COVID Credit Policies Around the World: Size, Scope, Costs, and Composition

by Gee Hee Hong and Deborah Lucas

by:

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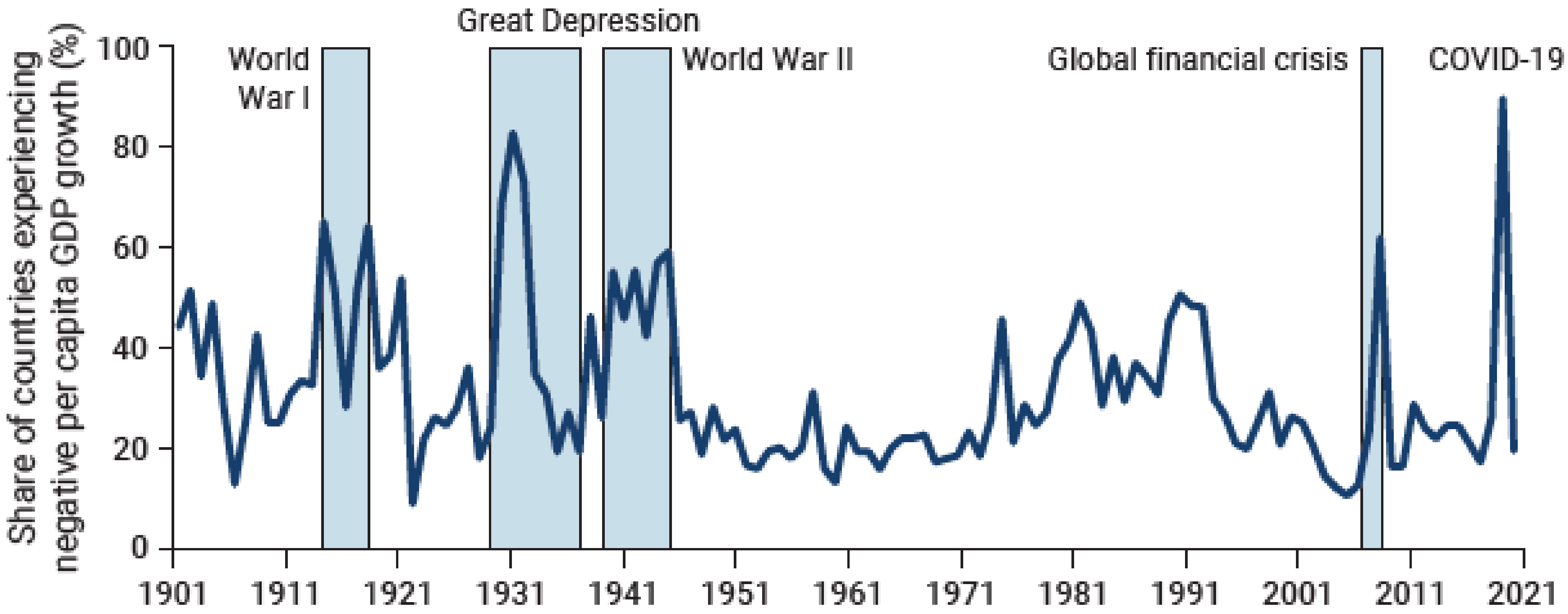
Preamble to discussion: The global scope of the shock

The COVID-19 shock: Share of countries with annual declines in real per capita GDP, 1901-2021



Source: Holston and Reinhart (2022) and sources cited therein.
Notes: The number of countries ranges from 34 in 1901 to 192 in 2020; *World Economic Outlook*, October 2021 estimates for 2021.

Aim of paper

While a growing body of work studies various aspects of these credit policies, this paper appears to be the first to ***estimate the effective size of these policies in a way that allows aggregation across credit support, forbearance, and traditional fiscal policies, with the aim of producing statistics that can be used to explore the connections between these policies and various macroeconomic outcomes.*** *Specifically, we introduce the idea of "incremental resources provided" as a unifying concept for sizing credit support, forbearance, and traditional fiscal programs. We operationalize that idea by equating size to principal take-up for government loan and loan guarantee programs; equating size with total avoided payments for forbearance programs; and equating size to reported expenditures for traditional fiscal policies.* ***The size estimates for large-scale credit forbearance programs are an original contribution of this paper,*** *while those for direct lending and guarantee programs are taken from Hong and Lucas (2023), and incremental fiscal spending is taken from the October 2021 release of the IMF database on fiscal policies*

What I really like about the paper

- Given the unprecedented (to my knowledge) scale and broad use of less orthodox financial sector policies in response to the health crisis, the focus of the paper is a very important **area for exploration that deserves more attention than it has thus far received.**
- **The narrative on what was done is rich in detail and comprehensively sourced.**
- The authors also offer estimates of what may be called ***"augmented"*** **fiscal policy--that is, the combined cost of "traditional" fiscal policy, government credit, and forbearance policies for households and firms.** This is both novel and necessary to gauge the macroeconomic impact of the COVID policy response (which differs greatly from, say the GFC) in the overwhelming majority of countries around the globe.

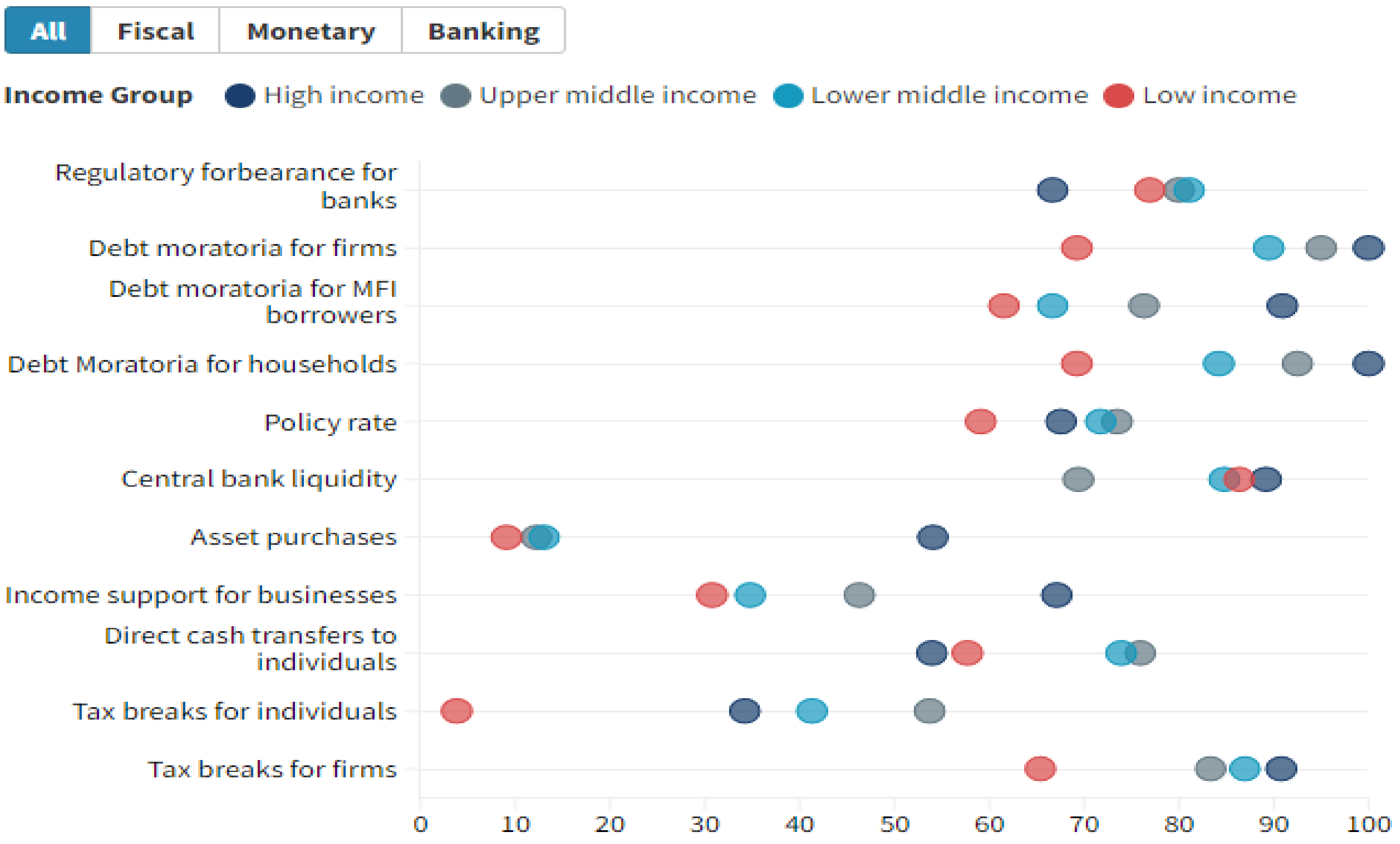
My three quibbles with the paper:
#1 This paper focuses on seven Advanced Economies (AEs)--which is not the world, as the title suggests

The next figure, from the World Bank's ***World Development Report 2022***, lists the varieties of policies adopted to soften the COVID-19 shock and provides a "big picture" of the adoption of these policies across countries in different income brackets.

The menu of fiscal and monetary policies was broad. Less traditional responses were financial sector policies that included debt moratoria for households and firms.

In many countries, most notably emerging markets and developing countries (EMDEs), regulatory forbearance for banks was introduced so as to encourage banks to lend more than they would otherwise**. The policy stimulus mix and scale varied enormously across countries in different income groups and even across countries within the same income group, so drawing broad policy lessons will not be a trivial task.**

Share of countries adopting policy (%)



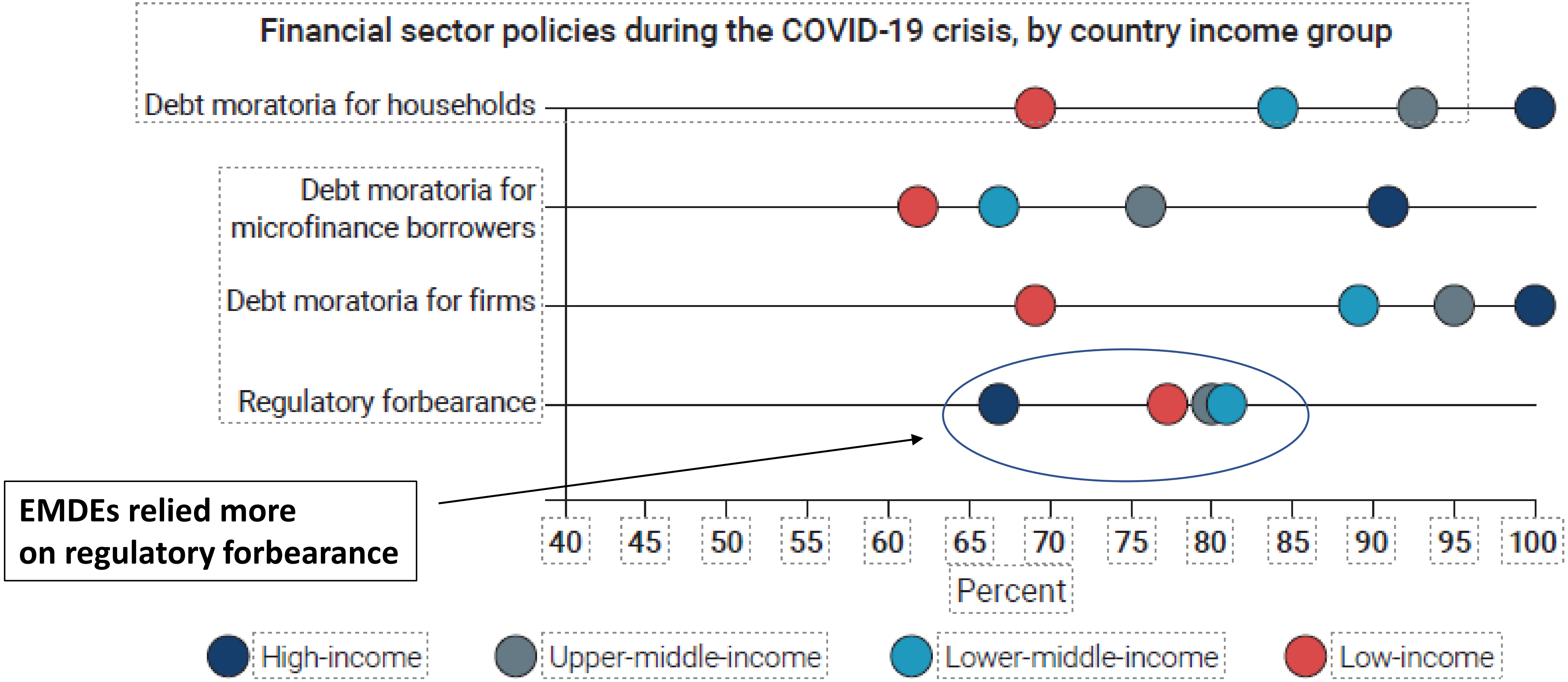
Source: World Development Report 2022:

#2 Financial sector policies also carry potential financial stability risks worth emphasizing more

While this paper addresses and quantifies the (very important) fiscal costs associated with credit and forbearance policies, **it is also important to bear in mind that these policies also carry potential risks beyond the additional fiscal burden.** **One such risk is associated with regulatory forbearance for banks that has tended to reduce the transparency of the balance sheets of financial institutions—TO BE FAIR TO THE AUTHORS, this risk greater for many EMDEs than the AEs that are the focus of this paper.** (see next figure)

The lack of balance sheet transparency extends beyond the public sector. As the 2022 World Development Report highlights, many countries introduced accounting and regulatory forbearance and guarantees to mitigate the impact of the pandemic on the economy. The unintended consequence of these measures is the potential for an increase in nonperforming loans that are not yet reflected on banks' balance sheets. The rise in hidden nonperforming loans, together with increased sovereign debt holdings, has reinforced the so-called sovereign-bank nexus, in which the financial soundness of banks has become increasingly intertwined with that of governments. Banking and sovereign debt crises have often erupted in close succession (Reinhart and Rogoff 2011). The pandemic has strengthened this "doom loop" while increasing the opacity of private and public balance sheets.

Ceyla Pazarbasioglu and Carmen M. Reinhart "Shining a Light on Debt," *Finance and Development*, International Monetary Fund, March 2022



Source: World Bank, COVID-19 Crisis Response Survey, 2021, http://bit.do/WDR2022-Covid-19_survey.

Note: The figure shows the percentage of countries in which each of the listed policies was implemented in response to the pandemic. Data are as of June 30, 2021.

#3 links to macroeconomic outcomes (growth, inflation, saving) needs to be taken with many grains of salt

Disclaimer: My intuition certainly agrees with the thrust of the authors. Namely, that credit and forbearance policies provided an added source of stimulus and, in some cases a very important one, among both AEs and EMDEs.

Having said that:

A useful starting point to that discussion would be to offer a simple conceptual framework that highlights some of the channels of transmission between policies that provide credit or short-term liquidity to households and firms and economic activity. Making a connection to inflation is, in my view a different matter altogether, and beyond the scope of what should be included under macroeconomic outcomes. The conceptual framing need not involve a theoretical contribution, it can be of a very basic variety (see, for instance, *World Development 2022 Report).*

#3 links to macroeconomic outcomes (continued)

Drawing sharp conclusions about the incremental effects of credit and forbearance policies on real GDP (or some of components, such as consumption and investment) **from seven observations is problematic**—even if the other shocks these seven countries faced were identical during period under study and the only cross-country differentiation was the scale of the financial sector policies.

But complicating matters, the other shocks during the pandemic varied considerably across countries, starting with the unfolding of COVID-19 itself. The waves of infection rates varied importantly in their timing and intensity. The policy of shutdowns was far from uniform among the seven countries examined here. Both the course of the disease and the shutdowns were immensely impactful on economic activity. The authors need to address this issue to get to the answers they seek. Nor was COVID-19/shutdowns the only difference.

#3 links to macroeconomic outcomes (concluded)

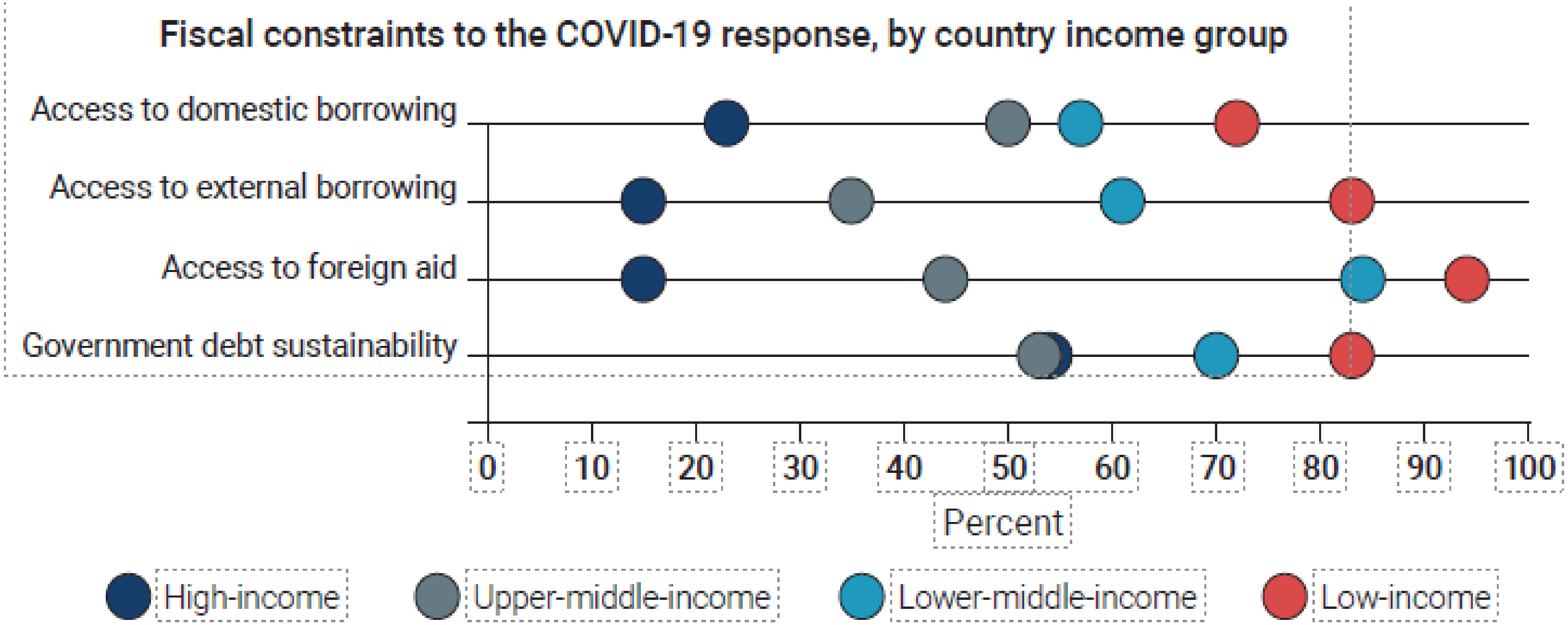
Initial macroeconomic conditions varied greatly across countries (see next figure)-including AEs.

In addition, central banks were active during this period with policy changes that were consequential for the availability of credit in general and the support of firms via asset purchase programs.   Presumably, the impact of these actions on economic activity were in the same direction as those of the programs considered in this study. Comparisons among the eurozone are easier in that regard, but Japan, the UK and the US are three of the countries in the sample. The analysis could be supplemented by also examining credit trends during the pandemic.

In sum, the study would benefit from trying to control for these sources of shocks to tease out the effects of the credit and forbearance policies.

In the meantime, caveats are in order.

Initial conditions varied enormously across countries



Source: World Bank, COVID-19 Crisis Response Survey, 2021, http://bit.do/WDR2022-Covid-19_survey.

Note: The figure shows the percentage of countries in which each of the listed factors was identified as a significant or moderate constraint to the response to the pandemic. Data are as of June 30, 2021.

Final takeaways

I think the authors have laid out a great roadmap to understand, integrate, and assess the role played by financial sector policies in response to the health crisis. I have learned a great deal from this paper.

The economic recovery from the COVID-19 shock has been far weaker for middle-income EMDEs than for the high-income AEs and weaker still for the low-income countries. I suspect that important differences in the magnitude of stimulus (fiscal, financial sector, and monetary policy) will be part of the answer for the widening gap between the income of rich and poor nations we have observed since 2020. I hope future research can extend this line of work to a broader sample of countries.

This paper is part a valuable line of research that will be rich in policy implications, as there has not been a comparable use across so many countries of financial sector policies in history (at least, that I am aware of).