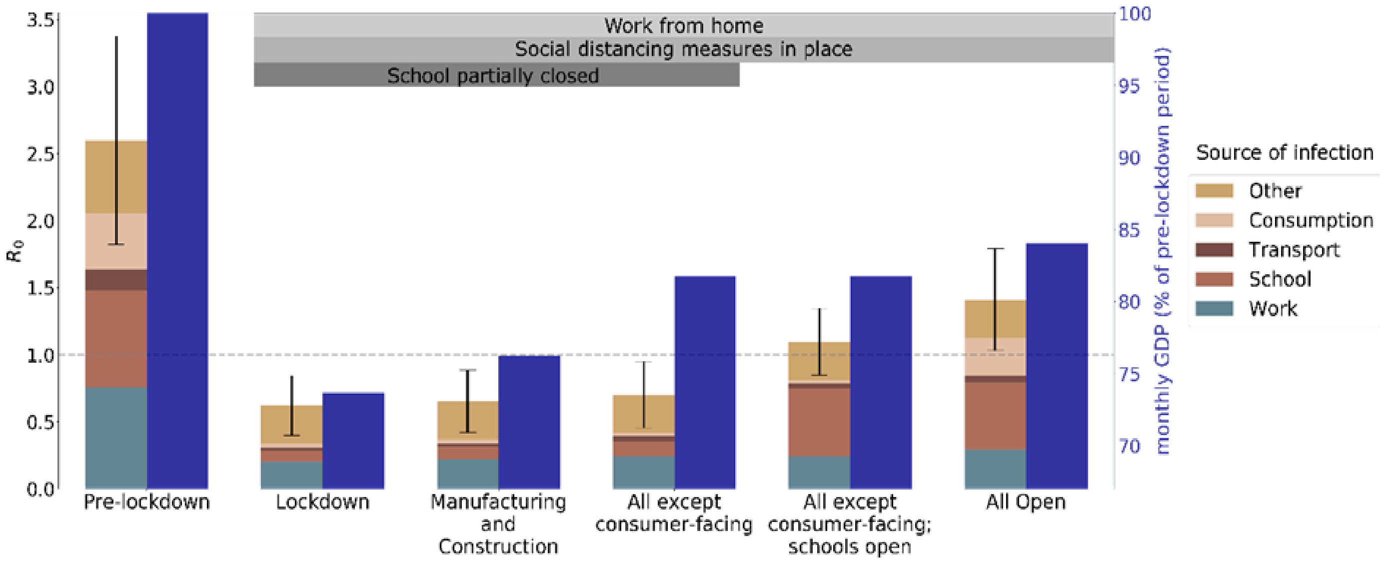
[2] https://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/documents/briefingnote/wcms_749399.pdf

[3] https://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/documents/briefingnote/wcms_745963.pdf

No recovery without a solution to the health crisis

The strictness of confinement measures and their impact on the spread of the virus continue to determine how quickly different economies can recover. Without a proper solution of the health crisis, a full return to pre-crisis level of activity is not possible. In particular, both a gradual lifting of confinement measures and individual behaviour respecting social distancing continues to depress activity and leads to a reallocation of demand across sectors. Figure 1 depicts the estimated impact of different policy scenarios on both economic recovery and the spread of the virus for the UK economy under different confinement assumptions. As the chart demonstrates, lockdown measures were necessary to bring the coronavirus reproduction rate, R0, significantly below one, from an estimated rate of 2.5-3.5 prior to lockdown. More importantly, even without a full opening of the economy, the reproduction rate can go significantly above one again. At this point, the economy would still only operate at 85 per cent of pre-lockdown capacity. A fast and durable solution to the current health crisis, therefore, needs to be seen as a pre-condition to a fast economic recovery. In contrast, premature opening of the economy, will prolong the health crisis and add to its social and economic costs.

Figure 1: The impact of different policy scenarios on economic output and the containment of the virus: The case of the UK



Note: The coloured bars show the contribution of different sectors to the reproduction rate, R_0, of the virus under different confinement scenarios. Different colours designate the activities that cause the epidemic to spread. The blue bars denote the percentage increase in value added relative to a full lockdown one month after the economy is opened under each scenario. Black lines are two standard deviation error bars (adapted from Pichler et al., 2020, figure 1).

Source: Pichler et al. 2020. Production networks and epidemic spreading: How to restart the UK economy?, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3606984

Size matters

The importance of the shortfall in economic activity even under relatively mild social distancing measures has led some observers to talk about the "90 per cent economy".[4] A return to pre-crisis levels, therefore, will require a significant amount of policy support, both through discretionary spending and by letting automatic stabilizers – for instance social protection systems – operate freely.

Table 1 demonstrates large differences even among advanced economies as to the overall size of measures and their composition. Most countries listed below seem to provide significant support for supply by focusing their measures on (tax and mortgage) payment deferrals or

[4] https://www.economist.com/leaders/2020/04/30/life-after-lockdowns

loan guarantees, as these measures have less immediate fiscal impact. In contrast, very few countries provide – so far – significant discretionary fiscal stimulus, necessary to help demand to recover. The situation is different in emerging (G20-) economies (see Figure2).

Measures in these countries have been, so far, significantly smaller, reflecting their limited fiscal space, and are more balanced between support for supply and for demand.[5] Given the limited size and possible lack of capacity to administer the support in these countries, it might do little to support a quick recovery. In conjunction with high uncertainty, such measures may be overall too timid to prevent a "stagnation trap" to occur and might lead to a permanent shortfall in output, a possible further reduction in investment and innovation causing lower productivity, employment and wage gains.[6,7] Worse, insufficient support might prolong the health crisis, for instance when it forces informal workers to pursue their activities despite the risk of infection.

▶ **Table 1: Fiscal policy support measures (selected advanced economies) (continued on next page)**

	Discretionary fiscal impulse	Deferral	Other liquidity/ guarantee	Total measures engaged
Belgium	1.4	4.8	21.9	28.1
Denmark	2.1	7.2	2.9	12.2
France	3.6	8.1	13.9	25.6
Germany	13.3	7.3	27.2	47.8
Greece	1.1	2.0	0.5	3.6
Hungary	0.4	8.3	0.0	8.7
Italy	0.9	13.2	29.8	43.9
Netherlands	3.7	7.9	3.4	15.0
Portugal	2.5	11.1	5.5	19.1
Spain	2.3	0.9	9.2	12.4
United Kingdom	4.8	1.9	14.9	21.6
United States	9.1	2.6	2.6	14.3

Note: All measures reported in per cent of 2019 GDP. The measures only refer to fiscal policy action. Monetary policy measures such as the Pandemic Emergency Purchase Programme (PEPP) by the European Central Bank are not included.

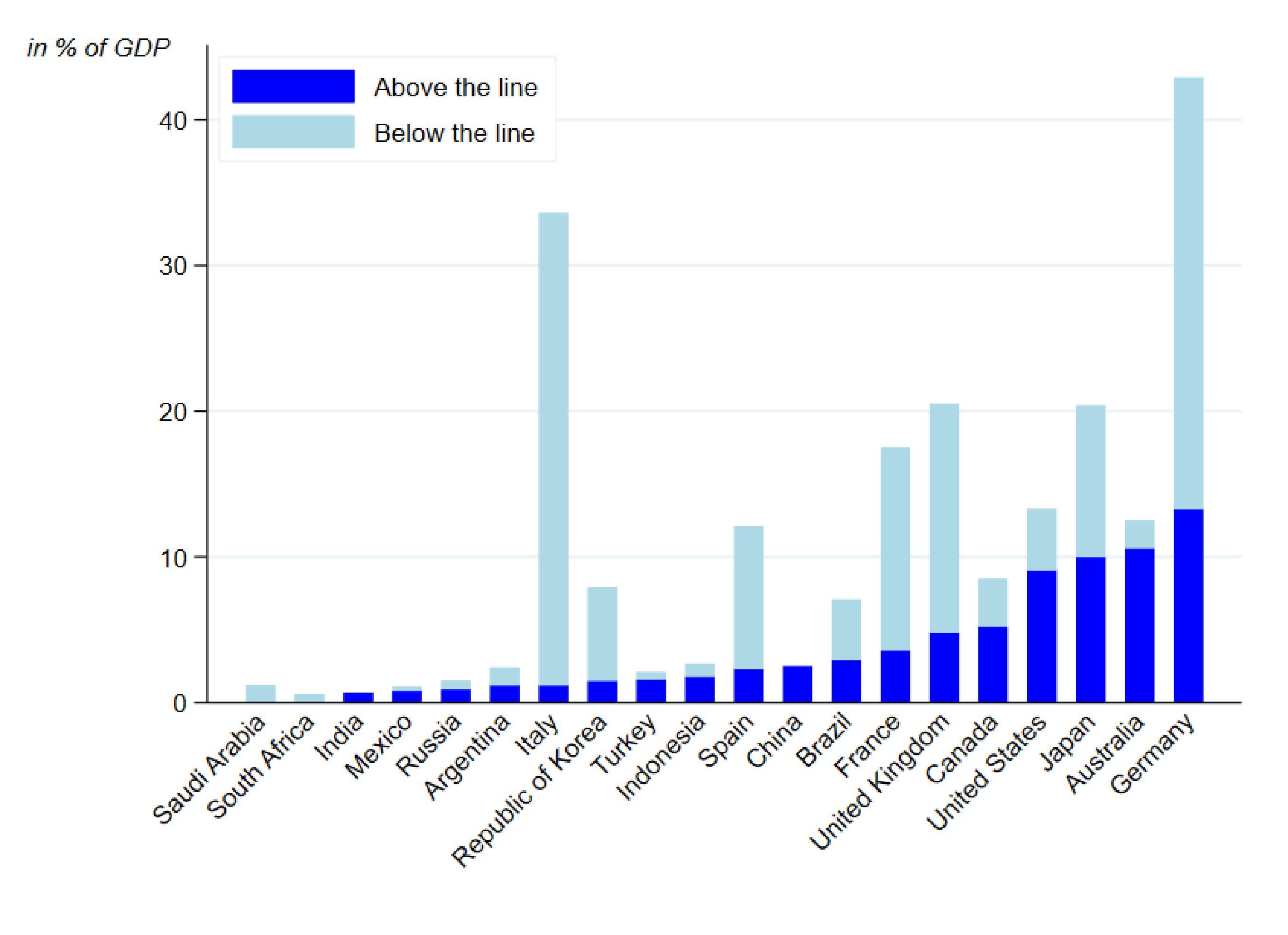
Source: Bruegel, available at: https://www.bruegel.org/publications/datasets/covid-national-dataset/

[5] https://blogs.imf.org/2020/05/20/tracking-the-9-trillion-global-fiscal-support-to-fight-covid-19/

[6] https://www.imf.org/en/Publications/WP/Issues/2020/05/29/Hysteresis-and-Business-Cycles-49265

[7] https://academic.oup.com/restud/article-abstract/85/3/1425/4587556

▶ **Figure 2: G20 - Fiscal support: Direct stimulus vs capital injections/guarantees**



Note: "Above the line" refers to direct fiscal stimulus; "below the line" to capital injections (both equity and credit) as well as credit guarantees. Latest information as available on 14 June 2020.

Source: IMF, Fiscal Monitor April 2020. For Germany, France, Spain, Italy, United Kingdom and the United States, data are from Bruegel, available at: https://www.bruegel.org/publications/datasets/covid-national-dataset/

▶ Social protection key for automatic stabilization

Considering the speed at which the crisis has unfolded, providing support quickly and in a targeted manner remains a key concern. In this regard, existing social protection systems play an important anchor for automatic stabilization and in order to reach those most in need.[8] To ensure adequate support, many countries, therefore, have expanded existing social protection systems – for instance by relaxing eligibility criteria, increasing benefit duration or removing income and wealth tests that prevented the coverage of a larger part of the labour force. Freelancers and sole entrepreneurs were included into social assistance programmes and received grants in countries such as France, Italy and Germany, although often only for a few months. Other countries such as Spain preferred to provide income support for low-income households.[9]

Well-developed social protection systems have proven to be crucial in terms of both speed and efficiency in

[8] https://www.ilo.org/wcmsp5/groups/public/---ed_protect/---soc_sec/documents/publication/wcms_742337.pdf

[9] https://www.worldbank.org/en/topic/socialprotection/coronavirus

providing support at the start of the crisis. For instance, countries that disposed of an established job retention scheme (e.g. France, Italy, Germany and Switzerland) managed to reach firms in need effectively, thanks to a well-funded system with clear eligibility criteria. Other countries that set up such programmes just at the start of the crisis quickly faced funding problems, delays in providing support and significant oversubscription even from those companies that did not necessarily need support (as they were operating in different sectors not directly affected by mandatory workplace closures). In these countries, support often came late, proved ineffective in helping firms to retain staff and proved costly in the implementation.[10]

Providing support through social protection systems poses a particular challenge in low- and middle-income countries, which often do not dispose of an adequate administrative capacity, have limited fiscal space, or face low fiscal multipliers besides a large informal economy. Countries confronted with these constraints have reverted to measures prioritizing particularly vulnerable groups in the informal economy (e.g. South Africa, India).[11] Previous experience shows, however, that a more universal approach is likely to be more effective both in terms of its administrative cost and its stimulus impact.[12] Indeed, policy innovation has been significant in this area with a view of providing broader support measures, including in countries that, so far, had only very limited or no protective systems.[13] International support could help these countries ramping up quickly effective administration and providing necessary liquidity.[14] In addition, novel channels to transmit support quickly need to be explored.[15] A key focus of such funds should also include administrative support to enhance efficient and timely release of these funds.

▶ Macro policies need to react to long-term shifts in demand

As confinement measures are being lifted and economies recover, a particular challenge will be to navigate reallocation of workers across occupations and sectors without increasing long-term unemployment, informality or inactivity.[16] Some countries, such as France, that have actively encouraged occupational mobility met with resistance by private actors.[17] Given the crisis-induced reallocation, such occupational mobility will eventually take place. In this regard, fiscal measures to support furloughing and other employment retention schemes need to be complemented with skilling, reskilling and hiring incentives in order to support occupational transition towards fast recovering sectors and occupations.[18,19] In addition, policy makers need to make provisions to education incentives and support for vocational training programmes, especially for young people who have suffered an interruption in their educational career during the lockdown.[20]

▶ How to prevent disruption in supply?

Besides measures to support demand, loan guarantees and other supply-side measures are needed to keep economic ties intact by helping firms to stay in business. As Table 1 and Figure 2 display, these measures represent currently the largest share of governments' support packages in many advanced economies, mostly owing to the fact that these measures do not have immediate

[10] https://www.piie.com/publications/policy-briefs/when-more-delivers-less-comparing-us-and-french-covid-19-crisis-responses

[11] https://www.wiego.org/blog/pandemic-informal-workers-urgently-need-income-replacement-and-more-protections

[12] See, for instance, https://www.brookings.edu/blog/future-development/2017/05/31/rethinking-the-universalism-versus-targeting-debate/ and https://www.thepolisblog.org/2012/05/why-universalism-trumps-targeting-in.html

[13] http://documents.worldbank.org/curated/en/127921590528612831/pdf/Social-Protection-and-Jobs-Responses-to-COVID-19-A-Real-Time-Review-of-Country-Measures-May-22-2020.pdf

[14] http://documents.worldbank.org/curated/en/951811585836124198/pdf/Macroeconomic-Policy-in-the-Time-of-COVID-19-A-Primer-for-Developing-Countries.pdf

[15] https://www.imf.org/~/media/Files/Publications/covid19-special-notes/en-special-series-on-covid-options-to-support-the-incomes-of-informal-workers-during-covid-19.ashx?la=en

[16] https://www.instituteforgovernment.org.uk/sites/default/files/publications/coronavirus-unemployment-five-nation-comparison.pdf

[17] https://www.lopinion.fr/edition/economie/emploi-plan-secret-grand-remplacement-217286

[18] https://www.alliancembs.manchester.ac.uk/news/productivity-and-the-pandemic/

[19] https://voxeu.org/article/rescuing-labour-market-times-covid-19-don-t-forget-new-hires

[20] https://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/documents/briefingnote/wcms_745963.pdf

budget implications (they are "below the line" in accounting parlour). Indeed, loan guarantees are up to six times bigger than discretionary fiscal spending measures. Especially in countries with limited fiscal space, such measures are considered to provide support without further immediate strain on public budgets. Experience in Switzerland and the United Kingdom suggests, however, that even in countries with ample fiscal space, the size of the initial programmes were often too small and support funds quickly ran out, requiring costly re-adjustment that caused further anxiety.[21]

Most of these supply measures have been time-bound, limited to the period of the confinement and removed as soon as the economy is allowed to operate again at its pre-crisis level. To the extent that demand does not fully recover after the lockdown period, such strict time-bounds might fall short of providing the necessary support for businesses. Regardless of their generosity, however, these supply measures also represent the largest challenge for a swift recovery and long-term growth and job creation. Companies that take out such loans to cover their fixed costs over the confinement period will be burdened with additional debt, threatening their solvency and capacity to serve their pre-existing liabilities, which limited their incentives to access these funds in the first place. Where they are enforced, strict repayment conditions or a tight repayment schedules after the official removal of all measures might push especially small firms to the brink. Even in a situation where public support comes with some leniency regarding repayment requirements, the increase in firms' indebtedness is likely to restrict their development and future investment. This raises the question whether other instruments – such as equity stakes in companies taken by a Pan-European Sovereign Wealth Fund[22] or simply offering the support as a grant – would not be more suitable to guarantee a sustainable long-term recovery of the economy.

▶ How to create fiscal space, not only in low- and middle-income countries

The significant size of the fiscal packages necessary to address the crisis raised the spectre that even in advanced economies fiscal space might be too small. In low- and middle-income countries, the above-mentioned programmes are often unavailable for lack of funds and administrative capacity. Whereas advanced economies often face pre-existing high levels of public debt that were accumulated during the previous global financial crisis, low- and middle-income countries have a significantly larger share of informal enterprises and vulnerable employment that requires support.

In such a circumstance, debt-financed public support might quickly reach the limit of even the richest countries. Especially countries with prior low sovereign debt ratings, or those whose debt is owned primarily by foreign investors, are likely to face significant constraints that limit their room for action. In this respect, measures to support supply could be financed primarily through alternative mechanisms, such as the previously mentioned Pan-European Sovereign Wealth Fund or the German Stabilization Fund that takes equity stakes in companies in exchange for support.[23] The advantage of such equity stakes is that they do not raise the solvency risk of companies in which sovereign wealth funds take a stake but provide a lifeline for businesses. In addition, when properly set up as para-fiscal institutions that can issue their own bonds or making use of national investment banks, such funds do not need to increase a country's central government debt and add, therefore, little to a country's risk profile. Importantly, however, such equity stakes should be set-up through non-voting shares and with the unique objective to provide temporary relief.

Such funds are likely to play a larger role in the future as the digital economy expands and requires novel ways of addressing its economic impact. The current crisis could indeed be an opportune moment to expand its presence even in countries that so far did not dispose of one and enhance its acceptance especially among small-business owners that are reluctant to let external equity partners enter their businesses.

Sovereign wealth funds are potentially also a policy option for developing countries who often have established such funds to deal with fluctuating export prices for their primary commodity exports. Where such funds exist, their role can be enhanced to expand their mandate for

[21] https://www.cnbc.com/2020/04/06/small-businesses-worry-paycheck-protection-program-money-will-run-out.html Switzerland reacted quickly once realizing that the initial program had been too small, though.

[22] https://voxeu.org/article/try-equity-coronavirus-and-financial-stability

[23] https://www.bmwi.de/Redaktion/DE/Coronavirus/WSF/wirtschaftsstabilisierungsfonds.html

economic stabilization. Some developing countries have indeed started introducing new approaches to increase their fiscal space and provide targeted support to their vulnerable populations (see box below). Nevertheless, these funds require a sound institutional set-up and expenditure targets to prevent abuse and over-spending once the pandemic has receded.[24]

Box: Social intervention funds: Nigeria and Ghana

Lower-middle income countries such as Ghana and Nigeria are particularly hard hit by the COVID-19 crisis. Nigeria was one of the first countries in Sub-Saharan Africa to detect infected patients and has now almost 35,000 total infections and more than 760 people who died from COVID-19 (data from 16 July 2020). In Ghana, the corresponding figures are more than 25,000 infections and almost 140 deaths. The actual numbers are likely to be much larger, but lack of a sufficient number of testing kits prevent the establishment of a more precise picture.

Both countries were also fast in imposing strict confinement measures, fearing that their fragile health care systems would be quickly overburdened. The resulting economic crisis was further compounded by the dramatic fall in prices for crude oil, the main export article in both countries. Fiscal authorities were faced with quickly dwindling budgets and announced severe cuts to their spending plans. In response to the crisis, both countries announced setting up special COVID-19 funds to help attract additional resources that would be funnelled into health care and relief measures.

In Nigeria, a Solidarity Support Fund (NSSF) was set up to attract donations from nationals, the diaspora, multinational donors, philanthropists and international businesses. The Fund hopes to raise USD50 million to support physical infrastructure of healthcare centres in local governments and existing social investment programmes.25 The Fund will also support initiatives that support the most vulnerable populations, such as the elderly and people with underlying conditions, and strengthen health care systems. In addition, the Fund also aims at supporting the economic recovery, targeting specifically the skills gap to strengthen jobs creation. The Fund will be managed under the auspices of the Nigerian Sovereign Investment Authority, the country's sovereign wealth fund whose objective is to promote infrastructure development in Nigeria. The overall ambition of the Fund is significantly lower than an earlier proposal but might grow over time, especially as so far many international donors – such as the European Union – have opted for individual disbursement approaches that lack coordination with the overall Government strategy.

In Ghana, a COVID-19 National Trust Fund was passed into law by Parliament in early April 2020. It was set up to collect donations from both domestic individuals and businesses as well as the international diaspora.26 Plans for such a Diaspora fund had already been discussed earlier this year.27 However, the initial plan for an investment trust fund with preferential rates for investors was replaced by a more traditional donor fund to complement government efforts and receive donations targeted towards addressing the crisis. To guarantee independent management, a board of trustees was set up which was not composed of Government officials. So far, however, the fund has attracted only limited resources, covering at best half a per cent of GDP. Nevertheless, such a targeted fund could help funnel international donor money more effectively into recovery efforts put in place by the Ghanaian authorities.

[24] For previous experiences with such funds see: https://mpra.ub.uni-muenchen.de/7656/1/MPRA_paper_7656.pdf

[25] https://www.globalcitizen.org/en/content/covid-19-nigeria-solidarity-support-fund-explained/

[26] https://dowuonalaw.com/news/novel-coronavirus-covid-19-national-trust-fund-act-2020-act-1013/

[27] https://www.bloomberg.com/news/articles/2020-01-03/ghana-targets-its-diaspora-for-3-billion-in-investments

Coordination between monetary and fiscal policy remains important

A key lesson from the aftermath of the global financial crisis is the importance of a coordinated approach between fiscal and monetary policy. Indeed, a return to a less accommodative monetary policy stance even when economies are still not operating at full capacity would severely restrict the effectiveness of fiscal policy, thereby creating an undue drag on the economic recovery.[28] In addition, a better coordination of monetary and fiscal policies can help in choosing the right (public) debt instrument, alleviating the cost for fiscal policy makers, and therefore preserving fiscal space. Indeed, in times of ultra-low interest rates, short-term borrowing might be cheaper than issuing debt with long maturities.[29] This requires, however, a certain security by policy makers to face only gradually increasing short-term rates when the recovery sets in.[30] Forward guidance and a clear communication between monetary and fiscal policy makers can help, in this respect, to prevent negative surprises for public borrowers as was the case during the previous European Sovereign Debt crisis.

Policy coordination will become a major challenge for those emerging and developing countries that also face a crisis in their external balance, due to loss in foreign revenues from plunging commodity prices, flight to safety of international investors or a drop in remittances. The international community must need to stand ready providing sufficient liquidity for these countries to face such challenges to their external balance in order to help them successfully fight the socio-economic consequences of the crisis. In this regard, early action is necessary, for instance through an international debt moratorium, in order to prevent a gradual but quickly accelerating shift towards a sovereign debt crisis in these countries.[31] Where possible, such a moratorium should be extended broadly, including to highly indebted middle-income countries, and come with concessional financing conditions depending on the evolution of a country's health situation.

Summary: What preliminary conclusions can we draw?

It is still early days in the COVID-19 pandemic but a few issues have already emerged from the crisis regarding how national governments are utilizing different mechanisms for their responses. Some of this will be useful when guiding policy makers in their long-term response:

1. First, tackling the health crisis first remains primordial. Only when new infection rates have dropped sufficiently low to prevent a further outbreak of the crisis can countries consider a full re-opening of the economy. In this respect, institutional capacity is key and countries with decentralized administrative systems and strong accountability or social dialogue have proven to react more rapidly.
2. Second, largesse pays. Countries that had well-developed social protection systems or were able to mobilize larger support measures seem to fare better during the crisis than others. Lack of intensive care units or ventilators posed challenges to mitigate the health crisis in the most severely affected countries. Typically, countries where governments spend more on the provision of health care were also those that had better health outcomes.[32]
3. Third, and related, providing support across the board, and without targeting seems to allow for faster, less bureaucratic and more impactful pay-outs. Initial conditioning of loan guarantees to less than the full amount, for instance, led banks to extend the available additional credit lines only reluctantly.[33] When governments started to increase their guarantees to 100 per cent of credits granted to firms, those in need could access additional funds rapidly. To prevent fraud, ex-post monitoring of the use of funds is still necessary ("keep the receipts").[34]

[28] https://www.frbsf.org/economic-research/files/el2020-13.pdf

[29] https://voxeu.org/article/using-perpetual-bonds-finance-european-recovery-fund

[30] One of the triggers of the European sovereign debt crisis that broke out in 2011 was the rapid increase of short-term interest rates by the European Central Bank, following an initially fast recovery after the global financial crisis.

[31] https://www.project-syndicate.org/commentary/covid19-sovereign-default-time-bomb-by-pierre-olivier-gourinchas-and-chang-tai-hsieh-2020-04

[32] https://www.dkv.global/covid

[33] https://www.theguardian.com/business/2020/apr/24/uk-treasury-mulling-government-backed-loans-smallest-firms

[34] https://www.imf.org/~/media/Files/Publications/covid19-special-notes/en-special-series-on-covid-19-keeping-the-receipts.ashx

4. Fourth, monetary policy alone will be unable to stem the recovery process. Around the world, governments have taken action to inject necessary funding, directly supporting businesses and workers. This support is key to a successful recovery and needs to be maintained and expanded. At the same time, monetary policy needs to remain accommodative to allow for such fiscal injections to produce maximum impact.
5. Fifth, wherever possible support should be provided to both supply and demand, which can take the form of grants – for companies – and unconditional cash transfers – for households. The latter can be provided directly through digital payment systems, including in low- and middle-income countries. The former, also given the relative larger size of the support to guarantee companies survival, can be tied to higher tax payments after the crisis, so called cash-for-tax systems. This would ensure that repayment of grants is closely linked to companies' profitability and would not unduly impact on their post-crisis investment dynamics and survival chances. In contrast, adding more debt to either households or companies will delay the recovery and stifle job creation once current confinement measures are lifted.
6. Finally, policy makers need to add "resilience" to their vocabulary, besides "efficiency".[35] Economic systems can only bounce back when supply is not being destroyed in the wake of a crisis such as this. Long-term, sustainable economic performance requires, therefore, that some redundancy is being built into the system, be it through additional capacity in health care and education systems, ample fiscal and monetary space, public employment programmes or production networks that allow supply chains to withstand a shock. In this regard, well developed social protection systems have demonstrated their systemic relevance to deal with such type of crises. Redundancy thus understood may look inefficient in good times but provide the necessary space for policy makers to react quickly in uncertain times.

[35] https://productivityinsightsnetwork.co.uk/2020/05/does-productivity-still-matter/

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