Institute of Policy Studies

CLOSED-DOOR DISCUSSION ON ECONOMIC, BUSINESS IMPLICATIONS AND FINANCIAL COSTS OF COVID-19, 31 MARCH 2021

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Executive Summary

Every crisis creates economic losses as reflected during the Asian Financial Crisis (AFC), the Global Financial Crisis (GFC) as well as the current COVID-19 pandemic. According to the Asian Development Bank (ADB), the coronavirus pandemic could cost the global economy between US $5.8 to $8.8 trillion, equivalent to between 6.4 to 9.7 per cent of global economic output. This is due to policy measures implemented to slow the spread of COVID-19 (e.g., social distancing) that have paralysed economic activities. In addition, the huge uncertainty and mounting losses due to COVID-19 have created economic shocks on a global scale. Businesses are used to uncertainty but policymakers would need to assess who should bear the financial risks of this uncertainty.

The Institute of Policy Studies held a closed-door discussion (CDD) on 31 March 2021, titled "Economic, Business Implications and Financial Costs of COVID-19". An assessment of the East Asian region was provided, and in general the East Asian region has fared better due to interventionist governmental policies. The business community were consulted for their views on economic recovery, which included CEOs, SMEs, women entrepreneurs and workers. For businesses, going digital and transforming their business model enabled them to reach out to new consumers across the world. Despite uncertainties, it was possible to quantify various risks scenarios and provide insurance cover. Nonetheless, this would involve cooperation among key stake holders such as governments, industry and the insurance companies.

Introduction

Governments are assessing the scale of the economic shocks and implementing measures to save their economies from collapse. Banks and investors realise that many companies, especially SMEs without adequate cash flow and reserves, will default. Together with governments, banks and investors are trying to protect financial stability and public savings. The CDD examined the best approach at identification, quantification, allocation and financing of recovery. What useful lessons and experiences can we gather from previous crises that is applicable to the current and future crises?

The Institute of Policy Studies (IPS) conducted a closed-door discussion on 31 March 2021 titled, "Economic, Business Implications and Financial Costs of COVID-19". The forum was convened by IPS Senior Research Fellow Dr Faizal Yahya and moderated by Mr Manu Bhaskaran, IPS Adjunct Senior Research Fellow. The panellists were Ms Cecile Thioro

Niang, Practice Manager, East Asia and Pacific Finance, Competitiveness and Innovation, World Bank (WB) Group; Mr Colin Wilson, Past President, Institute and Faculty of Actuaries and Deputy Government Actuary, United Kingdom; Mr Sam Kok Weng, Markets and Financial Services Leader, PwC Singapore; and Mr Timothy Colyer, Partner and Head, Oliver Wyman, Indonesia.

The first panellist Ms Cecile Niang from the World Bank presented on "COVID-19 in Southeast Asia: Impacts on the Financial and Private Sectors, and Opportunities for the Recovery". COVID-19 has had major impacts on firms and financial institutions in ASEAN countries. The East Asian region fared relatively better compared with other regions. While few firms have closed permanently and others are opening up for businesses; the impact of COVID-19 is diverse. Nonetheless, the adverse impact on sales remained substantial by Q4 of 2020. For example, across the ASEAN countries, sales decreased by 56 per cent in the Philippines, 42 per cent in Indonesia, 31 per cent in Cambodia and 29 per cent in Vietnam. On average, micro-SMEs and female-led firms were more adversely impacted. For micro-SMEs, on average their sales decreased by 35 per cent but for larger companies it was 25 per cent. For female-led companies, their mobility was constrained and household matters occupied their time. Similarly, in sales, employment figures have rebounded but have yet to fully recover. This is in line with global trends as firms reduce wages or working hours instead of retrenching their workers. This is an important area for assistance in the economic recovery process. In terms of cash flow and liquidity, Non-Performing Loans (NPLs) were still below 4 per cent, which was better when compared with other regions. Nonetheless, it would be important to focus on NPLs, which were reflecting historical highs in some economies.

ASEAN governments in total had adopted more than 400 support measures to benefit both SMEs and large companies. Generally, the measures were clustered around these areas: subsidies, payment deferrals, soft loans, credit guarantees and tax reliefs. At the start of the pandemic, companies were unaware of the availability of support measures but their awareness increased with time. However, targeting still needs to be improved; while the share of companies accessing some government support has increased, this trend is uneven across the region. Very few schemes target female-led SMEs. There is further need for government to support SMEs through well-targeted liquidity and incentive for foreign investment.

Digitalisation

The rapid adoption of digital technologies by companies across varies sectors and economies had peaked around mid-2020. Also, companies were keen to digitalise for sales and marketing purposes and less for backend business functions. In many SMEs, the reported shift to digitalise their businesses reflected lower starting points and less complex uses but also the declining fixed costs of starting an online business through the use of digital platforms. This digitalisation trend has some correlation with lower job loss but no clear evidence of impact on sales or productivity by the end of 2020 in most countries. Moreover, only a few East Asia Pacific governments such as Malaysia and Singapore have made SME digitalisation and digital skills a key part of their relief efforts.

Financing

The innovations in Fintech and digital finance are key to boosting SMEs' access to financing for their recovery. The Fintech and digital finance innovations such as AI-powered solutions, digital peer-to-peer (P2P) lending would be able to benefit SMEs that faced a lack of access to traditional credit, including companies led by women. For example, the World Bank's SME digital finance project in Indonesia provided larger loans to women entrepreneurs and statistically their NPL rates were similar to the larger business loans pre-COVID-19. Digital P2P lending was growing rapidly in the East Asia and Pacific region, and remains a powerful tool to address the collateral and mobility constraints for SMEs. In Indonesia, the volume of P2P lending has increased by 600 per cent over the last three years and amounts to US$9 billion in 2020. Nearly half (47.2per cent) of all P2P borrowers were female. Digital lending has the potential to transform access to financing for female-owned SMEs. The advantages of digital lending include quick approvals, deep outreach through digital delivery and data-driven scoring, which reduces collateral requirements. Banking partnerships with Fintech can be critical because Fintechs have the latest technology and banks have the liquidity. In Indonesia, the World Bank has assisted with the matching of P2P between Fin Techs and banks in channelling partnerships to roll out digital credit to women.

Managing Risks

The second panellist Mr Colin Wilson focused on how governments could manage a crisis such as a pandemic. COVID-19 is unpredictable and provided a reminder of the many potential hazards that could occur. He presented on the "UK Financial Risk Management: Lessons from COVID". COVID-19 is a reminder of the many potential hazards that could emerge. The three areas of his presentation were:

- The importance of building resilience
- Who bears the risks?
- What is a good system that is effective and resilient?

The rethinking of risk management would involve three components, they are: identifying the price of risk; acknowledging the cost of uncertainty; and exploiting the value of flexibility. Some risks can be resolved but some cannot be predicted. Therefore, the price of risks costs could be shared appropriately. Some things cannot be quantified and there is a need to explore the value of mitigation on the operational side, its financial aspect and its impact on society.

There are many potential hazards, and the International Science Council identified 302 hazards in eight categories: biological, hydro meteorological, technological, geohazards, chemical, environmental, extra-terrestrial and societal. How could these potential risks be managed? One approach is not to rely on optimising efficiency in the system but to build resilience. In this context, there has to be redundancy and modularity as a buffer or cushion to prevent a "knock-on effect". Preparations would also require flexibility, having contingency plans and being adaptable in the system. These various needs point towards the conclusion that an international body is required to provide resources and information to assess what's going on. This is to enable improved prediction and better response in order to better protect people.

In the process of risk management, who bears the remaining risks? In terms of fairness, it is useful to examine who benefits from the activity generating the risk. In terms of practicality, how would global interconnectedness, externalities and public goods impact? At what level can and should the risk be pooled? The various stakeholders would include individuals, communities, affinity groups and nations. There will be limits to private insurance, and the government may need to step in as the insurer of last resort. In relation to public and private partnerships, the UK government has prepared various reports on managing risks. These included the following;

- Office for Budget Responsibility (OBR) Fiscal Risks Report (2017, 2019)
- Her Majesty's Treasury (HMT) Managing Fiscal Risks (2018)
- HMT Contingent liability approval framework (2017)
- HMT Establishment of Contingent Liability Central Capability (2021)

The financial costs of recovery could be met in several ways; firstly, as reserve financing through accumulation in past revenue. Secondly, through existing budgets as borrowing with interest against future revenues. In terms of revenue streams to pay for the deficit financing, the government could target several sources, such as targeted levies, generational taxation and reduced alternative spending. However, in the short term, some key challenges had emerged such as the effectiveness of the current system to meet these additional financing needs. In this context, an incentivise system might be useful but should be monitored for moral hazards. Furthermore, the system has to be financially sustainable in the long term and should be resilient and flexible to cope with unexpected events.

Prospects of Economic Growth

The third panellist Mr Sam Kok Weng from PwC examined the prospects of economic growth for 2021. In PwC's survey among 5,000 CEOs, against the context of the COVID-19 re-infection scenario, the majority of CEOs at 76 per cent believed that the economy would improve in 2021. When the responses of the CEOs were compared against those during the Global Financial Crisis (GFC) in 2008–2009, the confidence of the CEOs in 2021 going forward for the next 3 years showed a higher level compared to 2009. In 2009, the CEOs believed that the growth for the next 12 months would be better than for the next three years. Against the context of global investment and trade flows and a rising middle class, the funding required for economic recovery will impact on the spending required for growth. Despite the optimism of growth, the economic ecosystem is still evolving and even with the distribution of vaccines, many of the public health measures will remain in place. This is because COVID-19, due to globalization, is already endemic and there will be sporadic spikes in infections. CEOs in the technology, private equity and healthcare sectors were the most confident of short-term growth. The CEOs were also polled on the threats to growth. The various threats included pandemics, cyber threats, policy uncertainty, misinformation, and climate change. In particular, misinformation concerning the news on healthcare is believed to have a huge impact on the prospects of recovery for the global economy. Climate change is likely to be a key driver of the economy and the focus on sustainability could provide revenue inflows for the government. In this regard, the business subsidies and furloughs were helpful for companies especially those that are progressive. However, due to its broad nature, it was a missed opportunity to be a catalyst for companies that require transformation of their business model.

Going forward, given that COVID-19 is a feature of the ecosystem, what would be the best way to mitigate its adverse impacts and contain the costs of the financial risks? The availability of key skills is a major concern, as well as the costs of the health and containment measures. Looking at the various sectors, industries such as technology, e-payments and even groceries have done well when compared with hospitality and leisure. The social distancing and health measures may seem excessive for these sectors and could be reduced through better coordination internally and across borders. However, the dynamics of re infection is still very fluid and some of the countries that appeared the most vulnerable were still in a "state of denial" and did not appear prepared for the continuing onslaught of reinfections.

Human Capital

In a survey of 32,000 workers, most believed that they could meet the challenges of work in the future. Around 80 per cent of workers both in Singapore and globally believed that they could adapt to new technologies at their work place. However, workers were concerned over job security and more than 60 per cent believe that many jobs would be at risk through automation, and they would like to see governments taking action. Nonetheless, workers want to reskill and it has been proven during the pandemic that they could transition quickly to remote working and keeping productivity high. At least 40 per cent said that they were able to do this by learning new digital skills. Remote working is in demand and the percentage of workers wanting to go back to the office full-time is low, at just 4 per cent.

The availability of key skills to generate revenue is critical. CEOs saw more alignment and purpose to retaining their staff and keeping them occupied. The ability to raise the employment level which would increase consumption and assist in economic growth. Business leaders would need to repair, rethink and reconfigure their business models as the economy restarts. The COVID-19 response requires more than repurposing their business models because it has impacted the economy structurally. Companies have to find ways to increase their value without adding more debt into the financial system. These could come in several ways such as transforming into a sustainable and green business model. This transformation may involve leveraging on energy efficiency, the electrification of transport and green logistics. These growth sectors would also provide revenue for the economy.

Looking Forward

The last panellist Mr Tim Colyer from Oliver Wyman presented on "COVID's Economic Fallout – What Comes Next?" The focus was on the medium term macroeconomic impact of COVID-19. His three key questions were framed as follows:

- First, "the long haul to normalcy. In surveys he had conducted in the early days of the COVID-19 pandemic, respondents were provided three time lines for the duration of the pandemic: three, six or nine months. The longest estimate of nine months has now been exceeded by at least three months.
- Second, "economic whiplash", which describes the massive fiscal and monetary response to the pandemic. The fiscal and monetary assistance has been greater than during the 2008–2009 GFC but it runs the risks of creating asset bubbles, rising interest rates and inflation for the macro economy and in particular for the Southeast Asian region.

- Third, “new normal or old normal?” — in the context of the changing behavioural norms occurring during COVID-19, and whether these would be game changers and last beyond the pandemic or will it be business as usual after the pandemic.

The road to normalcy would depend on the level of infection and the rate of vaccination to be able to develop herd immunity among the population. At the start of the pandemic, governments were examining the coverage of the vaccines and the rates of their approval and efficacy. In addition, there were huge concerns over their manufacturing and distribution that tested the limits of governments’ administrative capacity. In the corporate sector, different industries felt the impact of the pandemic in variety of ways in terms of sector revenue and profit shocks. Clearly, the obvious conclusion would be to try and avoid further lockdowns that will have devastating impact on economies. The key strategy would be to effectively roll out vaccinations.

In Singapore’s case, COVID-19 is still a novel virus and we are vulnerable to an outbreak because the natural level of immunity in the population is still very low. The burden of rolling out an effective vaccination programme is greater given the low levels of infection rates. In comparison, for countries that have a higher baseline of infections, the reopening of their economy will be easier because they are better able to maintain their baseline of infection rates. In this context, the travel industry is an important economic sector but the reopening of the economy has to be managed carefully. This is because, given the low baseline of infection rates in Singapore, even with herd immunity through vaccination, the reopening of borders will likely see an increase in infection rates.

For developed economies, they are likely to achieve herd immunity in the second half of 2021 but would not likely be open to trade with emerging economies that have not achieved herd immunity until at least 2022 and beyond. The geopolitical impact of this, especially towards the emerging economies, will need to be examined. Furthermore, the threat of virus variants indicates that regular booster shots maybe necessary and this will create lasting inequality.

The release of stimulus measures opens up a host of scenarios in relation to how governments would manage their deficits going forward with the decline of moratorium schemes with the potential of widespread insolvency and adverse impact on employment. There will be a knock-on effect on the financial sector, which will be tested on how they manage potential asset bubbles and rising inflation rates. While NPL rates for emerging economies are less than 4 per cent, banks in some countries are reporting loans at risk in the 28 to 35 per cent range.

In the medium term, how would economies manage their debts? Using the GFC as an example, the post financial crisis saw the rise of price bubbles as liquidity chased yields such as in commodities. This manifested in the rise of oil prices among other things and thereafter a sharp decrease in prices or crash. This is because of the rise to meet the uneconomic challenge of rise in oil prices due to speculative activities. In Southeast Asia, as commodities are important to trade in the region, are economies in danger of more financial instability as prices decline? In the medium term, how might governments respond to this scenario?

Governments had financed current debts out of future revenue because they were unable to cut budgets. How are governments likely to manage these debts going forward? Will there be increasing austerity measures and a decade of low growth rates? As governments accommodate 20 to 30 per cent more debt, will they be able to pay for these increased debts or will there be more defaults? Will governments revert to the 1960s scenario and balloon their balance sheets? Will there be a return to the high inflation rates of the 1970s? Can governments afford more debt and keep interest rates low?

The COVID-19 pandemic has been the great accelerator of existing trends like digitalisation and healthcare, but it has also decelerated some global trends such as mobility. In a post COVID-19 world, some trends such as digital adoption are irreversible but uncertainties deriving from behavioural change such as remote working in relation to management are emerging. Among various economic sectors, there will be sectoral winners such as health and wellness.

Q&A Segment

Stemming from the lessons learns from the GFC, what could the financial and insurance sector expect to come out from the pandemic crisis? What would be the likely impact on consumers? Mr Wilson responded that in the UK, discussions are ongoing as to which sectors out to be insured by the private or the public sector. The government has stepped in to provide insurance for some sectors such as the film industry that would have normally been provided by private industry. There is a tendency to create more complexity in the modelling of risk assessments from crises like COVID-19, when the system might be better served to simplify the insurance needs.

Ms Niang emphasised the need to put in place systems that could provide better resilience to shocks. This could be in the form of credit financing schemes that are co-funded by the public and private sector to protect portfolios and cover payments to more vulnerable stakeholders such as SMEs. According to Mr Colyer, the current macroeconomic shock has been the greatest in memory but not a single bank has failed. In retrospect, the 2008–2009 banking system would not have survived these shocks. The blame dynamics or narrative has changed from the 2008 to 2009 GFC period from loose financial and monetary regulatory regimes in industry to shocks in industry caused by an external event.

In this regard, the solution emerging is a cooperative framework among key stakeholders such as governments and the insurance industry to prefund reserves for such pandemic and other crisis in future. However, as impacted countries were still in a moratorium stage for loans and debts, some countries would likely relook financial and monetary regulations once this stage is over. Some of the financial and regulatory measures imposed and relaxed after the GFC may be reintroduced. Ms Niang added that credit guarantee schemes among key stakeholders is another way to guarantee livelihoods especially among SMEs from being disrupted by future shocks.

A participant inquired about whose interests do the financial system serve? Is it to protect the public or the banks' balance sheets? Mr Sam responded that the financial and banking system has stood up well but may not be effective in providing the necessary credit for SMEs. Alternatives such as digital channels, crowdfunding or (Peer-to-Peer) P2P maybe useful and create greater efficiency; however, the maturity of the P2P is still in process and defaults are still happening. Some of the regulatory measures such as delayed dividends are also useful to provide greater liquidity for companies.

Mr Colyer added that the P2P channel was not quite developed and had doubts over the low risk levels claims of short-term loans with high interest rates. In addition, bad debts could also be hidden by the fast-growing balance sheets. Ultimately, P2P remains a small segment and may not be systematically significant because of its lower impact on the overall financial and banking system.

A participant queried about whether the current regulatory regime would revert back to normalcy once the pandemic has passed. Ms Niang answered that the pandemic provided an opportunity to reshape the social contract in various ways. Structural reforms are required due to various concerns that existed even prior to COVID-19. For example, this was a window of opportunity for tax reforms, policies to support companies and workers, social protection, and leveraging on the digital economy for growth. In the financial sector, the crisis is an impetus to create crisis management frameworks to add resilience. Mr Wilson added, there would likely to be more regulation as the public would expect the government to intervene. However, it would be difficult to remove such additional regulatory regimes in future.

Ms Niang was concerned over the speed of the vaccine rollout and the divergent policies of developed and emerging economies. How would this affect capital flows, currency depreciation and debt? Will there be a reduction of capital inflows into emerging economies?

Questions were asked about banking solvency and whether the panellists expected the market to correct itself. A participant added that, the risk models in insurance were not capturing the risks concerned and risks were being transferred to the customers. Is a change in thinking required to protect the customer instead of the balance sheet? Milton Friedman's narrative in the 1970s and 1980s has shaped the thinking of the current financial system and this created the current system, where the pursuit of individual interests is superior to the pursuit of collective interests. Mr Wilson said we needed to refocus away from the balance sheet towards the needs of the customer, and nothing in the current crisis that would help to make the paradigm shift towards this new focus. Mr Sam added that the role of the financial system was diminishing and it is worth looking at how to reset this narrative.

Participants queried about the role of the public and private sector to adapt to different requirements needed by the work force such as digitalisation?" Mr Sam highlighted that SMEs were finding it the hardest to cope with digitalisation in areas such as knowledge, scale and cost. Any interventions would need to consider these three aspects in relation to potential solutions. Mr Colyer said markets would help to clear some of the shortfall in skills and demand such as in IT and cyber security, but the speed at which this happens may not be fast enough to prevent the shortfalls. Governments should accelerate the change and deal with the inequality effects that result from these skills shortfalls. In addition, there is the need to consider demographic and industry aspects when it comes to reskilling because digitalisation has created the problem of inequality due to wage disparities.

Conclusion

Mr. Wilson added that reskilling is essential to supporting innovation and to build back better. In addition, governments should look into the requirements for future jobs as part of their overall industrial strategy. In relation to this, while certain sectors such as manufacturing are leading the economic rebound, Ms Niang also urged policy makers to examine the disproportionate impact of the pandemic on SMEs as well as women owned enterprises that do not have access to assistance and funding. Mr. Colyer mentioned that forward looking industrial entities are working with governments to prepare for future pandemics and other crises. Mr Sam concluded by highlighting that it is indeed timely for change and a reset is required to make a better world.

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If you have comments or feedback, please email ips.update@nus.edu.sg

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