



# GROUP OF TWENTY

## G-20 SURVEILLANCE NOTE

G-20 Finance Ministers and Central Bank Governors' Meetings  
July 18, 2020  
Virtual Meeting



Prepared by Staff of the  
**INTERNATIONAL MONETARY FUND\***

\*Does not necessarily reflect the views of the IMF Executive Board

July 2020

## EXECUTIVE SUMMARY

**The pandemic has entered a new phase.** Covid-19 continues to spread, though at varied speeds across countries. Some advanced economies initially hard-hit by the crisis have stabilized or reduced infection rates, while some emerging market economies are seeing fast transmission. Mobility restrictions are generally being eased but social distancing is likely to prevail for some time.

**Global economic activity is starting to recover from a very low level.** Contact-intensive services have been particularly hard hit, but recent indicators point to stabilization or a slight pickup. Financial conditions have eased on extensive policy support, including for some emerging market economies that are seeing a return of capital inflows. Commodity prices have stabilized or inched up.

**Global output is projected to decline by 4.9 percent this year.** The markdown since April reflects a deeper contraction during necessary lockdowns than previously anticipated. Inflation has edged down further. A tepid recovery is expected for next year, and potential scarring through bankruptcies and persistent unemployment weigh on the outlook. Poverty and inequality are set to worsen.

**Uncertainty remains very high.** Activity could pick up faster than expected in economies that have reopened, and medical breakthroughs on treatments and vaccines could lift confidence and activity. Yet, a further spread of the disease could lead to widespread disruption. Stretched asset valuations, political instability, volatile commodity prices, rising protectionism, and natural disasters pose risks.

**Policy support has been extensive across most G-20 economies.** Fiscal policy provided support to individuals, firms, and the health sector. Amid low inflation, monetary policy was eased decisively through policy interest rate cuts and unconventional measures to help the functioning of markets. Regulators have allowed banks to use capital and liquidity buffers to support lending.

**Policymakers must continue providing robust safety nets while ensuring foundations for a resilient and inclusive recovery.** Unemployment rates are high and unlikely to return to pre-crisis levels quickly. Provision of adequate unemployment insurance and social protection therefore remains necessary. With continued weak activity, bankruptcies are set to rise, leaving governments with difficult choices on whether and how to support firms. Liquidity provision might be enough for industries where revenue losses appear temporary, while equity injections may be needed for some insolvent firms that are essential for fighting the pandemic or on which many others depend. Moreover, support measures should not hinder the reallocation of workers toward expanding sectors. Alongside, any lifting of lockdown measures should be supported by public health measures to maintain control over the disease. Though policy needs are similar across countries, financial and administrative capacity to implement them vary widely. Economies with less fiscal space will have to prioritize health and social spending.

**Collective efforts by the G-20 are essential to end the health crisis and reignite growth.** Policymakers must work together to guarantee production and distribution of goods and health supplies essential to fight the pandemic, especially vaccines. Trade restrictions on essential goods should be lifted, as they slow the fight against the pandemic. Developing economies need support to finance critical spending, making all countries safer. Advance planning is needed as the global financial safety net could be further tested. Remaining uncertainties around the G-20 Debt Service Suspension Initiative should be clarified. Without vigilance and collaboration, the pandemic will continue to spread. Every opportunity must be seized to promote a stronger, more inclusive, and greener future.

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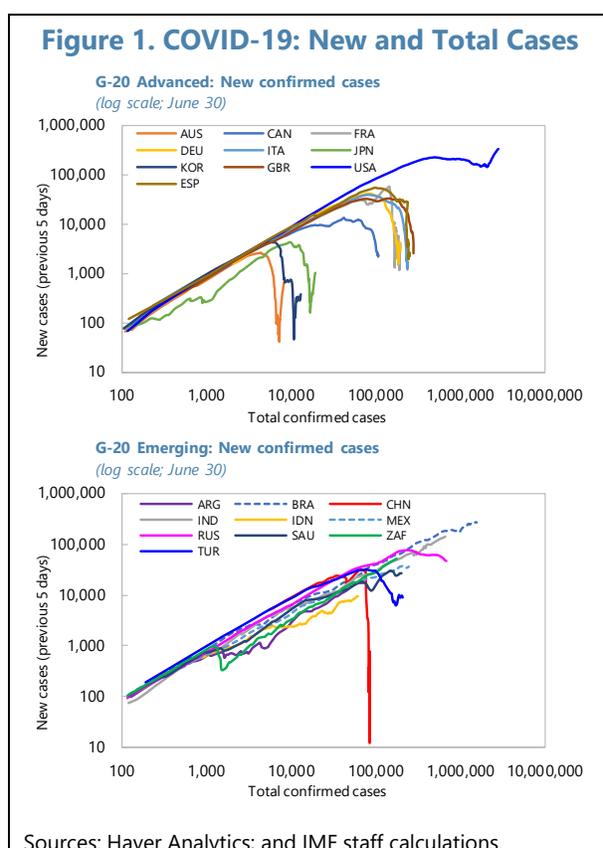
# THE OUTLOOK REMAINS WEAK

The world economy is expected to contract by 4.9 percent in 2020, with a gradual recovery starting in the second half of the year as economies re-open and the pandemic becomes more contained. Widespread job losses, rising bankruptcy rates, disruptions to education, and signs of rising poverty and inequality point to persistent weakness and a delayed recovery.

## A. Activity has Started to Recover from a Very Low Level

**1. The twin health and economic crises, prompted by COVID-19, have further worsened the outlook.**<sup>1</sup> The pandemic depressed economic activity in the year through April more than originally anticipated, especially owing to weak consumption during the necessary lockdowns. In turn, the IMF's June *World Economic Outlook Update* revised down global growth by 1.9 percentage points for this year to a contraction of 4.9 percent, with a softer rebound in 2021 at 5.4 percent (Table 1).<sup>2</sup> As a result, global economic activity is expected to be even weaker in 2021 than projected in April, and significantly below the pre-crisis trend. Growth is expected to be held back in regions where the pandemic is spreading rapidly, in tourism-dependent or oil-exporting economies, and in economies with pre-existing fiscal and financial sector vulnerabilities. Growth is now expected at below -2 percent in all G-20 economies apart from *China* and *Indonesia*, with contractions at double-digit rates in *France*, *Italy*, *Mexico*, *Spain*, and the *United Kingdom*.

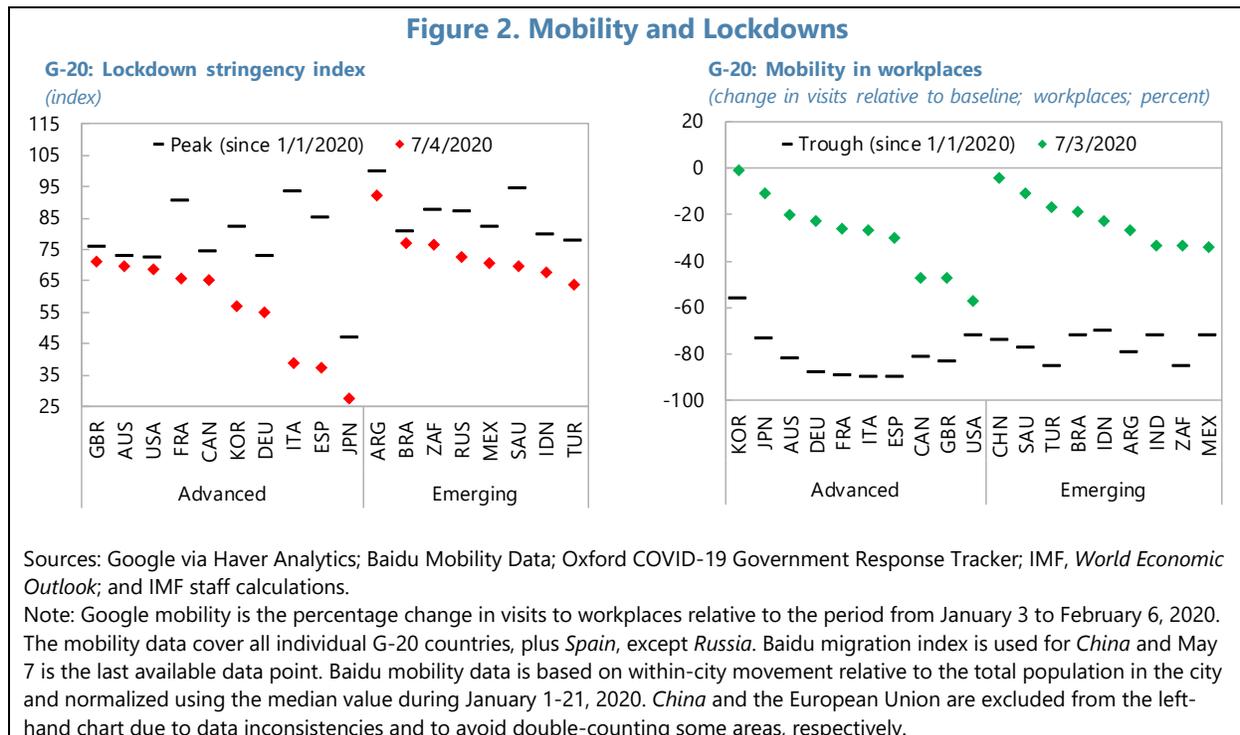
**2. While several economies appear to have put the peak of infections behind them, the pandemic continues to spread.** While new clusters of cases have resurfaced in some areas, many G-20 advanced economies and *China* have seen a marked decline in new confirmed cases—in some economies to very low levels—resulting in reduced pressure on health systems (Figure 1). However, the situation in some economies is more tenuous, especially in Latin America and South Asia, and only few emerging market economies have had success in reducing the flow of new confirmed cases (e.g., *Turkey*, *Russia*). Outside the G-20, several emerging market and developing economies continue to suffer from high levels of new infections and deaths.



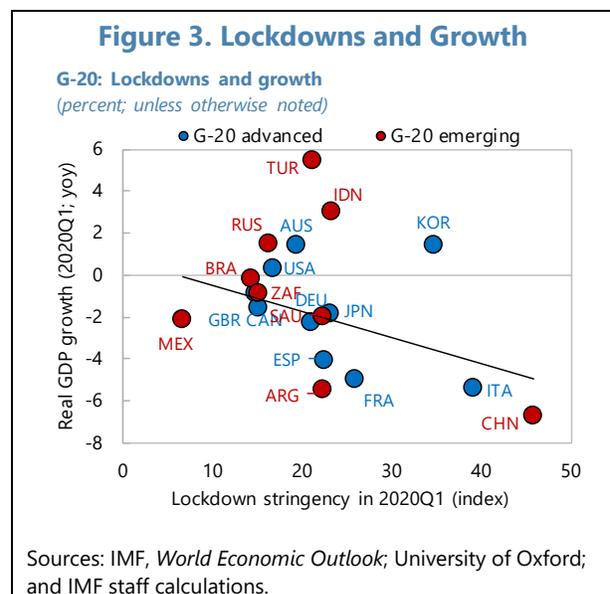
<sup>1</sup> IMF, 2020. "G-20 Surveillance Note: COVID-19—Impact and Policy Considerations," April 15.

<sup>2</sup> IMF, 2020. [World Economic Outlook Update](#), June.

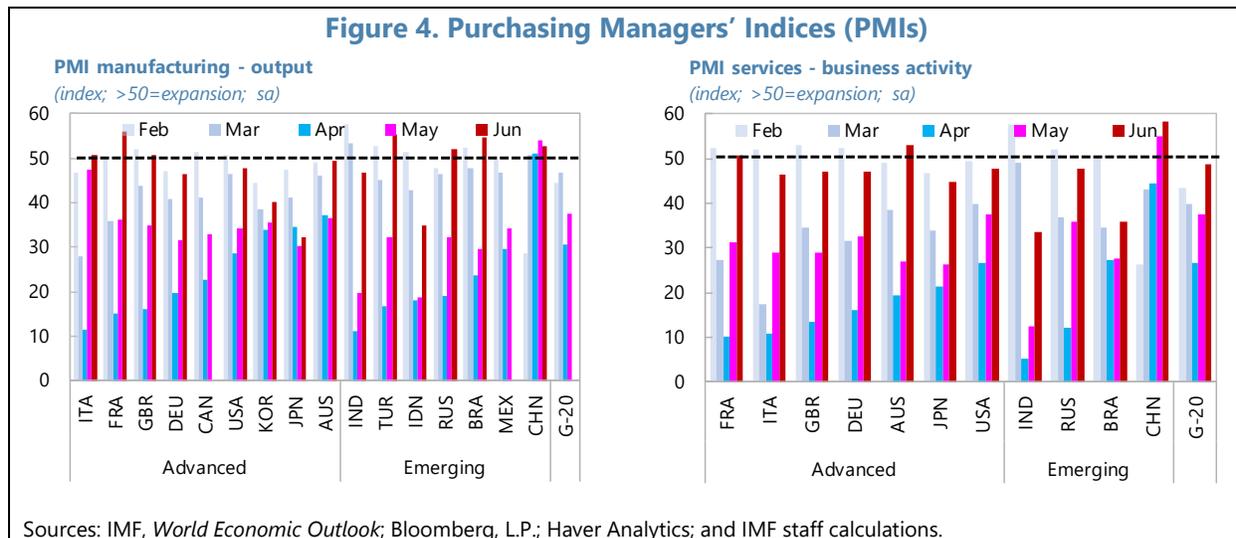
**3. As the disease has yet to be defeated, a certain extent of social distancing persists, even as lockdown measures are gradually being lifted.** As of early July, measures of mobility remained around 25 percent below the levels observed in late January and early February (Figure 2). While mobility in G-20 emerging market economies, excluding *China*, tended to decline later and more severely than in advanced economies, it has also started to pick up more rapidly there. By early July, the largest recoveries in mobility occurred in *China*, *Germany*, *Saudi Arabia*, and *Turkey*.



**4. Economic activity has started to recover from very low levels.** GDP contracted sharply in the first quarter of 2020 by 1 percent relative to the same quarter last year, with especially large declines in *Argentina*, *China*, *France*, *Italy*, and *Spain*. Lockdowns were needed to preserve health care capacity and save lives. In addition, even though they are associated with short-term economic costs, actions to get the disease under control will allow economies to reopen more sustainably and have long-term economic benefits (Figure 3). Since March, business conditions and industrial production have been recovering in *China*. PMIs outside *China* dropped to record lows in April but started to improve in May and June as lockdown

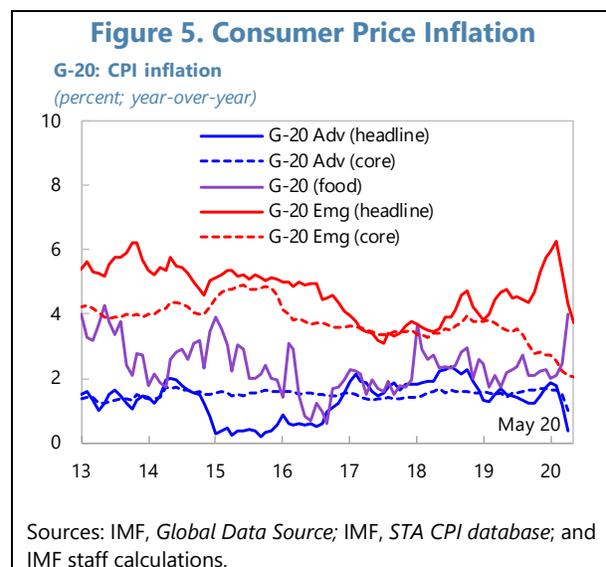


measures were gradually lifted (Figure 4). Electricity consumption has also improved slightly since the troughs in *France, Germany, India, Italy, Spain,* and the *United Kingdom*. Restaurant reservations have picked up in advanced economies, with a significant recovery in *Australia* and *Germany*. More flights departed in all G-20 economies in May, although there are still far fewer departures than at the same time last year.

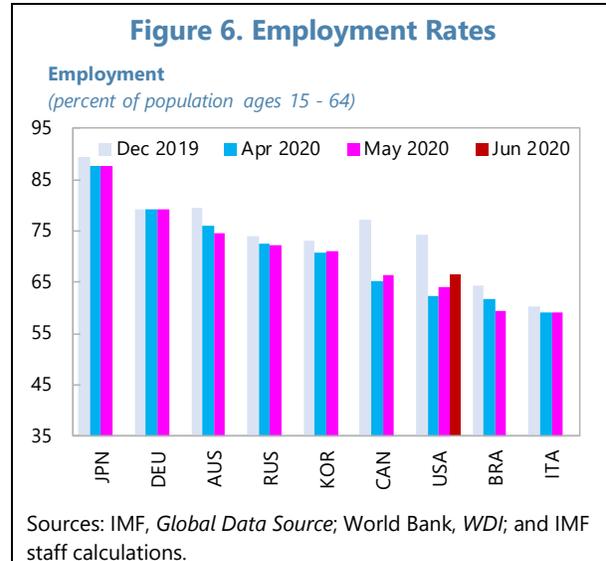


**5. Deep declines in demand have driven inflation lower, despite countervailing pressures.**

In contrast to conventional recessions, consumption fell sharply, rather than being smoothed with past savings or new borrowing. This reflects a reluctance to visit stores, fewer opportunities to consume as businesses were closed or operated at low capacity and travel was restricted, and disrupted labor income due to reduced employment and hours. The impact has been acute for consumption of services, which tend to be more contact intensive. In turn, weak demand and low commodity prices have weighed on inflation, despite exchange rate depreciations, supply disruptions for specific products, and measurement difficulties (Figure 5). Fears of widespread disruptions to food supply chains did not materialize and prices of most primary agricultural commodities have fallen. Nonetheless, supply disruptions did affect food supply in a few countries, and food prices in the G-20 increased in April by some 4 percent over the same month last year. Moreover, reduced demand—including a cessation of cross-border tourism—also led to a significant decline in trade in the first quarter.



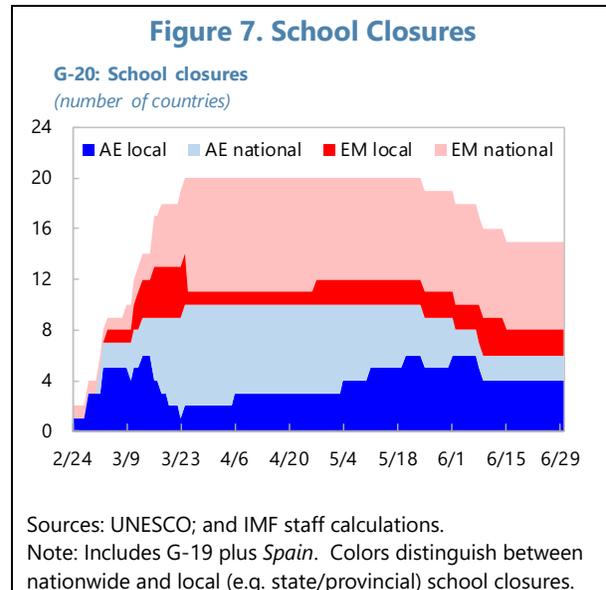
**6. Severe labor market dislocations could delay the recovery.** The decline in business activity prompted a sharp decline in demand for labor. More jobs were lost in March and April in *Canada* and the *United States* than were created since the end of the global financial crisis, even though some jobs in the *United States* have been regained in May and June. While many workers believe their job loss to be temporary, job recovery could be delayed by skill mismatches, economic uncertainty, and closures of small businesses, which account for a large share of employment. In countries with short-time work schemes (e.g., *France, Germany, Spain*), employers often reduced hours rather than relying on layoffs, thereby mitigating the impact on unemployment (Figure 6). Large proportions of the labor force filed for unemployment or job protection benefits in *Canada, France, Germany, Italy, the United Kingdom, and the United States*. However, even where unemployment did not rise much, labor force participation has fallen, amid reduced opportunities for work and more family responsibilities that prevent job search (e.g., *Brazil, Italy, Japan, and Korea*).



## B. Signs of Scarring Cloud the Outlook

**7. Bankruptcies are becoming more common as firms exhaust their cash buffers.** Bankruptcy filings and corporate bond defaults in the *United States* have risen to levels not seen since the global financial crisis (see Annex I). Market-implied probabilities of default have increased in every G-20 economy, going up in the median G-20 country by 0.1 percentage point. Small firms are particularly hard-hit, given their financing constraints, and more than one-third of small businesses in *Canada, Korea, the United Kingdom, and the United States* worry about their viability or expect to close permanently within the next year. As small and medium-sized enterprises account for a large share of employment, closures by many of these could have persistent adverse effects on employment. And as the pandemic continues to spread in some emerging market economies, concerns about bankruptcies are rising there too.

**8. Human capital is at risk as learners are out of school, people are unemployed for prolonged periods, and workers fall sick.** By the beginning of April, schools were at least partially closed in all G-20 countries (Figure 7). UNESCO has estimated that on June 7, the education of 1.1 billion (or 64 percent of enrolled) learners in primary, secondary, and tertiary education across 162 countries was disrupted by country-wide restrictions. As of end-June, 15 G-20 countries (including *Spain*) had some form of school closures in place to limit the spread of the virus, while *Australia, China, France, Japan, and Korea* had reopened schools nationwide.<sup>3</sup> As in past crises, children may also drop out of school for financial or family reasons, with long-term repercussions for earnings and inequality.



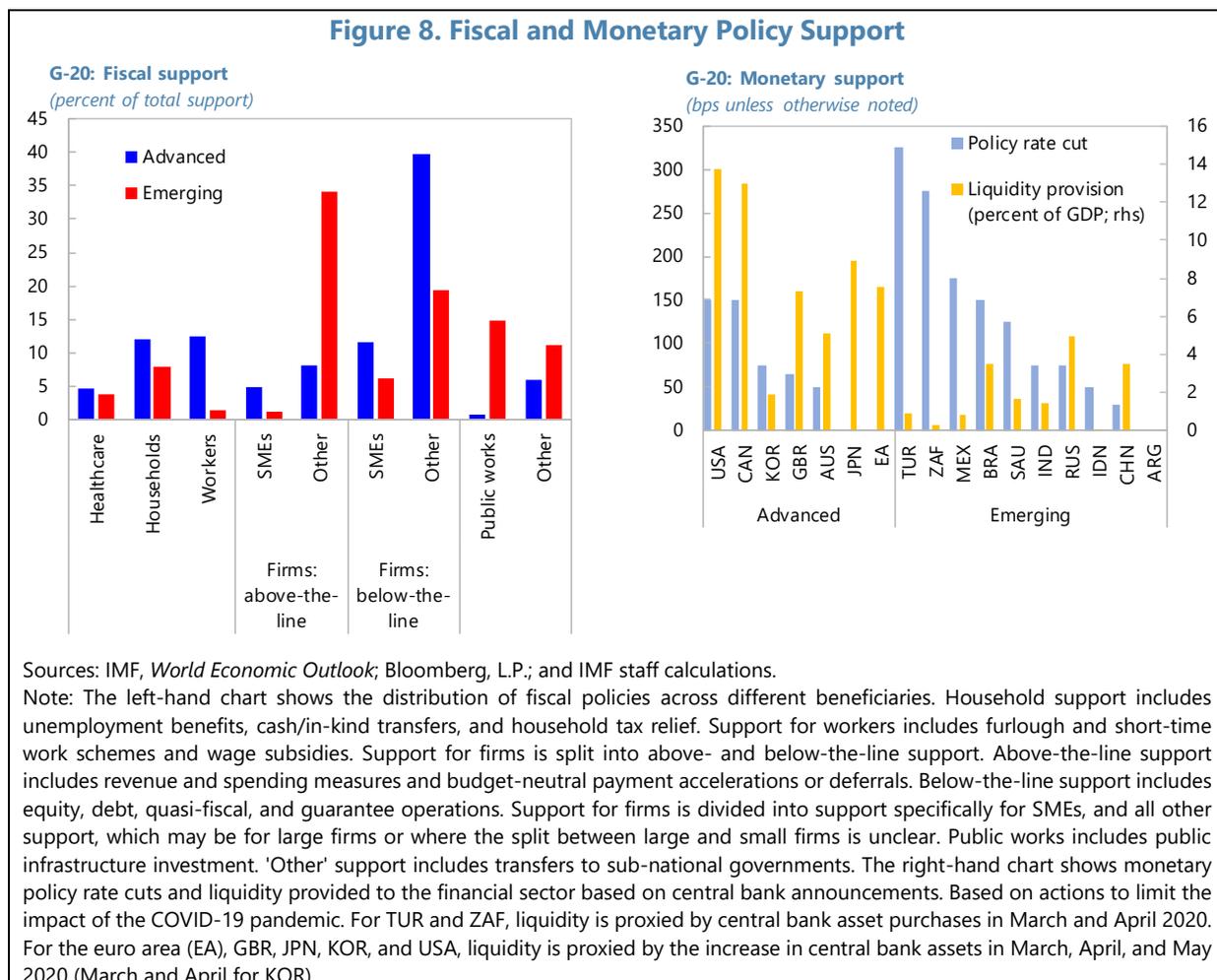
**9. The pandemic is likely increasing poverty and inequality.** Mitigation is more challenging for lower-income groups, for those in densely populated areas, and for those without access to water or health care. Moreover, lower-skilled occupations tend to be less amenable to remote work, and women continue to more often bear the responsibility of caring for dependents. Indeed, job losses in the *United States* have been concentrated among the less educated and among women. Informal sector workers are also more exposed to job loss and have less access to social security systems. Low-income households typically spend a greater share of their income on essential goods and are disproportionately affected by the increase in food prices. In emerging market economies, the poor often rely on remittances from abroad, and will be hurt by any decline in remittances owing to income losses in migrant destination countries.

### C. Policy Support Has Been Swift and Extensive in Many Economies

**10. To avert even more devastating outcomes and support conditions for the recovery, fiscal policy support has been extensive in most countries, especially in those with more fiscal space.** G-20 countries have supported their economies with fiscal measures, unprecedented monetary policy accommodation, and steps in financial regulation and supervision to ease financial conditions. Overall, fiscal support in G-20 economies amounted to some US\$ 10 trillion, when including within-year accelerations and deferrals. Partly reflecting differences in fiscal space, G-20 advanced and emerging economies have provided 10½ and close to 4½ percent of GDP in above-the-line discretionary support, respectively, and 12 and around 2 percent of GDP in below-the-line operations

<sup>3</sup> Some countries also moved from nationwide to local school closures, which can also be seen as a relaxation of restrictions, because some localities may be open.

and guarantees. The support has been targeted at health care systems, individuals, workers, and firms (Figure 8).<sup>4</sup>



- **Resourcing health care.** The health sector has received resources to fight the pandemic in the form of new facilities, staff, supplies, and equipment. Resources have also been committed to screening, testing, tracing, and research on therapies and vaccines. In total, some 0.6 percent of GDP has been provided.
- **Protecting individuals.** Unemployment benefits have been introduced or extended in eligibility (e.g., to contractual workers or the self-employed), increased in size, paid faster, and lengthened in duration (e.g. *Argentina, Australia, China, France, Germany, Indonesia, Japan, Korea, Russia, Spain, United States*). Governments have provided sick leave, parental leave, childcare benefits (e.g. *Australia, Canada, Germany, Japan, Korea, Russia, United Kingdom, United States*), targeted cash transfers (*Australia, Brazil, India, Indonesia, Japan, South Africa, Turkey, United Kingdom*), and in-kind support, especially food aid (e.g. *India, Indonesia, South Africa, United States*).

<sup>4</sup> IMF, 2020. G-20 Background Note on "[Implementation of the G-20 Action Plan](#)", July.

- *Preserving employment relationships.* Some layoffs have been avoided through wage subsidies (e.g. *Australia, Canada, Japan, Korea, Saudi Arabia, South Africa, United Kingdom*), short-time work programs (e.g. *Brazil, France, Germany, Spain*), and forgivable loans (e.g. *United States*).
- *Supporting firms.* In addition to support in the form of wage subsidies, firms in the G-20 have received financial support of some 8.7 percent of GDP, helping to preserve human and physical capital. Financial support has primarily been of the liquidity type to provide temporary relief and fill financing gaps left by the private sector. Advanced economies have relied extensively on guarantees to encourage the private financial sector to extend credit (e.g. *France, Germany, Italy, Japan, Spain, United Kingdom*). Other instruments have included tax and social security deferrals, accelerated tax refunds, and new loans and bond purchases. SMEs have received targeted support in, for example, *Argentina, Australia, Brazil, China, France, Germany, Japan, Korea, Mexico, Russia, Saudi Arabia, Spain, the United Kingdom and the United States*. In addition, some solvency support has been provided in the form of capital injections and subsidies, especially for hard-hit industries. However, notwithstanding the extensive support available in most countries, programs have faced implementation challenges in some areas, including in their ability to achieve timely disbursement and high participation, and in their ability to reach the desired beneficiaries.

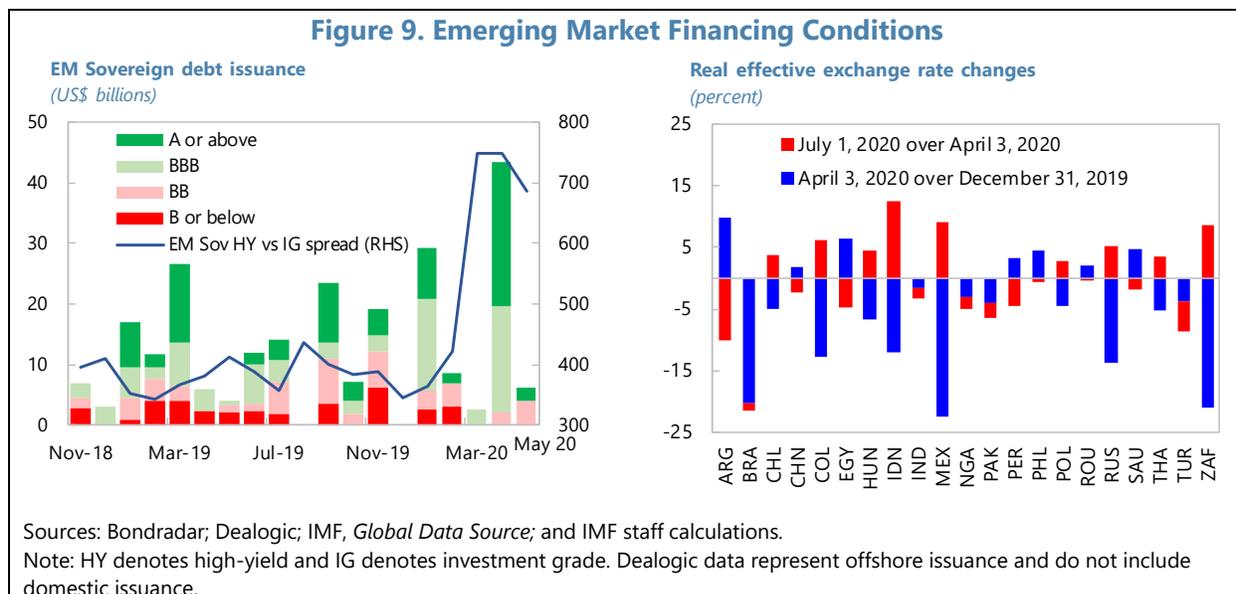
#### **11. Central banks eased their policy stances and applied unconventional tools to ease financing conditions and maintain safe and sound financial systems.**

- *Conventional easing of the policy stance.* Many G-20 economies lowered policy interest rates following the onset of the crisis (Figure 8).
- *Maintaining credit supply and market functioning.* Liquidity has been provided to financial systems through unprecedented asset purchases and other unconventional tools. Regulators have loosened some prudential requirements and have encouraged capital, liquidity, and macroprudential buffers to be used to support lending.
- *Ensuring financial stability.* Asset purchases have preserved the functioning of markets for specific assets, like government bonds, commercial paper, and asset-backed securities (*euro area, Japan, United Kingdom, United States*). The balance sheets of the U.S. Federal Reserve, European Central Bank, and Bank of Japan expanded by an average of 11 percent of GDP between February and May. Authorities intervened in foreign exchange markets to provide international liquidity and avoid disorderly conditions (*Brazil, India, Indonesia, Mexico*).
- *Policy coordination.* Several major central banks coordinated their actions to enhance the provision of U.S. dollar liquidity.

**12. Fiscal policy easing, including through automatic stabilizers, has likely provided substantial support to GDP this year.** Fiscal multipliers in this crisis are likely very large but are also very challenging to estimate given the lack of similar historical episodes or applicable models. Notably, support for firms and household incomes is preventing even worse economic outcomes in terms of sharp increases in bankruptcies, major labor market dislocations, tighter financial conditions, and deteriorating confidence. Moreover, part of the impact of today's fiscal measures to support conditions for the recovery will only be seen long after the fiscal spending occurs. Thus, conventional

estimates of annual fiscal multipliers would dramatically understate the true impact of policy actions in this crisis. Below-the-line operations and guarantees have also helped limit financial and private debt distress—though these also pose fiscal risks and add to government debt if they incur losses in the future.

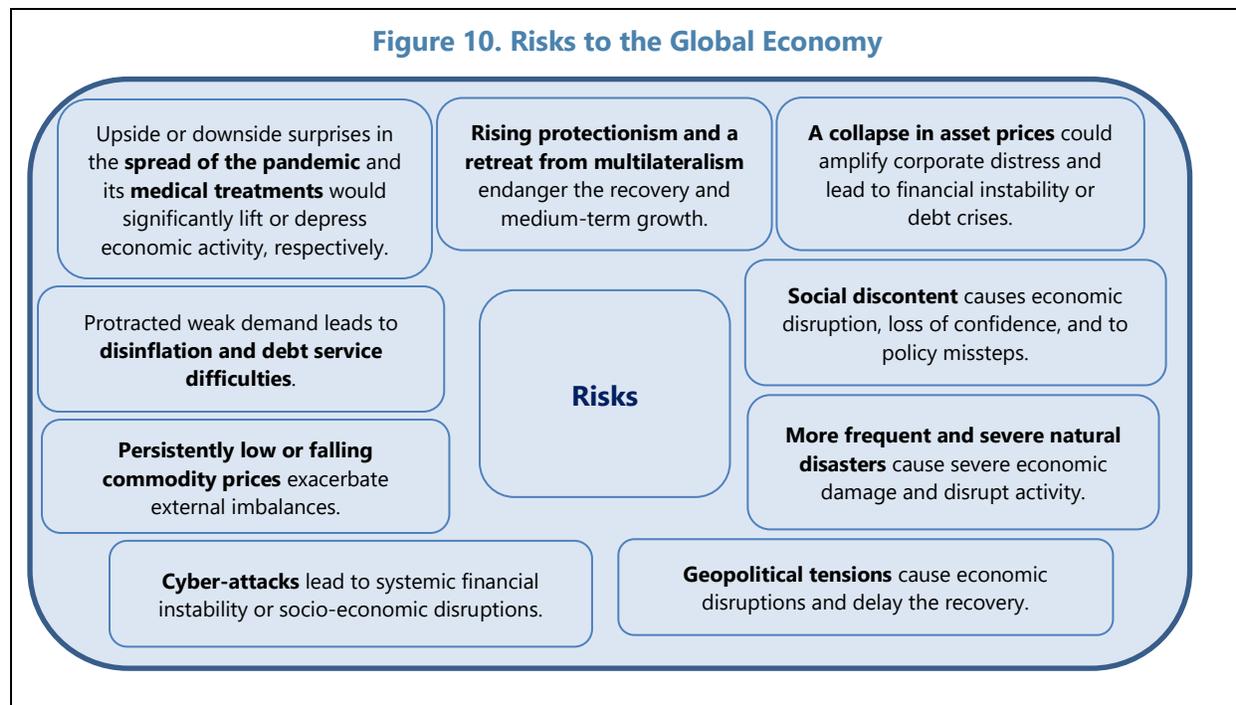
**13. Helped by the policy actions, financial conditions have eased, although they remain tight for some firms and emerging market and developing economies.** Since April, benchmark interest rates have declined, and risky asset prices have risen. As a result, global financial conditions have eased dramatically, even after accounting for a sizable correction in some markets in mid-June. Risky asset prices have rallied substantially, despite deteriorating economic news, resulting in stretched asset valuations.<sup>5</sup> Spreads on *euro area* government bonds have narrowed after purchases by the European Central Bank. International costs of short-term borrowing of U.S. dollars remained low, helped by the Federal Reserve’s expansion of swap lines and access to its repurchase facility. Nonetheless, financing conditions have bifurcated, reflecting underlying fundamentals and risks: while firms and emerging market and developing economy sovereigns with high credit ratings have been able to issue debt, those with lower ratings and frontier market sovereigns with less access to financial markets have continued to face tight financing conditions (Figure 9). After unprecedented portfolio capital outflows from emerging market and developing economies, nearing 0.5 percent of GDP by end-May, some 0.05 percent of GDP had returned to some economies by late June. In the oil market, increased supply, rapidly falling demand, and storage bottlenecks led some oil prices to turn negative in April, followed by some recovery in May. The overall decline in prices from early 2020 levels is exerting enormous pressure on oil exporters.



**14. However, uncertainty and risks to the outlook are significant.** On the upside, the downturn could be less severe than projected if social distancing and a widespread adoption of testing, tracing,

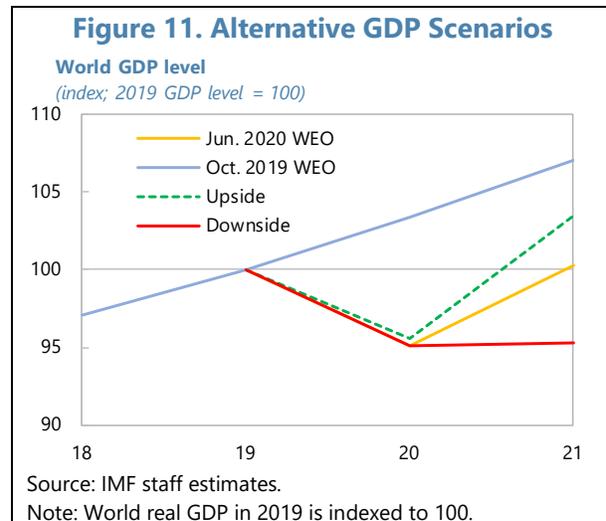
<sup>5</sup> IMF, 2020. [Global Financial Stability Report Update](#), June.

and isolation practices help keep the disease under control, allowing for a lifting of strict containment measures and a faster-than-expected pickup in economic activity. Medical advances on therapies or vaccines could also allow a quicker lifting of movement restrictions and a return of confidence. Nonetheless, downside risks are significant, especially from a second wave of the disease (see below). If investors reassess risky asset prices or are disappointed by earnings, falling asset prices could further disrupt production (Figure 10). In turn, falling asset prices or rising non-performing loans could test the resilience of financial systems and delay the recovery, especially where fiscal capacity to support financial systems is limited. Similarly, tightening of global financial conditions could cut off market access to vulnerable economies and push them into debt distress. After sizable fiscal deficits and borrowing by corporates and sovereigns with access to finance, a legacy of high debt levels may weigh on the economic recovery. Social discontent, possibly spread by the pandemic, policy responses to it, or rising poverty and inequality could lead to political instability. A reescalation of geopolitical tensions could precipitate crises or conflict. If commodity prices persist at low levels or fall further, commodity exporters could face worse external imbalances and require more painful adjustments. Rising protectionism and a retreat from multilateralism also endangers the recovery. Renewed trade or geopolitical tensions would raise uncertainty and disrupt cross-border economic activity, delaying the recovery. In turn, a weak recovery itself raises the chances of disinflation and a prolonged period of low interest rates, which can undermine debt sustainability and financial stability. In an environment of heightened reliance on technology, cyber-attacks on critical infrastructure and institutions also present risks. More frequent or severe natural disasters would cause economic damage and exacerbate health risks.



**15. An analysis of alternative downside and upside scenarios illustrates the high uncertainty surrounding the outlook.**

A second major global outbreak in 2021 and accompanying containment measures could reduce global GDP by 4.9 percent in 2021 relative to the baseline outlook, and longer-lived damage to economic production would lead to a more delayed recovery (Figure 11). The scenario assumes that containment measures will be less disruptive to firms and households than during the Great Lockdown, monetary and fiscal policy ease where space is available, and financing conditions tighten slightly for advanced economies but more



substantially for corporate and sovereign debt in emerging market and developing economies. An upside scenario is also possible where containment measures like testing, tracing, and isolation are effective, fiscal support is maintained, and the confidence of households and firms returns more quickly, relaxing their precautionary behavior and easing financial conditions. Under this upside scenario, global output would be half a percent higher in 2020 and 3 percent higher than the baseline in 2021.

## FURTHER ACTION NEEDED FOR A SHARED RECOVERY

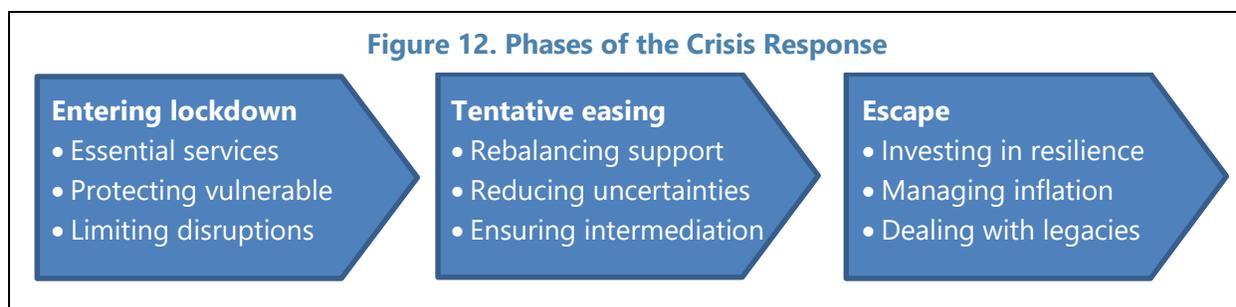
*Successfully getting past the crisis requires continued strong domestic policy measures and joint action by the G-20. As many individuals across the globe struggle to maintain livelihoods and as the virus will only be contained once it is contained everywhere, collective action by the G-20 is vital to minimize the duration of the crisis and the resulting scarring and ensure a strong and inclusive recovery.*

### A. Domestic Policies Must Focus on a Safe Restart of Activity

**16. Any lifting of lockdown measures should be done sequentially, informed by incoming evidence, and supported by public health measures, to ensure a safe restart of the economy.**

Sequencing the reopening can provide the time needed to see the effects of easier restrictions on the spread of infection. The health system's capacity to test and treat patients will heavily influence the ability to reopen safely. The costs of missteps are high: an overly abrupt reopening may lead to a resurgence of infections, triggering the need for further lockdowns and undermining the credibility of mitigation policies and confidence in economic prospects.

**17. When considering the policy design, the domestic crisis response can be ordered into three phases.** Since countries are at different stages of containing the pandemic, their policy responses will differ as well (Figure 12).



- *Phase 1: Entering lockdown.* In the lockdown phase where containment is key, all efforts are devoted to controlling the spread of the disease and saving lives, especially through mitigation measures. The health system needs enough resources to fight the pandemic. Economic policies should be focused on producing and distributing essential supplies, cushioning income losses for people, and enabling the shift of resources away from sectors that will likely be smaller after the pandemic. Examples include temporary tax breaks, targeted cash transfers, wage subsidies, paid sick and family leave, temporary credit guarantees and liquidity provision for financial systems.
- *Phase 2: Tentative easing.* Once the spread has come under control, the next phase is a gradual reopening, where health experts may advise on a phased relaxation of mitigation measures. Some economic activities may gradually resume when it is safe to do so, but risks of disruptions remain elevated. Policies should aim at supporting a nascent recovery and preparing for the future while managing constraints, risks, and the legacies from the containment phase. A key objective is to reduce uncertainty to restore confidence, for example with testing and contact tracing, to limit the need for stricter containment measures, and with stress-testing of financial systems. A progressive unwinding of targeted support is needed as economic activity picks up—but any withdrawal of support should be gradual to guard the recovery. Policies should not disincentivize the reallocation of workers to expanding sectors, and significant training will be needed to prevent persistent unemployment.
- *Phase 3: Escape.* Once the disease is effectively controlled, likely due to the development of effective treatments and vaccines, health risk subsides, and lockdown measures are fully lifted, normal economic activity can resume, and the recovery can take hold. Policies should focus on managing business cycles, addressing the legacies of the prior phases, building resilience, and promoting inclusion. Where fiscal space is available, public investment can accelerate the recovery and provide employment to lower-skilled workers, including through investments that would also bolster potential output, such as in green infrastructure, health care systems, and education.

**18. Emerging market economies face steeper trade-offs and may need to support people more than firms.** Many emerging market economies are lifting containment measures to revive economic activity and alleviate economic pressures on the poor, despite continued spread of the disease and limited health care capacity. While this may allow activity to pick up, the elevated risk of infection will likely depress consumption, work, and productivity. Amid limited fiscal policy space and tight external financing conditions in some economies, policy support is likely to rely more on monetary than on fiscal policy relative to advanced economies, provided that inflation is contained,

and financial stability is preserved. Budget priorities need to be assessed with an eye on the most cost-effective policies. In particular, in some economies it may be challenging to sustain hard-hit firms given prohibitive fiscal costs and modest administrative capacity, making it even more important to provide social protection and support workers. In flexible exchange rate regimes, the exchange rate should be allowed to operate as a shock absorber, while guarding against potential financial stability risks. Foreign exchange intervention may be necessary in the event of disorderly market conditions. Governments should resist the temptation of unduly denominating new debt in foreign currencies. To improve automatic stabilizers, emerging market economies should consider widening social safety nets and raising the progressivity of tax systems, while containing other rigid current expenditures like public wage bills.

**19. Policies should protect workers who have lost their jobs and facilitate their movement to expanding sectors.** Given prolonged economic weakness, limited fiscal capacity and potential structural changes in consumer preferences, it would be infeasible to preserve all employment linkages and to sustain all firms. Instead, workers and capital will need to move to more productive firms. Hence, policies should encourage firms to create new jobs, encourage the unemployed to maintain their labor market attachment, and make job search easier. Hiring subsidies can support job creation, labor market attachment and employment recovery, by making firms willing to hire despite the uncertainty they might face over future demand conditions.<sup>6</sup> By targeting them at the long-term unemployed or other vulnerable groups, they can be made more cost-efficient. Given that large skill mismatches could emerge, training programs would be important to prevent persistent unemployment and the associated loss of human capital. Once firms demand more workers, so that labor market slack declines, short-time work schemes and unemployment benefits should be assessed to ensure that they do not stifle incentives for job search.

**20. Policy support for firms should be tailored to firms' circumstances.** As economies move into the second phase, policy frameworks will need to diagnose whether firms face a short-term liquidity problem or are at high risk of insolvency. Liquidity provision might be enough for those industries where the revenue losses are highly likely to be temporary and can be recouped. Firms at risk of insolvency that are either essential for fighting the pandemic or on which many others depend may need to be supported through equity injections, which give taxpayers a claim on the upside potential. However, non-viable firms should not be supported, given that this would delay inevitable reallocation and divert scarce resources from other important fiscal policy needs.<sup>7</sup> For SMEs for which equity injections are not feasible, loan guarantees, direct lending, or wage subsidies can be considered if the costs are not prohibitive and if fiscal space is ample. Support for young and dynamic firms, in particular, can help boost employment and prevent undue increases in market power. Any phasing out of support for firms should be done gradually to avoid precipitating bankruptcies before the recovery can get underway.

**21. At the same time, it is essential to guard against rising inequality that rapid structural change could produce.** Low-income households affected by movement restrictions need support,

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<sup>6</sup> Wage subsidies can also encourage firms to create jobs but they entail large costs and can be challenging to target.

<sup>7</sup> See Annex I for additional considerations regarding support for firms.

like paid sick leave, to comply with them. Public works programs can provide income and work experience to low-income workers, while building capacity for socially beneficial services. Informal workers are particularly vulnerable to job loss and often lack access to formal social insurance. To reach these workers and other vulnerable households, such social assistance programs as cash and in-kind transfers (especially food distribution) and social services (e.g. health, education, housing, and utilities) should be expanded in size and eligibility.<sup>8</sup> The ideal delivery mechanism is digital cash transfers, which are contactless and fast, avoid leakages, and allow beneficiaries to choose how to spend the receipts. Where these are impractical, for example due to lack of identity system or social registry, in-person cash transfers may be needed. Food aid can complement cash transfers and protect recipients against volatile food prices. Price controls and energy subsidies should be avoided given their distortionary effects.

**22. Policies should preserve financial stability.** Financial intermediaries could face significant credit losses from the supply disruptions and rapid structural transformation. Regulation and supervision should support the flexible use of existing capital and liquidity buffers in line with international standards, which would facilitate the continued provision of credit to viable firms and insurance services. However, policies should maintain incentives to preserve buffers, for example through restrictions on dividend distributions and plans for restoring capital. Policymakers should continue to ensure that financial intermediaries can obtain funding and that major money, foreign exchange, and securities markets function.

## B. Collective Efforts by the G-20 are Essential to Reignite Global Growth

**23. Important steps have been taken to provide financial assistance to countries in need.** The G-20 together with other members of the IMF has supported important reforms at the IMF that help address the immediate liquidity needs of its members. A number of actions were taken.

- *Larger emergency financing.* This was done by doubling access to emergency financing facilities—the Rapid Credit Facility and Rapid Financing Instrument—and approving emergency financing to 70 countries in the amount of US\$ 24.7 billion between March 26 and June 10.
- *Higher loan resources for low-income countries.* This was done by mobilizing additional loan resources to triple our concessional lending through the Poverty Reduction and Growth Trust for low-income countries.
- *Additional liquidity and credit lines.* This was done by establishing a new Short-term Liquidity Line, a revolving and renewable liquidity backstop for members with very strong policies and fundamentals, extending new Flexible Credit Lines (FCLs) to *Chile* (US\$ 24bn) and *Peru* (US\$ 11bn); and renewing *Colombia's* FCL (US\$ 10.8bn).
- *Provision of debt relief.* This was done by providing immediate debt relief for six months to 28 of the poorest and most vulnerable countries under the Catastrophe Containment and Relief Trust

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<sup>8</sup> F. Díez, R. Duval, C. Maggi, Y. Ji, I. Shibata, and M. Mendes Tavares, 2020. "[Options to Support the Incomes of Informal Workers During COVID-19](#)," Special Series on COVID-19, Research Department, International Monetary Fund, May 20.

(CCRT) and working toward reaching the fundraising goal of US\$1.4 billion to extend this relief to up to two years.

**24. Support has also been provided through debt service suspension.** The G-20 Debt Service Suspension Initiative (DSSI) permits a temporary suspension of debt service payments to official bilateral creditors for the world's poorest countries. As of June 27, 39 out of 73 eligible countries had formally requested to join the DSSI.<sup>9</sup> Going forward, it is critical for the successful implementation of the initiative to continue making progress in resolving uncertainties, especially on non-Paris Club creditors' modalities for eligible countries to make DSSI requests, the perimeter of the claims that are covered by the DSSI, and the scope of any creditor debt data disclosure.

**25. Amid the devastation caused by the health and economic crises unleashed by COVID-19, further cooperation is vital.** If countries are left behind, the disease could continue spreading around the world and economies could become unstable. Amid falling incomes and likely rising inequality, cooperation is needed to avoid reversing more than a century of poverty reduction. A number of actions are essential.

- *Guarantee adequate health supplies.* International action is needed to boost the production and distribution of health supplies to tackle the crisis. An important part of this action is to develop a strategy for production, purchase, and distribution of therapeutics and vaccines.
- *Lift trade restrictions on essential goods.* Export restrictions on critical supplies should be lifted—they are counterproductive because they discourage domestic production and encourage other exporters to follow suit. Moreover, they restrict products to poor, import-dependent countries at great humanitarian cost. Import restrictions on critical supplies should also be lifted to make it easier to fight the pandemic at home. Restrictions in the name of security should be carefully assessed because international diversification can be a source of resilience.
- *Ensure that developing economies can finance critical spending and meet international liquidity needs.* Mechanisms are needed to restore debt sustainability, through restructuring debt with official and private creditors, in a way that limits reputational risks for the borrower. An absence of international liquidity for emerging market and developing economies could result in escalatory capital account restrictions, amplifying financial instability.
- *Enhance the global financial safety net.* It is important that the global financial safety net be proportional to liquidity needs in future stress scenarios. Further extensions of swap lines would be helpful in this regard, as would an enhanced use of existing special drawing rights to better help emerging market and developing economies in need.

### C. Capturing Opportunities for a Sustainable, Inclusive Future is a Must

**26. We must seize every opportunity for a strong, more sustainable, and inclusive future.** The crisis has caused much pain and suffering across the world, which cannot be undone. As we look forward, it is therefore vital that no opportunity for a better future is left behind. G-20 policymakers

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<sup>9</sup> As confirmed by the G-20 creditor template and by information from debtor countries.

must take every opportunity brought by the crisis to ensure a path to strong, sustainable, balanced, and inclusive growth.

**27. To prevent scarring, measures are urgently needed to limit the disruptions to education.**

Where school closures are needed to prevent the spread of the virus, mitigating measures are needed to prevent a long-term decline in human capital. Key among these are distance learning strategies, which require teaching and learning materials, channels of communication with learners (e.g., online, television, or radio), enhanced provision of information and communication technology infrastructure, and methods for evaluation. When schools are opened, guidance, training, and resources will be needed to ensure they operate safely.

**28. To promote an inclusive recovery, policies need to ensure that access to opportunities are widely shared.**<sup>10</sup>

Inequalities in income and education tend to persist between generations absent policy intervention. In the recovery phase, the first step for inclusion is to ensure that fiscal support is used wisely, by limiting contractions in economic activity and providing access to essential services like health care and water. These can, for example, be partially financed by making spending more efficient. The second step is to empower the next generation by enhancing access to education. In many countries, this requires improvements in the quality of education, rather than simply spending more. In addition, harnessing the power of financial technology can provide important benefits. Emergency cash transfers, like those provided in response to the pandemic, are quicker, cheaper, and safer when done digitally.

**29. A green and resilient recovery would promote health and prosperity for future generations.**

Reducing emissions and adapting to climate change are becoming ever more urgent. A phased approach to curbing emissions can provide both an initial fiscal stimulus, helping to bolster the recovery, and when the recovery is underway, a means to control public debt. In the initial stimulus phase, governments can use a variety of tools (including subsidies, guarantees, tax incentives, and direct public investment spending) to encourage green investment, especially in public goods like clean air, public transportation, smart electricity grids, flood defenses, weatherization retrofits of buildings, and resilient infrastructure. At the same time, credible commitments to gradual future increases in carbon prices, that would start when the recovery is underway, would help strengthen public finances and provide the private sector with the incentives it needs to allocate resources sustainably and limit investment in carbon-intensive capital that might become stranded. Standard disclosures in the financial sector are needed to guard resources against physical and transition risks associated with climate change. Finally, regressive fuel subsidies are less challenging to phase out amid low commodity prices.

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<sup>10</sup> IMF-World Bank, 2020, G-20 Background Note on [“Enhancing Access to Opportunities.”](#)

**Table 1. Real GDP Growth**  
(percent change)

	Year over Year					
	2018	Projections (Jun. 2020)			Deviations (from Apr. 2020)	
		2019	2020	2021	2020	2021
<b>World</b>	<b>3.6</b>	<b>2.9</b>	<b>-4.9</b>	<b>5.4</b>	<b>-1.9</b>	<b>-0.4</b>
Advanced Economies	2.2	1.7	-8.0	4.8	-1.9	0.3
Euro area	1.9	1.3	-10.2	6.0	-2.7	1.3
Emerging Market and Developing Economies	4.5	3.7	-3.0	5.9	-2.0	-0.7
G-20 1/	3.8	3.0	-4.8	5.7	-2.0	-0.4
Advanced G-20 2/	2.1	1.7	-8.0	4.6	-2.0	0.1
Emerging G-20 3/	5.1	4.1	-2.5	6.5	-2.1	-0.8
Argentina	-2.5	-2.2	-9.9	3.9	-4.2	-0.5
Australia	2.8	1.8	-4.5	4.0	2.2	-2.1
Brazil	1.3	1.1	-9.1	3.6	-3.8	0.7
Canada	2.0	1.7	-8.4	4.9	-2.2	0.7
China	6.7	6.1	1.0	8.2	-0.2	-1.0
France	1.8	1.5	-12.5	7.3	-5.3	2.8
Germany	1.5	0.6	-7.8	5.4	-0.8	0.2
India 4/	6.1	4.2	-4.5	6.0	-6.4	-1.4
Indonesia	5.2	5.0	-0.3	6.1	-0.8	-2.1
Italy	0.8	0.3	-12.8	6.3	-3.7	1.5
Japan	0.3	0.7	-5.8	2.4	-0.6	-0.6
Korea	2.9	2.0	-2.1	3.0	-0.9	-0.4
Mexico	2.2	-0.3	-10.5	3.3	-3.9	0.3
Russia	2.5	1.3	-6.6	4.1	-1.1	0.6
Saudi Arabia	2.4	0.3	-6.8	3.1	-4.5	0.2
South Africa	0.8	0.2	-8.0	3.5	-2.2	-0.5
Spain 5/	2.4	2.0	-12.8	6.3	-4.8	2.0
Turkey	2.8	0.9	-5.0	5.0	0.0	0.0
United Kingdom	1.3	1.4	-10.2	6.3	-3.7	2.3
United States	2.9	2.3	-8.0	4.5	-2.1	-0.2
European Union	2.3	1.7	-9.3	5.7	-2.2	0.9

Source: IMF, *World Economic Outlook Update*, June 2020.

1/ G-20 aggregates exclude the European Union.

2/ Includes *Australia, Canada, France, Germany, Italy, Japan, Korea, United Kingdom, and United States*.

3/ Includes *Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, and Turkey*.

4/ *India's* real GDP growth rates are for the fiscal year with, for example, 2019 referring to FY2019/20 (ending March 2020).

5/ *Spain* is a permanent invitee.

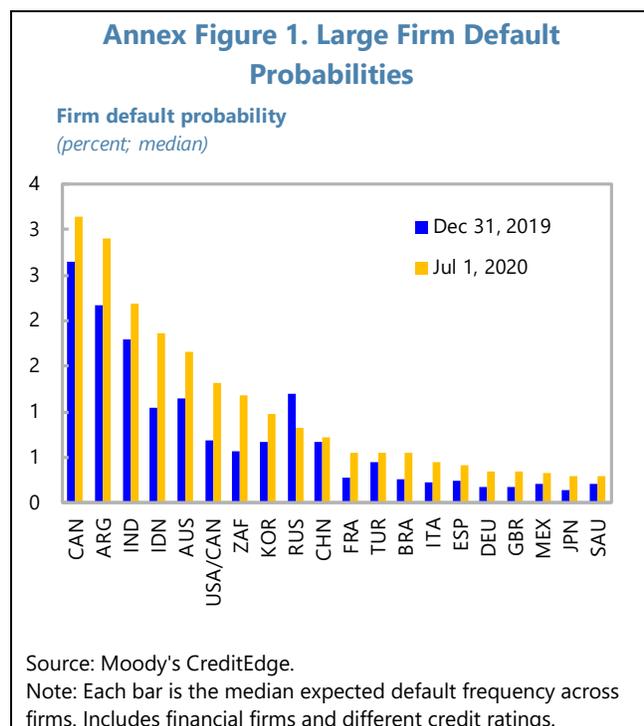
## Annex I. Policies for Supporting Non-Financial Firms<sup>1</sup>

*In the early phases of the crisis, the objective of many governments was to help bridge as many jobs and firms as possible over what appeared to be a temporary shock. Amid likely prolonged economic weakness and limited fiscal capacity, support going forward should be targeted toward solvent firms experiencing liquidity problems or strategic and systemic firms at risk of insolvency. In addition, policies should facilitate the movement of workers to expanding sectors, while protecting the vulnerable.*

### A. The Crisis Has Further Added to Vulnerabilities

**1. The pandemic has significantly damaged firms' revenues, while costs have only partially adjusted.** Amid mandated and voluntary social distancing, customers have stayed away from stores, and workers across many sectors have remained at home—especially in the services sector. The result has been a dramatic drop in sales volumes and revenues. At the same time, variable costs (such as wages) have not fully adjusted and fixed costs (such as rent and interest payments on debt) linger, generating losses and cashflow pressures. These occur despite firms' efforts to change products, reduce employment, adopt teleworking or staggered shifts where possible, draw down on cash and working-capital buffers, and, for larger firms, tap credit lines and issue bonds.

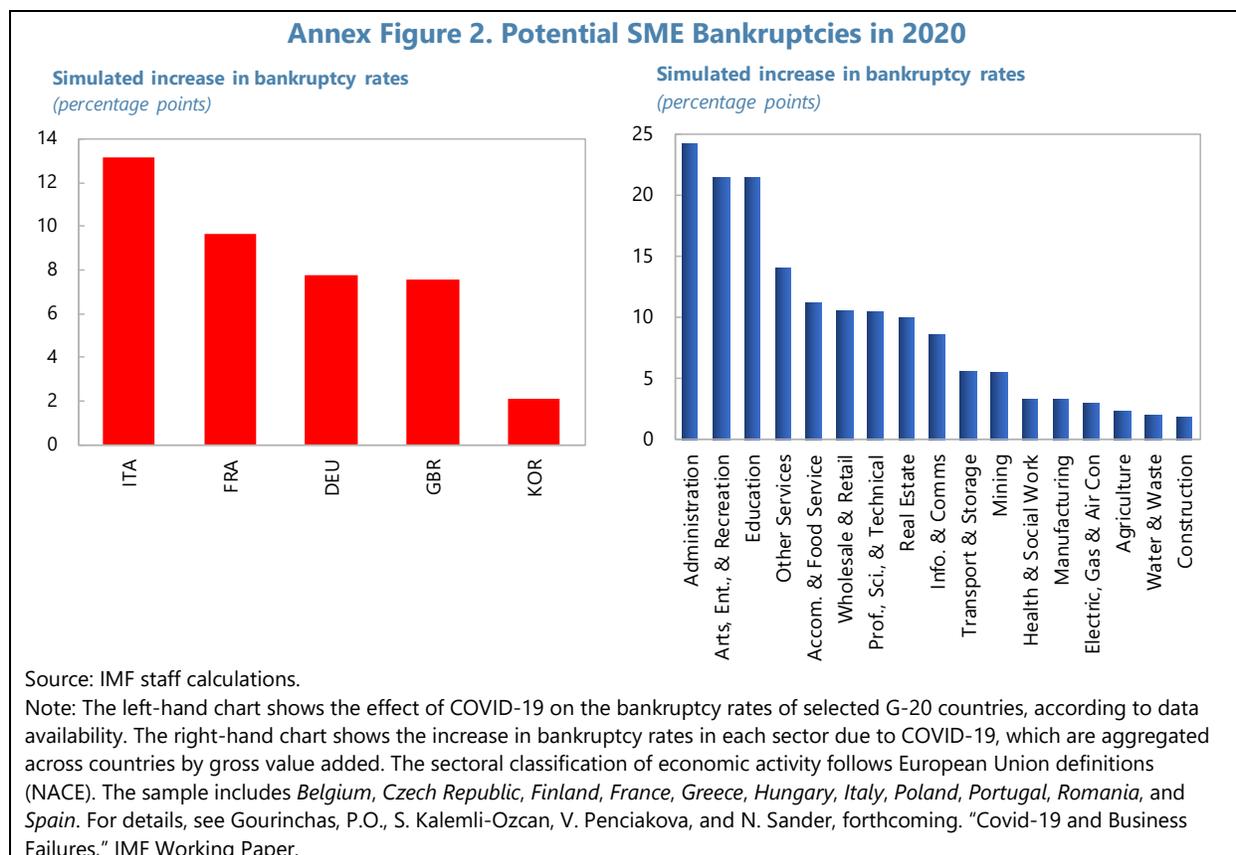
**2. Policy support has provided a bridge, but risks of defaults and bankruptcies have risen.** Unprecedented policy interventions in some countries in the early stages of the crisis were aimed at bridging firms' financing gaps—expected then to be temporary—and preventing bankruptcies and job losses. Nevertheless, temporary liquidity disruptions have been widespread, amplified by high leverage before the crisis,<sup>2</sup> and have heightened the risk of insolvency for many firms. Bankruptcy filings and corporate bond defaults in the *United States* in 2020 reached highs not seen since the global financial crisis, and forward-looking indicators for the rest of the G-20 are pessimistic. Market-implied probabilities of default for larger firms increased from a median of 0.5 percent across G-20 countries to 0.6 percent between December and May (Annex Figure 1). Moreover, these may understate actual probabilities of default, given stretched asset valuations. Small firms are especially susceptible to insolvency, as they



<sup>1</sup> This annex draws on work by F. Diez, R. Duval, C. Maggi, M. Tavares, and Y. Ji in the IMF's Research Department.

<sup>2</sup> IMF, 2019. "Global Corporate Vulnerabilities: Risker Business," Chapter 2, [Global Financial Stability Report](#), October.

often lack access to finance and therefore cannot easily borrow to keep the business running. Indeed, staff analysis on a sample of 17 countries suggests that bankruptcies could triple from an average of 4 percent of SMEs before the pandemic to 12 percent in 2020 without policy support (Annex Figure 2).<sup>3</sup> The largest increase would occur in *Italy*, due to the large drop in aggregate demand and the high share of production in contact-intensive industries. Services sectors are the hardest hit, with bankruptcy rates in the average country increasing by more than 20 percentage points in administration services, arts, entertainment and recreation, and education, while essential activities, like agriculture, and water and waste, experience only small increases in bankruptcy rates. More than one-third of small businesses in *Canada*, *Korea*, the *United Kingdom*, and the *United States* worry about their viability or expect to close permanently within the next year.<sup>4</sup> In turn, widespread bankruptcies could weigh on the economic recovery—owing to large costs of reallocating labor and capital—and cause financial instability. The key question is therefore, “How should policymakers respond?”



<sup>3</sup> The sample includes *Belgium*, *Czech Republic*, *Finland*, *France*, *Germany*, *Greece*, *Hungary*, *Italy*, *Japan*, *Korea*, *Poland*, *Portugal*, *Romania*, *Slovak Republic*, *Slovenia*, *Spain*, and the *United Kingdom*. Bankruptcy is defined as a situation where revenues and existing cash buffers are insufficient to cover the costs of wages, materials, and interest. The simulation assumes an 8-week lockdown with aggregate demand shocks taken from WEO forecast revisions, sector-specific supply shocks related to the ability to work remotely, and productivity shocks.

<sup>4</sup> Based on a meta-analysis of surveys in OECD, 2020. “Coronavirus (COVID-19): SME Policy Responses,” May 19.

## B. More Targeted Policy Support is Warranted

**3. As the pandemic lingers and the need for social distancing is likely to persist, structural adjustment could become increasingly pressing.** Full suppression of the disease without a vaccine has become less likely, extending the need for prolonged social distancing that will weigh on demand and productivity. As a result, some activities and firms that were previously thought to need only temporary liquidity support may become insolvent—especially those that rely on in-person interactions. At the same time, increasing constraints on fiscal capacity mean that not every firm that could survive with some solvency support can be saved. Hence, governments will have to be selective, and some reallocation of capital and workers toward viable and expanding activities will be inevitable.

**4. A framework for the policy response should diagnose firms' financial conditions and then match firms with targeted support, taking into account fiscal capacity.** In designing policy support to firms, policymakers should distinguish between firms that are facing temporary liquidity shortages (where an otherwise solvent firm lacks access to finance) and those that have a high likelihood of insolvency (where revenues are likely smaller than costs in present value terms, making the firm unviable over the longer term).<sup>5</sup> Among insolvent firms, governments will need to consider which ones they can and should save. Moreover, a high number of bankruptcies and layoffs may inevitably occur, requiring governments to also support the unemployed in getting back to work. Annex Figure 3 summarizes these ideas in a stylized diagnostic framework.

**5. The uncertain duration of disruptions calls for setting a high threshold for liquidity support, especially where fiscal space is constrained.** Policymakers should rely on the comparative advantage of financial markets and institutions, including development agencies, to screen borrowers and manage the subsequent credit risk.<sup>6</sup> Even so, some eligibility criteria may be needed for support programs. Overdue taxes or interest payments can be signs of illiquidity. Some minimum threshold of past profitability or maximum leverage threshold can be useful for qualifying for solvency support, but exceptions would be needed for new firms. More firms will shift from experiencing liquidity problems to solvency problems as the economic weakness continues. Although the illiquidity versus solvency distinction is important for using government resources most effectively, the uncertain duration of disruptions may cloud the distinction in many cases. Moreover, criteria are backward-looking and likely imperfect, necessitating a higher threshold for liquidity support in more fiscally constrained settings.

**6. As many firms face insolvency risks, governments will also need to consider which firms to prioritize within available fiscal space.** Natural candidates for solvency support are systemic, strategic, and essential firms.<sup>7</sup> Even for a solvent firm, liquidity support alone may not be enough,

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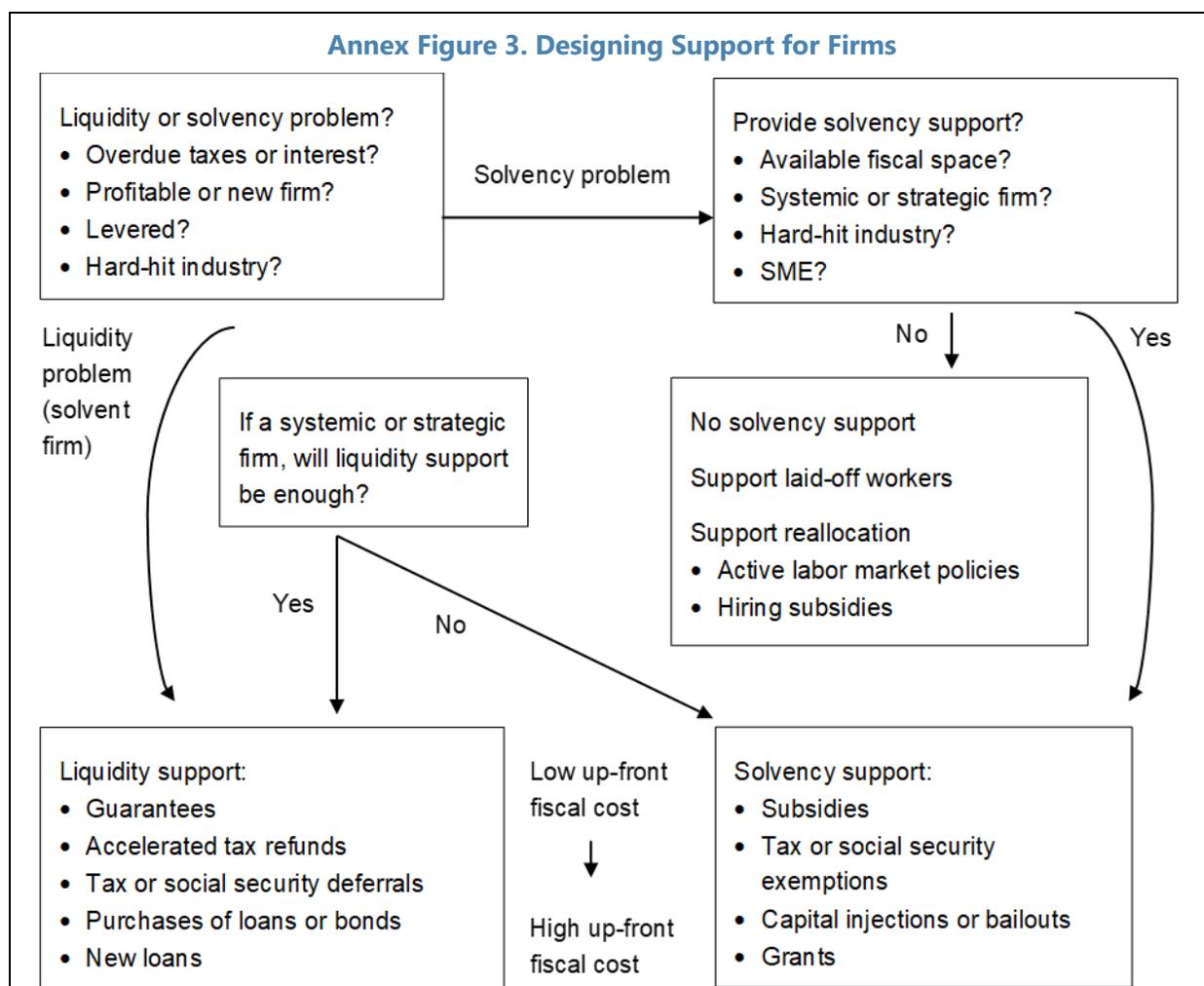
<sup>5</sup> This note uses 'viable' and 'solvent' interchangeably. However, there is likely a spectrum of viability, where firms that are clearly solvent and not facing liquidity shortfalls are the most viable, followed by solvent but illiquid firms, followed by those that are illiquid and/or at moderate risk of insolvency, followed by those that are likely to be insolvent.

<sup>6</sup> Policymakers can improve the functioning of financial intermediation by providing information or insurance to reduce risk.

<sup>7</sup> Systemic firms are firms on which many other firms depend, whether as suppliers or customers. Systemic firms tend to be complex and interconnected. Strategic firms are important for non-economic interests, like public health or national security. Essential firms are life-sustaining, like health or food services.

because management or creditors may prefer bankruptcy. This creates steep trade-offs for policymakers who may choose to provide solvency support to a systemic or strategic firm that is merely liquidity constrained.

**7. Small firms likely need separate support programs.** Imposing any criterion (to assess the nature of financial problems) can exclude small firms, since they may not be able to provide verifiable proof of indebtedness and profits, while tax information may not exist for them. As such, separate programs with few eligibility criteria may be needed to reach small firms.



### C. Options for Providing Liquidity and Solvency Support to Firms

**8. Liquidity support can be provided in several ways to provide quick, short-term relief for solvent firms.**<sup>8</sup> Liquidity support can be provided to solvent firms by the public sector if the private sector is constrained from doing so. Liquidity support is meant to improve the cashflow of firms and

<sup>8</sup> IMF, 2020. "[Considerations for Designing Temporary Liquidity Support to Businesses](#)," Special Series on COVID-19, Monetary and Capital Markets Department, May 8.

can take the form of tax or social security deferrals or exemptions, new loans or loan restructurings, bond purchases, guarantees, or support to financial intermediaries. These tools can complement each other. For example, guarantees can make banks more willing to extend loans under a funding-for-lending scheme.

- *Tax or social security deferrals.* These can be implemented rapidly because they use existing systems. However, they tend to provide only small amounts of relief and risk excluding small or informal firms outside these systems.
- *New loans and purchases of loans or bonds.* New loan programs, preferably through financial intermediaries, can offset the uncertainty that makes the private sector unwilling to lend. *Argentina, Brazil, Japan, Korea, Mexico, Russia, Saudi Arabia, the United Kingdom, and the United States* have provided loans specifically for SMEs. Loans can be provided in the form of credit lines, where the recipient can draw on the facility at the time it is needed. Purchasing loans from banks can help free up capital on their balance sheets for further lending. Having banks retain some credit risk on sold loans retains incentives for sound underwriting. Bond purchases tend to help larger firms roll over maturing bonds, where the private sector may be reluctant to do so. They might be restricted to higher-rated instruments to limit fiscal risk. Purchases of loans and bonds from financial intermediaries have been undertaken in the *euro area, Japan, Korea, United Kingdom, and United States*. Finally, special purpose vehicles can be a useful tool for increasing the transparency of purchases.
- *Loan restructurings.* Restructurings alter the maturity or interest rates on debt contracts, which can make existing loan obligations easier to fulfil. Financial intermediaries would typically negotiate new terms with troubled borrowers of their own accord, but policy-driven restructurings are also possible. They come with financial stability risks that also need to be addressed.
- *Guarantees.* Guarantees can relieve firms' borrowing constraints and they require little upfront fiscal resources, but they are complex contracts that bring fiscal risks and require capacity to price and monitor. Access caps and disclosures can help limit fiscal risks. By reducing credit risk for financial intermediaries, they can free up capital for further lending. Guarantees can be partial, in which case credit losses are shared with intermediaries, thus retaining incentives for sound underwriting. With partial guarantees, it can be useful to provide a higher level of public guarantee on smaller loans. Guarantees on firms' local currency debt have been provided in recent months in *Australia, Brazil, China, the euro area, France, Germany, Italy, Japan, Korea, Russia, Saudi Arabia, South Africa, and Turkey*.
- *Support to financial intermediaries.* Preserving the health of financial institutions and markets, for example through central bank liquidity operations or subsidized term funding, can ease financing conditions for non-financial firms. Allowing financial intermediaries to use capital and liquidity buffers can also avoid a contraction of credit supply.

**9. Solvency support can take many forms and is likely to become a more pressing complement to liquidity support as weak economic activity continues.** Solvency support measures typically take the form of (i) capital injections, bailouts, and grants; (ii) forgivable loans; and

(iii) wage and interest subsidies. Staff analysis<sup>9</sup> suggests that solvency support can dramatically decrease the chances of business failure, for moderate fiscal cost, and that targeting can make interventions significantly more efficient.

- *Capital injections, bailouts, and grants.* Capital injections and bailouts improve the net worth of firms in exchange for an ownership claim, while grants do so as an unconditional transfer. Bailouts often encompass capital injections, debt financing, and other management actions to rescue a firm, while capital injections are less complex and can take place in advance of distress. *Indonesia* has announced capital injections into state-owned enterprises. All three types of support can ensure the continuity of (i) firms that are essential in the fight against the pandemic; (ii) firms that are important to the recovery phase; (iii) firms that have been forcibly shut down for public health reasons; (iv) systemic firms; and (v) firms with specific assets that are difficult to sell. If bailouts must be used over capital injections, they should ensure private sector participation in losses, contain safeguards for public resources that encourage the firm to grow out of the public support (like dividend suspensions), provide upside exposure for taxpayers, and accompany a clear exit strategy. Grants should be avoided as they do not provide the taxpayer with upside potential—though they may be the only option for reaching SMEs that are difficult to value. They can be tied to conditions to encourage the funds to be used well.
- *Forgivable loans.* These are similar to grants, but with conditions that are verified after the fact. For instance, they would be forgiven if employment and labor compensation is maintained. This shifts some risk from the taxpayer to the firm, making it less costly to the taxpayer but potentially discouraging adoption by firms. The *United States’* Paycheck Protection Program forgives loans to companies that preserve jobs.
- *Wage and interest subsidies.* Short-time work schemes help firms preserve job matches and the associated productive capacity, and they are more cost-effective than wage subsidies. However, they may not be enough to offset all operating costs if low revenues persist. They can support firms and, if temporary or phased, can smooth the transition for workers. If wage subsidies or short-time work schemes persist, they can slow needed reallocation of workers and weigh on public budgets. *Germany’s* existing and augmented short-time work scheme has helped prevent layoffs, and the European Commission is financing its expansion to *EU* member states. *Brazil, France,* and the *United Kingdom* launched schemes to pay part of the wages of furloughed workers. Interest subsidies tend to have a small effect on solvency.

**10. Like liquidity and solvency risk, the distinction between liquidity and solvency support is blurred.** Liquidity support can come with implicit subsidies that increase a firm’s net worth and thus its solvency. For example, if new loans are provided at below-market interest rates, then the interest rate reduction is a subsidy. Loan restructurings can have the same effect if the change in loan terms amounts to an implicit haircut, or transfer of resources from the lender to the borrower.<sup>10</sup> Another

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<sup>9</sup> Gourinchas, P.O., Kalemli-Ozcan, S., Penciakova, V. and N. Sander, forthcoming. “Covid-19 and Business Failures,” IMF Working Paper.

<sup>10</sup> Tax and social security exemptions provide immediate liquidity to a firm, but they also remove some of its obligations and therefore also improve its solvency.

hybrid instrument is a proposal to finance firms with debt or equity that can be repaid through value-added or corporate income tax.

**11. Cost and effectiveness considerations should also factor in as liquidity support is generally less costly, while solvency support can help address underlying vulnerabilities.**

Providing liquidity support is quicker and less costly. Yet, it merely defers costs on firms until later, potentially raising the risk of debt overhang in the recovery phase. In contrast, solvency support is costly in the near term but immediately reduces recipient firms' funding costs and risks, allowing them to continue operating and investing,<sup>11</sup> and addresses the root cause of distress in firms, thereby supporting longer-term viability. Moral hazard with solvency support is also not as big a concern as in 2008 because the pandemic was more difficult to anticipate than the subprime housing crisis. However, the expertise necessary to manage the credit risk, which is usually the activity of development banks or the private sector, highlight the fiscal capacity required. Where central banks participate in support programs, the programs need to be designed to fit within their mandate—for example, by limiting credit risk to the central bank.

#### **D. Reallocation Must Be Done in an Inclusive Way**

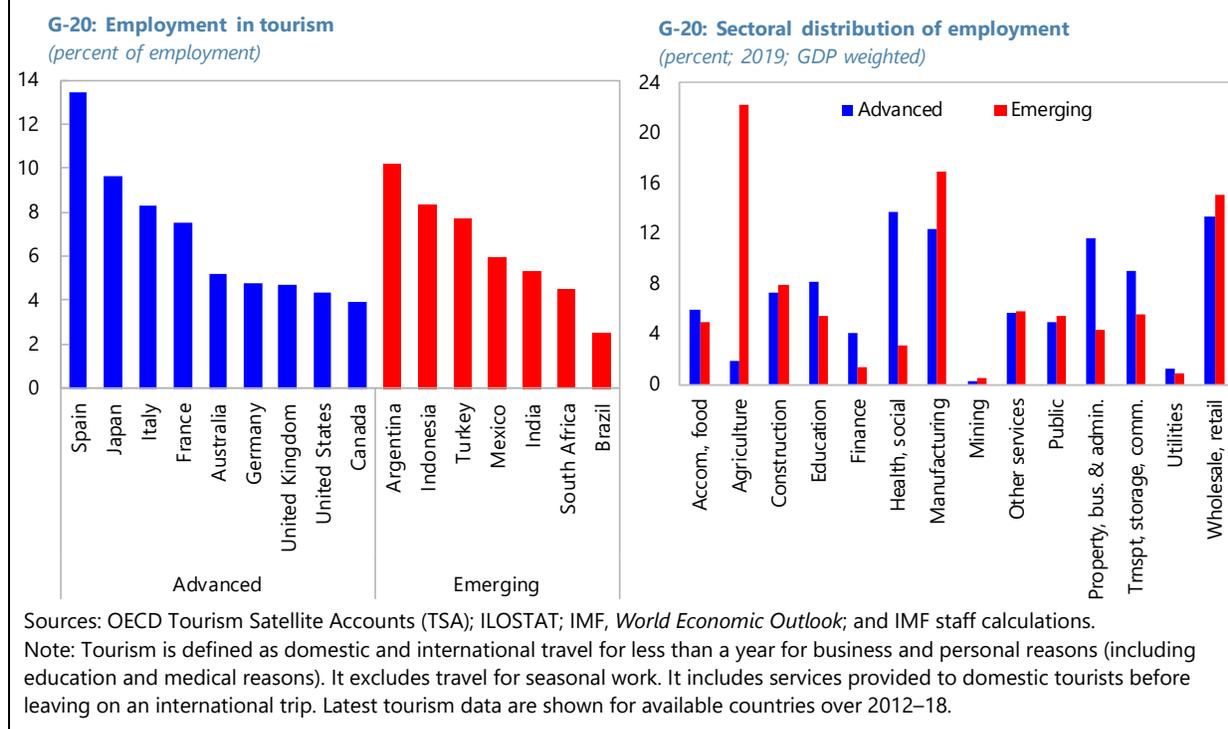
**12. Helping workers transition between firms and sectors can also enhance overall productivity.**

The structural changes in employment are likely to be large. For example, hard-hit industries like accommodation and food services account on average for 5 percent of employment in the G-20 (Annex Figure 4). The tourism industry employs more than 5 percent of workers in *Argentina, Australia, France, India, Indonesia, Italy, Japan, Mexico, Spain, and Turkey*. Therefore, policy support for transitioning between firms is essential. Options for helping workers transition include active labor market policies, like job-search assistance, employer intermediation, and training programs, to build new skills and maintain employability. Unemployment benefits should be provided to facilitate job search. Wage and hiring subsidies can encourage firms to create new jobs, thus supporting the recovery in employment and offsetting the firm's elevated uncertainty around future demand conditions and potential skills mismatches. They can also encourage workers to retain their attachment to the labor force. However, these policies likely need to be targeted at certain population groups, like the long-term unemployed, the young, or the elderly, to limit their fiscal cost. Supporting young, dynamic firms and market entry can also promote the creation of new jobs.

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<sup>11</sup> IMF, 2020. "[Public Sector Support to Firms](#)." Special Series on Fiscal Policies to Respond to COVID-19, Fiscal Affairs Department.

**Annex Figure 4. Employment by Economic Sector**



**13. At the same time, care should be taken to guard against increases in inequality due to rapid structural change.** Vulnerable groups, including the unemployed and the poor, need shielding in the transition (see main text). Public works programs can provide income and work experience to low-income workers, while performing socially beneficial services. Temporary support for small firms can smooth the transition for a large share of the workforce, but fiscal constraints make this challenging and it would slow likely needed reallocation of workers and capital.

## E. Additional Principles Should be Considered in the Design of Support

**14. Any policy response requires balancing important tradeoffs.** For example, preserving employment relationships can prevent the loss of job-specific human capital and matching costs, but it may also hold back unavoidable structural transformation that is important for the recovery. Avoiding bankruptcies can preserve productive capacity, but state support can make firms less productive and impede capital and labor reallocation to other firms. In addition, the need for swift action must be weighed against the benefits of potentially slower targeted support, which can better prioritize social needs and may be less fiscally costly.<sup>12</sup> In this respect, the need for urgency may be high during the immediate containing phase (especially if the impact is deemed to be temporary), while targeting becomes increasingly more important as the world moves past the immediate crisis and into the stabilization phase. Financial support through financial intermediaries needs to balance incentives for intermediary participation with limiting fiscal risks.

<sup>12</sup> IMF, 2020. "[Expenditure Policies in Support of Firms and Households](#)." Special Series on Fiscal Policies to Respond to COVID-19, Fiscal Affairs Department.

**15. Some additional principles can be useful when considering the most effective design of policy support.**

- *Support should have explicit objectives.* Objectives help in policy design, implementation, evaluation, and prioritization.
- *Support should be transparent and subject to good governance and oversight.* Priorities include clear lines of responsibility, recording all transactions, disclosing them in financial statements, and keeping transactions at arm's length.
- *The overall framework for supporting firms should be inclusive.* While specific programs may be targeted, the overall framework should be fair and avoid gaps in coverage.
- *Conditionality should be proportionate to the support received.* Small amounts of emergency liquidity support should have little conditionality to maximize effectiveness. However, greater support should come with more conditions that protect taxpayers against risk and align outcomes with social objectives. For example, conditions could include evidence of how funds were used and limits on the use of funds (like compensating shareholders, management, or creditors).
- *Support should be temporary.* Support should end with the passing of the pandemic to create incentives for firms to be self-sufficient. Uncertainties around disease spread and treatment make exact timeframes infeasible, but some expectations of program termination can be generated, for example with sunset clauses.

## **F. Non-Financial Support Can Also Assist Firms**

**16. Beyond financial support, policymakers can also help firms to operate safely and effectively.** Governments can provide trustworthy information on how to make workplaces safe for customers and staff, as well as resources for workplace screening, testing, and hygiene.<sup>13</sup> This is especially important for informal workers who are more vulnerable. Policymakers can provide legal clarity, for example on the application of *force majeure*. Regulatory flexibility can reduce operating costs and promote the manufacture of critical goods.

**17. In preparation for a possible future wave of bankruptcies and debt distress, insolvency and debt resolution frameworks should be strengthened.**<sup>14</sup> Under necessary lockdowns, interim measures should prevent viable firms from being pushed into premature insolvency. Options include moratoria on debt enforcement, increasing thresholds for creditors to initiate involuntary bankruptcy proceedings, suspending rules against insolvent trading or the director's duty to file for insolvency, and extending deadlines in insolvency proceedings. When economies reopen, bankruptcy proceedings should resume to facilitate efficient resource allocation. In this phase, policies should focus on streamlining procedures, triage of scarce legal resources, and on increasing the capacity of the legal system through out-of-court settlements.

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<sup>13</sup> WHO, 2020. "Considerations for Public Health and Social Measures in the Workplace in the Context of COVID-19," Annex to "Considerations in Adjusting Public Health and Social Measures in the Context of COVID-19," May 10.

<sup>14</sup> IMF, 2020. "[Private Debt Resolution Measures in the Wake of the Pandemic](#)," Special Series on COVID-19, Legal Department, May 27.

- *Increasing capacity of the legal system through special out-of-court frameworks.* Out-of-court frameworks can help firms and creditors reach settlement. Authorities can provide a dedicated restructuring agency or simply set out obligations, like a debt standstill agreement. Whatever the level of public involvement, effective coordination between public and private sectors is key.
- *Streamlining formal procedures.* Authorities can provide standardized solutions to make the restructuring process quicker and cheaper. These solutions broadly adapt to the circumstances of the case, like the size of the firm, but are less precise and costly than a fully customized restructuring plan. Simplified administrative proceedings may also be offered to small firms. For example, Subchapter V for small businesses in the *United States* allows the owner to continue managing the business, avoids some costs and delays of Chapter 11, and permits spreading out administrative expenses.
- *Triage of scarce legal resources.* To avoid overwhelming the legal system, a risk-based approach can be used to prioritize firms that have the best prospects for recovery, or are systemic, strategic, or essential. The highest-priority cases can be referred to out-of-court frameworks, cases eligible for standardized solutions can have these parameters set, and “zombie firms” can be marked for liquidation.