Peterson Institute for International Economics

# A New Policy Toolkit is Needed as Countries Exit COVID-19 Lockdown

Olivier Blanchard, Jean Pisani-Ferry, Thomas Philippon

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# The issue

Lockdown phase : Protection of fragile firms and workers

Workers: furlough schemes (Europe), special unemployment benefits (US)

Firms: tax deferrals, loans, grants

Largely common response. Plumbing differs (PPP combines loans and grants)

But as lockdown ended:

Companies must restart

Workers must get back to work

Some sectors must shrink, others expand

In an environment in which:

Profitability is down and firms are more leveraged

Unemployment has risen dramatically

Uncertainty is massive

# The policy challenge

Policy should set the incentives right:

Promote reopening and jobs

Balance protection and reallocation

Prevent avoidable bankruptcies

But:

The nature and duration of the shock is not known with certainty

Fiscal resources are not infinite

Administrative capabilities are limited

What should be done?

# The proposals in a nutshell

**Two new ad-hoc, temporary instruments**

1. **Sector-specific wage subsidies**
   – To help cope with temporary productivity shocks
   – To favor re-opening and jobs

2. **Special debt restructuring procedures for SMEs**
   – Haircuts to government claims conditional on banks restructuring their own claims
   – Contractual approach, no hands-on involvement of government
   – Government to accept higher haircut as "continuation premium"

# The measures taken: Workers

**US: unemployment insurance top-up and checks to households**

Income protected but employer-employee link can be broken

But incentive to re-hire (temporary lay-off)

**Europe: job retention, *Kurzarbeit, chômage partiel*** = “non work” benefits

State pays for furlough. Allowance paid by firm, reimbursed by state

Worker stays with firm. Link not broken

Generosity varies depending on country

Lockdown phase cost (France): 0.5 per cent of 2019 GDP per month

Special schemes in place in 89% of OECD countries

# The measures taken: Firms

**Guaranteed bank loans**

Schemes differ in detail but are broadly similar

State guarantee to banks: 80%-100% for loans to small firms

Possibly constraints on large firms: no dividend, no buybacks

Medium term (5 years)

**Ad-hoc deals for some industries / large firms**

US airlines: federal loans and grants

Europe: Ad-hoc deals with Air France, Lufthansa…

**Tax and social insurance contribution deferrals (or cancellations for very small firms)**

Total for France: 1% of 2019 GDP (at end-May)

**In Germany: coverage of fixed lockdown costs**

Again details differ, but philosophy is similar

# Jobs: From freeze to exit

Existing programs cannot go on forever. But exit should be gradual

"Stick" insufficient. Better use "carrot" too

1. **Existing schemes**

    Given high unemployment, support must remain generous. Low returns to search

    Keep link between workers and firms, but gradually align allowances to workers on general insurance system

    Tighten part-time eligibility (to avoid fraud)

    US: end above-100% replacement rate

2. **Wage subsidies**

    Two reasons for wage subsidies:

    - Productivity decline (distancing, etc..). May lead to postpone reopening
    - Given high unemployment, shadow price of labor << wage

    Risk of making furlough costly for firms: could precipitate layoffs

# Wage subsidies: How?

On shadow price of labor grounds, across-the-board subsidy desirable

But high fiscal cost

So: Focus on SMEs (as grant component of US PPP – but involves rationing)

Or focus on most affected sectors

Same list everywhere (hotels, restaurants, entertainment, passenger transport..)
# 4-9% of gdp

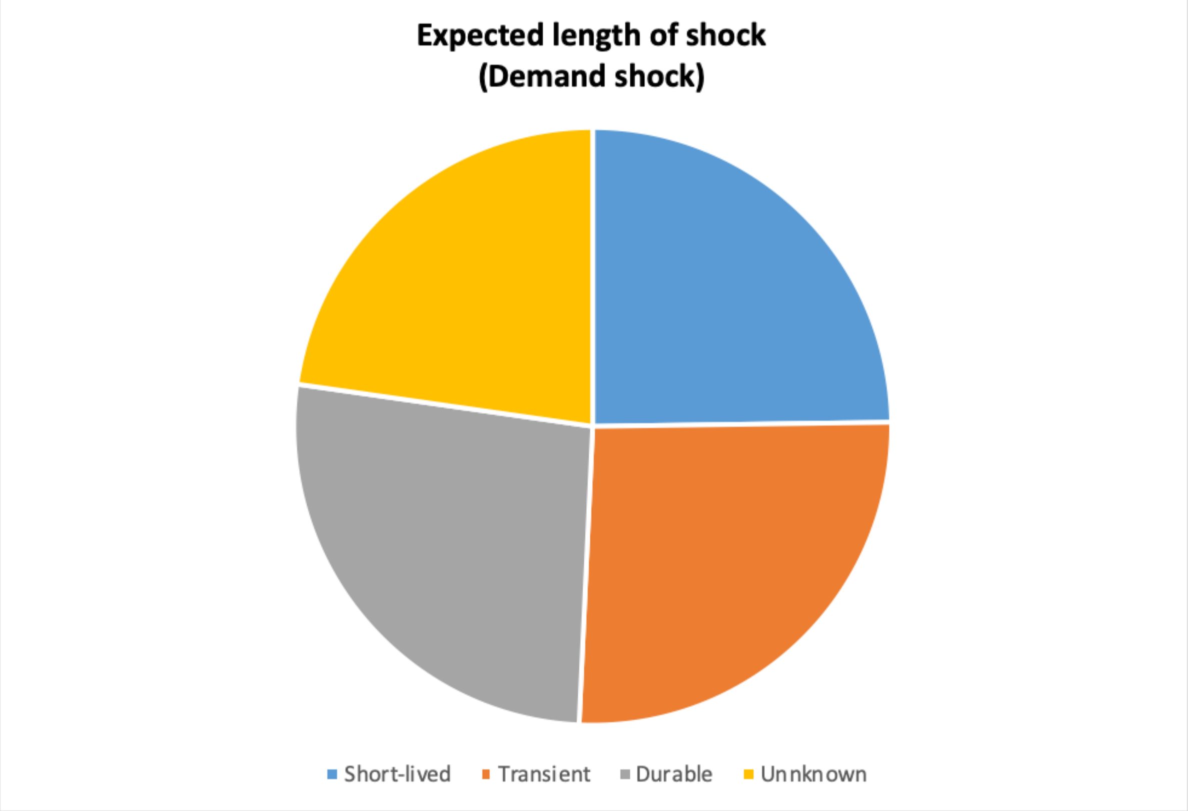
Gross cost of subsidy 0.8 to 1.8 per cent of GDP (France)

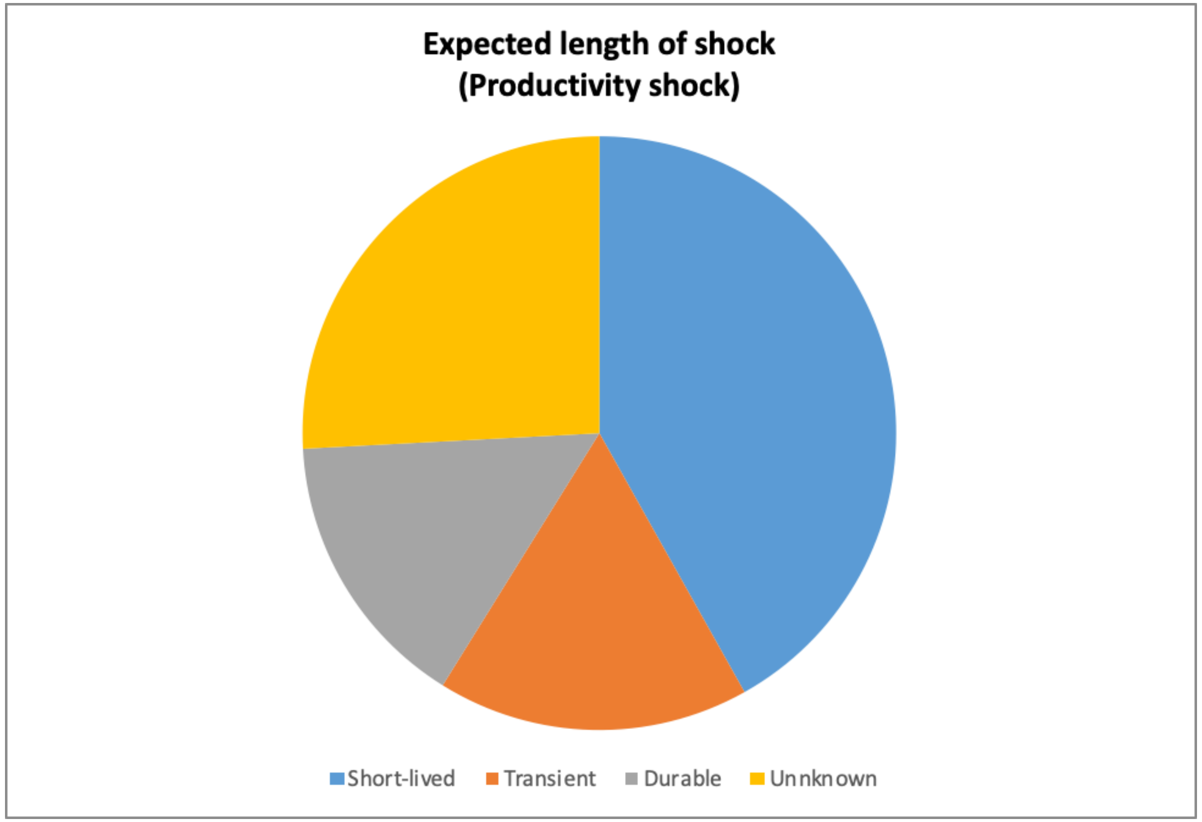
Net fiscal cost much lower taking furlough into account

And: Decrease subsidies over time

# Transitory vs. lasting shocks (France, company survey, May)

**Companies facing demand shock expect it to be longer-lasting than companies facing productivity shock**



# Firms: From freeze to exit

**1. Loan guarantees**

Given high macro and micro uncertainty, banks too reluctant to lend - even to viable firms

> Continue loan guarantees

But guarantee may encourage zombification

> Decrease degree of guarantee over time

**2. Triage and debt restructuring**

Conceptually, three categories of firms post-lockdown

| | |
|---|---|
| Viable, solvent firms: | Continue |
| Viable, insolvent firms: | Restructure |
| Non-viable: | Close |

But state has limited administrative capacity

And private creditors may not take the right decision (social value # private value)

# Debt restructuring: How to do it

Usual procedures can't cope

But banks know more than state about SMEs

Let the bank take the decision, under the following rule:

If decide to close, state is *pari passu* with bank

If decide to restructure, the state accepts a higher haircut than the bank (*continuation premium* of, say, 30 per cent)

Conceptually:

One decision maker rather than two

The continuation premium captures the social/private value difference

Variations on the theme

State can transform some of its claims in equity / quasi-equity position before restructuring

# Conclusions

Exit is delicate phase:

Temporary productivity declines

Risks on the demand side

Considerable uncertainty

Reallocation hampered

Proposed strategy:

Gradually tighten access to existing support instruments

Introduce two new supply-side instruments

(and maintain active demand policy!)

Advantages:

Two instruments for two objectives (jobs, firms)

Adaptable to changes in overall conditions

Best use of limited administrative capacity and resources

Addresses risk of capture

# Spares

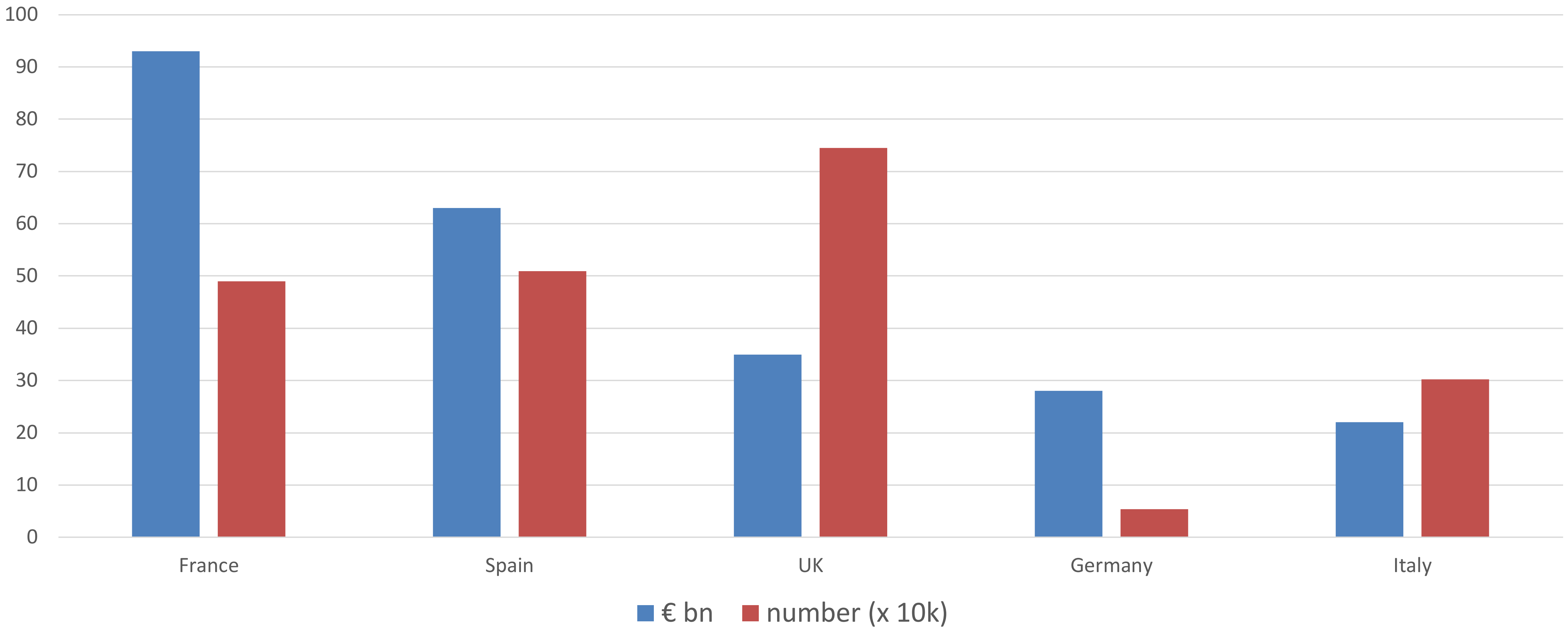
# Job retention schemes

| | United States | United Kingdom | Germany | France |
|---|---|---|---|---|
| **Name** | Paycheck Protection Program | Coronavirus Job Retention Scheme | Kurzarbeitgeld | Chômage partiel / activité partielle |
| **Principle** | Guaranteed bank loans to SMEs, convertible to grants if employer retains or rehires workers | Government refunds of 80% of gross wage of furloughed workers | Government refunds of 60% of net wage of furloughed workers (67% for workers with children) | Government refunds of 84% of net wage of furloughed workers (71% as of June 1st) |
| **Employee compensation** | No requirement | 80% of prelockdown wage + firm top-up | 60/67% of prelockdown wage + firm top-up | 84% of prelockdown wage (100% at minimum wage) + firm top-up |
| **Government refund** | 100% of actual wage bill (plus supplement for nonpayroll costs) | 80% of prelockdown wage per employee | 60/67% of prelockdown wage per employee | 100% of cost to employer (85% as of June 1st) |
| **Social insurance contributions** | Refunded | Refunded | Exempted | Exempted for wages below 3 times the minimum wage |
| **Eligibility** | SMEs (fewer than 500 employees) | All firms | All firms where a minimum 10% of workers have working hours cut by 10% | All firms |
| **Maximum wage** | No requirement | £2500 per month | €4687 per month | €5485 per month (4.5 times the minimum wage) |
| **Conditions** | Credit distributed by commercial banks; grant conditional on staff headcount at end-lockdown | Agreement with the employee | Collective agreement | Authorization of government agency (nominal requirement during lockdown) |
| **Work requirements** | No requirement | No work during hours covered, no other work | No work during hours covered, no other work | No work during hours covered, no other work |

# Credit guarantees

| | United States | United Kingdom | Germany | France |
|---|---|---|---|---|
| **Name** | Paycheck Protection Program | Coronavirus Business Interruption Loan Scheme | Wirtschaftsstabilisierungsfond + KfW Special Program | Prêt garanti par l'état |
| **Principle** | Government-financed bank loans to SMEs, convertible to grants if employer retains or rehires workers | Guarantees on bank loans | Guarantees on bank loans + subsidized KfW credits | Guarantees on bank loans |
| **Coverage of guarantee** | 100% | 100% up to £250K, then 80% | 90% for small firms, 70% for larger ones | 90% for small firms, 80% for larger ones |
| **Rate** | 1% fixed rates; lenders compensated by government | Interest holiday for 12 months, thereafter terms set by lender | Several subschemes with different rates | Interest holiday for 6 months,<br>low rates thereafter |
| **Maturity** | 2 years | Up to 6 years | Up to 5 years | 1 year, extendable to 5 years |
| **Eligibility** | SMEs (fewer than 500 employees) | SMEs | All firms | All firms |

# Credit guarantees: Amounts (rough estimates)




Source: Les Echos