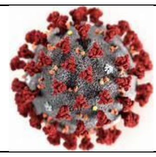
National COVID-19 Science Task Force (NCS-TF)	

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Title: Support to businesses in the second COVID-19 wave[1]

Summary of request/problem

The second wave of the COVID-19 pandemic raises additional challenges for businesses in sectors that are affected by non-pharmaceutical policy interventions and/or by collapsing consumer and intermediate demand. Wages continue to be compensated through well-established policy instruments. However, since the discontinuation of the Covid-19 bridging credits in July, no policy tool has so far been activated to support affected businesses with respect to their fixed capital costs.

Executive summary

The second wave of the pandemic has triggered a renewed contraction of economic activity, and it is likely that this situation will not improve in the months to come. As a consequence, ongoing revenue shortfalls in particularly hard-hit sectors will require continued public support, primarily in order to avoid a wave of bankruptcies of firms that would be viable in normal times. The hardship clause scheme currently under consultation risks being insufficient to stabilize the situation. We therefore propose that the "Covid-19 bridging credits" scheme offered by the federal government during the first wave of the pandemic be reactivated immediately. This scheme has proven to work efficiently and has the crucial advantage of being implementable quickly. We additionally propose that contingency planning be started now on how to support businesses in case that economic activity were to remain substantially reduced beyond the end of this winter.

[1] We are grateful to Roman Stocker for helpful suggestions.

Main text

1. *Introduction: The Case for Fiscal Support to Private Businesses in the Pandemic*

Public compensation of private-sector corona costs is efficient for a number of reasons.[2] In the current situation, state aid is largely free of the usual adverse incentive effects: the epidemic is spreading independently of economic policy. Moreover, a wave of bankruptcies or closures of firms that are viable in normal times would slow down the post-crisis economic recovery. There is thus an adverse effect on third parties (strains on aggregate recovery and growth) of individual entrepreneurial decisions (bankruptcies) - a clear example of a situation that calls for corrective public policy.[3] It is, therefore, important to preserve productive capacity for after the crisis.

Compared to compensation payments for labour costs via the unemployment insurance institutions, Swiss policy with regard to capital costs (rent, maintenance costs, storage costs, licence fees, depreciation, interest, etc.) is much more limited. This is uncontroversial under normal cyclical fluctuations, as capital owners are in a position to cope with the risks of unstable revenues. However, in an unprecedented crisis triggered by a truly exogenous shock to the economy as a whole, there is a risk that an absence of public compensation will push many companies that would otherwise have been viable into closure or bankruptcy. This is a real risk, given that fixed **non-wage outlays can account for significant shares of firms' costs**. Siegenthaler and Stucki (2015) have estimated that 30%-40% of average small and medium-sized firms' value added is accounted for by capital inputs (including profits) and 60%-70% by labour inputs. An effective instrument to support firms in this situation will need to balance fast liquidity support with some solvency elements to minimize the danger that otherwise viable firms fail in the short run as well as in the long run, while at the same time minimizing the risk that otherwise non-viable firms survive. Liquidity loans are debt in the books of firms. Even if the loan comes with a very low interest rate and long maturity, higher debt may prove to be an obstacle for recovery in the longer run and will discourage conservative entrepreneurs from taking it in the first place.

In March, the Federal Council quickly rolled out a scheme that by and large met the requirements for an effective support scheme: the "**Covid-19 bridging credits**" which provided loans at zero interest rates and with generous repayment conditions. The deadline for application to the scheme was July 31st. Out of an earmarked budget of CHF 40 bn, some CHF 17 bn have been disbursed. In economic terms, this scheme was both efficient and equitable, as it compensated affected firms equally for a shock that has hit them symmetrically.[4] Such a policy does not distort competition.

[2] See also Alós-Ferrer et al. (2020); Bonardi et al. (2020a, 2020b); Gersbach and Sturm (2020); Greenwood et al. (2020).
[3] On the internal and external costs of bankruptcy, see e.g. Andrade and Kaplan (1998), Bernstein et al. (2018, 2019), Bris et al. (2006).
[4] See also Kaufmann (2020) on the cost effectiveness of the scheme.

2. Main Recommendation: Reopen the Covid-19 Credit Programme and Plan Ahead

Our working hypothesis here is that measures to contain the pandemic will last through the winter, but that a gradual return to normality will occur in the spring of 2021. Against that background, **we propose that the Covid-19 credit programme be reopened**.[5] This would not require no new guidelines and procedures, but only rather small adjustments in the details of the provisions.[6] Therefore, it could be implemented with almost immediate effect. The reason for this recommendation is that the slowdown measures recently implemented by the confederation and the cantons to fight the spread of the pandemic will lead to a broad-based reduction of economic activity. This affects different sectors with different intensity, yet, due to interconnections, major parts of the economy are being hit by the second major exogenous shock this year. The current containment measures are less far-reaching than those implemented in spring, but (i) there is the possibility that they will have to be tightened if the pandemic is not sufficiently contained and (ii) it is highly uncertain when the current containment measures will be relaxed. A winter of significant restrictions for economic activity is quite likely. In this situation, it is a major relief for hard-hit businesses when they have the possibility to quickly soften the danger of running out of liquidity.

Even with our relatively optimistic epidemiological scenario of a gradual return to normality during spring 2021, many firms risk running not only into liquidity problems but into solvency problems. Pure liquidity support – fully and unconditionally repayable after the crisis – may not be sufficient for many firms. It is therefore important to understand the nature of these loans. Given the construction of the scheme, they create a rather **soft form of indebtedness** compared to common loans. In essence, they are designed in such a way that it should be virtually impossible for a company to be forced into bankruptcy if it does not repay these debts.

There is, first of all, an implicit grant element in the guaranteed zero interest rates.[7] Moreover, the repayment period has been considerably extended by parliament to up to 10 years. Finally, even if a firm is not able to repay the loan after 10 years, it will not be forced into bankruptcy. The loan is then transferred from the respective private bank to the loan guarantee organisation ("Bürgschaftsgenossenschaft", BG) that has given the "Solidarbürgschaft", i.e. has guaranteed the loan. The law does not set a deadline to the BG for repayment, and the terms for this will be established in an agreement between the BG and the Confederation (via the Federal Department of Economic Affairs, Education

[5] Our proposal for Covid-19 loans is most suitable for small and medium-sized firms in competitive industries, where a single firm's action does not significantly affect the revenue of the sector as a whole. For larger firms, an intermediate form between fully repayable loans and ex post non-repayable grants depending on whether such a firm would be profitable in the future could be a solution. This would be comparable to student loans that must be paid off by graduates in later life only if they earn sufficiently high incomes. Such conditionally repayable loans would likely reduce the risk of bankruptcy, while limiting moral hazard problems. Convertibility of loans into non-voting equity could also be considered (see Danthine et al., 2020; Boot et al., 2020).

[6] In particular, the limit of the overall credit to a maximum of 10% of the sales revenues in 2019 should be increased.

[7] Müller and Schnell (2020) estimate this to be worth over CHF 3 bn, or close to 20%, of the Covid-19 credits already disbursed.

and Research). It is foreseen that a BG shall not push any cooperating company into bankruptcy because of the repayment of these debts. In essence, this means that such debt is softer than ordinary bank loans. Of course, the bank and later the BG will press for repayment by insisting on a payment schedule, and the loan is subject to certain restrictions, such as a prohibition to pay out dividends. This should reduce the risk that firms with sufficient financial resources to weather the storm themselves profit from the scheme while not representing a binding constraint on the viability of firms that indeed need it. We recommend that the repayment features of the Covid-19 bridging credits be communicated openly, so as to avoid sub-optimal take-up of those loans due to an incomprehension of their relative generosity.[8]

However, even the relatively soft terms of the Covid-19 bridging credits imply that most of the capital cost share of lost sales due to the pandemic must eventually be borne by the business owners themselves. This might create problems if the pandemic were to significantly depress economic activity beyond spring 2021. We therefore propose that **contingency planning** be started immediately for the case that the crisis should last beyond spring 2021. In that case, conditional debt forgiveness at a future date might be a viable model (see Bonardi et al. 2020a, b).

3. The Hardship-Clause Approach: A Potentially Useful Complement

The **hardship-clause approach** currently under consultation ("Covid-19-Härtefallverordnung"), foresees grant support to firms whose annual turnover falls by more than 40% below the pre-crisis average. According to the draft regulation, the Confederation would add a 100% top-up to any loan or grant support paid out of cantonal budgets, up to a ceiling of CHF 200 million between September 2020 and the end of 2021. Importantly, most details on compensation amounts, eligibility criteria and administrative procedures are left for the cantons to resolve.

The severity of the economic downturn suggests that more than liquidity support will be needed for firms in particularly hard-hit sectors/cantons. Despite the caveats noted above, the grants provided under the hardship compensation scheme can provide a useful complement to the liquidity support of a renewed Covid-19 bridging credits scheme, but they are no substitute for it. Moreover, it is difficult to conceive of a fair and efficient mechanism for disbursing hardship compensation in the middle of a crisis of unknown duration. It might therefore be advisable to offer **hardship compensation initially as loans**, with an explicit promise of partial forgiveness after the crisis, when transparent and impartial comparisons of affectedness will be possible across firms, sectors and regions.[9]

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[8] Brülhart et al. (2020) find that, statistically, take-up of Covid-19 loans was determined to a considerable extent by non-economic, behavioural variables.

[9] Some of those amounts could in addition be used for co-payments to facilitate rent reduction agreements for commercial real estate, as proposed in an earlier Policy Brief (NCS-TF, 2020).

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