



Government Support Policy for Fixed Costs of Businesses in Crisis

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This is a short summary, for the full paper (in Hebrew) see
<https://www.idc.ac.il/he/research/aiep/pages/policy-papers.aspx>.

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The current period (July 7, 2020), which is characterized by a surge in the numbers of hospitalized COVID-19 patients and severe cases reported, amid new restrictions on economic activity, requires policy makers to prepare for a second wave or similar scenarios. Just like the preparation of the healthcare system, which must include clear measures for dealing with a second crisis,¹ similar preparation is necessary in the area of economic policy, including the necessary legal groundwork. The first outbreak, which started in March 2020, gave rise to economic policy measures which were designed within a short time frame, "on the go", in complicated circumstances and under public pressure, and might have not been the optimal steps to take at that point in time. Now, however, given the policy measures taken – which may have created some anticipation for their recurrence in case of a similar crisis – there is a need for an economic plan detailing government actions to be taken in case of another outbreak or a similar crisis, in order to alleviate uncertainty in the business sector regarding such a scenario.² It is difficult to estimate the negative economic impact of uncertainty, but undoubtedly it impairs the ability of businesses to make economic decisions, thus hindering employment and the growth of the economy, since the hesitation of policy makers in deciding on the means and extent of government support is detrimental to the willingness of businesses to return to full activity, which in turn reduces the availability of employment.

We would like to emphasize that economic research does not offer a definitive answer regarding the optimal means of support for periods such as this, due in part to the great heterogeneity of firms within the business sector and the characteristics of their activity. Therefore, it is difficult to make categorical recommendations regarding business support mechanisms. However, even given this complexity, there are some guidelines for an effective business support policy, essentially boiling down to programs which offer a cash flow bridge to businesses and firms expected to survive the crisis. Aid for strong businesses will facilitate quick recovery of the economy as a whole, along with streamlining of inefficient businesses and firms which may exit the industry, a process which acts as a catalyst for reallocation of resources and has a positive impact on economic growth. Policy tools and means of support must be proportional to the extent of economic damage and to the fixed costs of each business; they should provide incentives to parties bound by contractual agreements in the

¹ For further reading (in Hebrew) see Even, Eckstein, Hadad, Lifschitz, and Sumkin (March 2020), "Covid-19 Crisis: Recommendations for Economic Policy", Aaron institute for Economic Policy in collaboration with the Institute for National Security Studies (INSS), <https://www.idc.ac.il/he/research/aiep/pages/corona-crisis-economic-policy-recommendations.aspx> and Eckstein, Menahem-Carmi, and Sumkin (April 2020), "Analysis of COVID-19 Disease Situation in Israel and Comparable European Countries", Aaron institute for Economic Policy, <https://www.idc.ac.il/he/research/aiep/pages/sick-people-in-israel-and-europe.aspx>

² For further reading see also *OECD Employment Outlook 2020*, Section 1.4, https://www.oecd-ilibrary.org/employment/oecd-employment-outlook-2020_1686c758-en

commercial property market to reduce legal friction which incurs high economic costs; and they should be designed in a way which minimizes the bureaucratic barriers to receiving aid.

This paper aims to survey the support policies addressing fixed costs of businesses in developed countries during the first wave of the COVID-19 crisis. Government support towards the fixed costs of businesses is the primary policy tool of support for the business sector.³ The authors' advocacy for government intervention derives from a market failure concerning fixed costs. This market failure stems from the fact that business agreements which bind the business sector do not cover an event in which business activity is halted by the government, and in particular the lack of business insurance coverage for such an event. In developed countries, government support towards the fixed costs of businesses was provided through four principal policy measures:

1. State-guaranteed loans
2. Reducing or Deferring taxes
3. Fixed cost subsidy grants
4. Regulating commercial lease market activity

The first three policies have been implemented in Israel, however no steps were taken in the real estate market.

Our survey shows that many countries, including some countries which lead a tight fiscal policy and are not inclined to government intervention, such as the US and Australia, provided businesses with extensive government support during the first wave of Coronavirus disease. An international comparison shows that government support for the business sector in Israel was relatively slim compared to other developed countries, specifically the benchmark countries. Thus, for example, in Israel the share of state guarantees in a dedicated loan fund for the business sector is 15%, a significantly lower figure than the governmental share in the surveyed countries, which is 50%-100%. These guarantees affect the willingness of banks to provide credit for businesses with minimal or negligible funding costs. The volume of loans provided in the framework of state-guaranteed funds, as a percentage of the GDP, has also been low in Israel. Our international comparison also shows that tax payments for the Israeli business sector have been deferred for shorter periods, and government bailouts were lower, compared to the other countries surveyed.

³ For a recommendation for government support policy targeting job seekers (in Hebrew), see Eckstein, Larom, and Lifschitz, "Employment Policy Response for the COVID-19 Crisis", Aaron institute for Economic Policy, <https://www.idc.ac.il/he/research/aiep/pages/coronavirus-employment-policy.aspx>

These and other measures were outlined in the government support plan announced by the Israeli government, for which NIS 102 billion were allocated (in two phases).⁴ Data presented by the Accountant General in early July⁵ shows that the actual implementation rate of government plans in response to COVID-19 was 46% by the end of June 2020. Specifically, the Accountant General's data delineates the implementation of support plans focusing on businesses (dubbed "Business Continuity"), which consist mainly of programs for state-guaranteed loan funds, tax deferral, and bailouts. **The overall extent of support packages for the business sector is NIS 54.7 billion. According to the data, by the end of June 2020 the implementation rate of business support plans was as low as 46%.**

The authors posit that the extent of government support for state-guaranteed loans should be increased, since this remedial action alleviates the cash flow problem of companies which are predicted to survive the crisis. This policy tool is considered the most effective means of support from an economic point of view, also considering the low rates of state guarantees. In this situation, loan allocation is left to discretion of banks, who specialize in business credit provision. As of July 7, 2020, the volume of loans already allocated through a state-guaranteed fund for small and medium-sized businesses is NIS 15 billion, which represent 83% of the fund's loan volume. These loans were provided to accommodate 40.9 thousand applications submitted by small and medium-sized businesses (out of 57.7 thousand applications reviewed). Currently the banks are reviewing further 70.6 thousand applications, indicating a need to expand the volume of available loans.

As for direct support in the form of bailouts and grants, we will note that while such measures undoubtedly increase the survival chances of businesses, economic research literature does not provide a definitive answer regarding their level of optimality, and it is possible that in some countries the bailout amounts are excessive. We will note that the execution volumes of this support mechanism are low. These low volumes may stem from complex bureaucracy surrounding the application process, or high threshold requirements, and this issue warrants examination in order to increase execution volumes.

As for intervention in the commercial lease market, a policy tool employed in some other countries, we will note that under lockdown conditions preventing economic activity, the absence of suitable contractual infrastructure is detrimental to the operation of the market and acts as a market failure. Therefore, we may see numerous cases of breach of contract and failure to fulfill commercial lease contracts, some of which are already in litigation or about to

⁴ On March 30, 2020, the Israeli government presented a NIS 80 billion aid and relief package (Hebrew): https://www.gov.il/he/departments/news/press_30032020_b. On May 24, 2020, the government decided to expand the package to NIS 102 billion (Hebrew): https://www.gov.il/he/departments/news/press_24052020. This expansion consisted mainly of a back-to-work bonus (NIS 6 billion), guarantees for state guaranteed loan funds (establishment and expansion) for businesses at risk (about NIS 4 billion), and additional individual subsidies (support for the tourism and culture sectors).

⁵ Appendix 4.1 in the Accountant General's announcement (in Hebrew): <https://mof.gov.il/AG/BudgetExecution/BudgetExecutionReports/Pages/CurrentBudgetExecutionReports.aspx>

enter litigation. We believe that this experience in as of itself will not necessarily cause parties to a contractual relationship in the commercial lease market to account for such scenarios in future agreements, both because commercial lease agreements are long-term and because these contracts tend not to cover macroeconomic scenarios, just regular risks. Hence, this market failure may persist in a recurring disease wave or similar scenario. **Despite the high economic costs of legal conflicts, government intervention in commercial lease agreements should be avoided,⁶ even though such a solution was applied in some other countries,⁷ because government intervention in the property lease market might have long-term negative effects, even more harmful than those of an increase in the number of lawsuits.** We believe that from an economic perspective, government grants which are determined according to the extent of economic damage and the characteristics of each business in terms of rent and types of stock, thus engendering higher grants for businesses with higher fixed costs, are preferable to government intervention in commercial contracts.

⁶ That was also the main recommendation of the Inter-ministerial Legal Committee for Settlement of the Rent Issue During COVID-19 Pandemic, led by Mr. Erez Kaminitz, Deputy Attorney-General for Civil Legislative Affairs.

⁷ In some countries, government intervention in the property rental market is the norm under normal circumstances as well.