Public Sector Support to Firms

Public sector support to firms can help address liquidity or solvency needs during the pandemic and ensure that economies are well positioned to rebound once social distancing measures ease. Support should be timely, targeted, and temporary. The impact on government budgets and debts can be sizable. As such, it is imperative to ensure the support is done transparently and at arm’s length to ensure good governance. It should be costed, recorded and monitored. Governments have announced a series of measures, including tax relief and subsidies. Many countries are also using loan guarantees as a main tool to support small and medium firms. Equity injection may be needed for large firms in strategic sectors as the crisis deepens.

I. GOVERNMENTS ARE PROVIDING RELIEF TO FIRMS TO SUPPORT EMPLOYMENT AND AVOID LONG-TERM ECONOMIC DISRUPTIONS

The human and economic devastation caused by Covid-19 provides a strong rationale for temporary government support for firms. Some sectors have been hit particularly hard (e.g. airlines, restaurants), but the damage is propagating throughout all sectors and economies as restrictions on movement weigh on activity. Lack of government support could lead to an even deeper and prolonged recession and be highly disruptive to the functioning of businesses and lives of workers. Fiscal support can address firms’ liquidity needs and encourage them to preserve employment and wages. In the more vulnerable sectors, firms may also face insolvency challenges as the crisis deepens. A key objective is to avoid long-term effects from bankruptcies, downsizings, or asset liquidations.

Public support to firms should be timely, targeted, and temporary. Some sectors or firms may only need provision of liquidity to pay wages and cover other working capital needs. Others may need greater

1 Prepared by Emre Balibek, Paulo Medas, John Ralyea, and Sandeep Saxena.
financial support due to solvency concerns and to avoid a disruptive bankruptcy, especially in systemically important firms or sectors. Governments need to decide the right mix between direct support to households or through support to the firms that employ them. This will depend on the specific circumstances. For example, in some countries it may be easier to reach households than small firms or the self-employed, especially those in the informal economy (e.g. wholly outside of the tax system). As containment measures are lifted, firm-specific support should be withdrawn possibly in favor of more general stimulus to restart the economy.

Countries have adopted various forms of support. The question should be which tools are best to achieve the policy objectives—e.g. preserve jobs, support investment, maintaining critical supply chains—in a judicious manner. There are several country-specific aspects to consider: (i) government financing constraints. These will impact how much support can be provided and the type (e.g. lower taxes or higher subsidies will have an immediate impact on the budget, while guarantees may only have an impact in the future); (ii) administrative capacity to ensure timely support—what are the tools available that are more effective, easy to employ? and (iii) the recipient firms’ characteristics (e.g. facing a temporary cash shortage or bankruptcy, the size of the firm) and intended coverage, e.g. support all small and medium firms (SMEs) or a specific sector. For example, support to SMEs through guaranteed loans may be easier and more effective than other tools (e.g. equity support). The main types of firm-specific support are:

- **Revenue measures** to provide liquidity relief to firms that may face difficulty in paying taxes and other costs (see note on Tax Policy Responses). These have included tax deferral (China, Germany, Italy, Japan, Korea, Brazil, Indonesia, Russia) and tax relief (China, UK, Korea, Indonesia, Russia) and other measures such as making sure tax prepayments are realistic in now-changed circumstances. For example Australia waived fees and charges for businesses in regions most affected by COVID-19 and Russia extended tax deadlines for firms in the tourism and aviation industries.

- **Expenditure measures** to help pay for wages and other liquidity needs. These include wage subsidies (e.g. France, Germany, Japan, Australia, Korea), transfers, or more general liquidity support to firms (e.g. Canada, Germany, Japan, Russia). Wage subsidies preserve the employer-employee relationship which could help ensure a faster recovery. For example, Japan provided subsidies: 1 billion JPY allocated to small businesses that introduce work-from-home equipment/IT-system.

- **Government guarantees** have been widely used in past crisis and the current one. Umbrella guarantees (e.g. covering loans to SMEs) are often more efficient than direct government support, because the transaction cost of distributing subsidies or loans to multiple beneficiaries is likely to be higher. One-off guarantees can also be extended to large firms hardest hit to provide access to cheaper credit. Many European countries have already announced guarantees, amounting to around US$2¼ trillion

---

2 For example, China lowered VAT rates for small businesses in affected areas (until May 31, 2020); provided corporate income tax relief for businesses in affected sectors; and waived social security contributions for all firms in Hubei province and SMEs in the other provinces until June (50 percent for large firms in other provinces until April).

3 Many OECD governments ramped up their credit guarantee schemes (CGS) to support small and medium enterprises (SMEs) after the GFC, including Italy, Korea, Denmark, Portugal.
and rising.⁴ Examples of countries outside Europe that have extended guarantees on loans include Bahrain, China, Japan, and Peru. In some cases, these guaranteed loans have a grant component if the SMEs use them to preserve jobs (e.g. U.S.), which could be particularly important for those firms in more financial distress.

- Government may also provide directly subsidized loans (e.g. U.S. is planning to offer loans). Such support will be particularly useful for firms that mainly face liquidity pressures. However, additional measures may be needed to support the most vulnerable, largest, or strategic firms that face the risk of insolvency—these could include outright grants, and equity injections (as happened during the global financial crises).⁵ An advantage of an equity injection is that it immediately improves the balance sheet of the firm and reduces funding costs and risks, allowing the firm to continue operating and investing. As a shareholder, the government will have a stronger voice to ensure value for taxpayers’ money, including by setting conditions for the equity injection (which could also be legally imposed). On the other hand, equity is junior to debt and may be riskier for the government if the crisis is prolonged.

- Use of off-budget measures. Special purpose vehicles may be used by some governments to channel support (e.g. the announced French Solidarity Fund⁶ or Germany’s economic stabilization fund, WSF). These are set up as extrabudgetary funds (EBFs) that may receive budget funds and are managed by the public authorities. Government support can also be given by public banks or other public financial institutions (see note on Public Banks’ Support to Households and Firms).

II. BUDGET IMPLEMENTATION AND TRANSPARENCY

The implications of these measures for government budgets and debts can be sizable. As such, it will be crucial to ensure the firm-specific support is done transparently and at arm’s length to ensure good governance. All government decisions and announcements need to be costed, recorded, and monitored. Governments should ensure that mechanisms are in place to control and monitor risk exposure from guarantees, other contingent liabilities and quasi-fiscal operations. Governments should also consider risk mitigation measures. For example, partial guarantees, deductibles and fees can help address moral hazard and adverse selection problems often associated with the use of guarantees. Further, a guarantee scheme should clearly specify the purposes for which guaranteed loans can be extended and put a limit on the size

⁴ For example, Germany (€825 billion), France (€300 billion), Italy (€350 billion), Spain (€100 billion), United Kingdom (€330 billion). The European Commission has eased the EU’s state-aid rules in a bid to provide governments with full flexibility to support their economies.

⁵ For example, the U.S. government provided financial support to the auto industry in 2008 and took an equity stake in General Motors and Chrysler to prevent a large loss of jobs. See a discussion on some lessons by Richard Anderson and Charles Gascon “A Closer Look: Assistance Programs in the Wake of the Crisis”, Federal Reserve Bank of St. Louis (2011).

⁶ The measures announced by France include a Solidarity Fund for businesses (€0.75 billion), which will be managed by the Head of Tax and Public Finance Administration and provide support to micro businesses and independent professionals. It will be supplemented by a contribution of €250 million from subnational governments.
of the loan. More generally, a gatekeeper function/central approval, e.g., by the minister of Finance or Cabinet, would help keep track of support provided and ensure its consistency with the overall policy goals. This will help review whether existing mitigation measures remain appropriate and decide on exit strategies. Some implementations considerations:

- **Budget support** should be identified and explicitly disclosed in budget documents. The support should be extended through the normal budget execution channels through the government treasury. The accounting system should make it possible to identify beneficiaries and the benefits extended, which should be disclosed systematically in the government financial statements.

- **Extra-budgetary funds** should generally be discouraged—unless considered necessary for operational efficiency reasons—because they tend to undermine fiscal accountability and discipline. In case a government decides to establish an EBF, it would be desirable that: (i) the fund proceeds are maintained in the government’s treasury single account system; (ii) disbursements from the fund follow the normal budget execution procedures; and (iii) the income and expenditure of the fund are clearly recorded and disclosed in the budget documents and the government’s annual financial statements.

- **Quasi-fiscal support** should be measured systematically. The public financial institutions should be required to maintain separate accounts of such operations and share information with the government on a regular basis. The size of QFAs should be disclosed in the budget documents together with an analysis of potential impact on the budget in case of any need to compensate the institutions involved for their losses.

- **Government guarantees** should be recorded and disclosed in the public domain. Budget documents and the annual financial statements should carry a disclosure of all government guarantees. At a minimum, governments should disclose for each guarantee: (i) a brief description of the nature, intended purpose, beneficiaries, and expected duration; (ii) the government’s gross financial exposure—the maximum amount guaranteed, in nominal terms; and (iii) the possibility of any reimbursement, recovery, or counterclaim by the government.