Business cannot simply awake from this coma and carry on

It made sense to support everyone when the coronavirus crisis first hit but now hard choices are needed

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When the pandemic hit, there was widespread hope that economies would be able to reopen after a month or two of lockdown. Businesses would be placed into an induced coma, stay intact over the period of the lockdown and start production quickly when it was lifted.

With this in mind, rich countries supported their small and medium-sized enterprises with grants or wage subsidies, and their large companies with cheap loans. While expensive, the logic went, it would only be for a short while.

This view may be overly optimistic. Business reopening looks likely to be long drawn out, certainly in high-contact sectors like travel and hospitality, but even in manufacturing where supply chains need to be synchronised. Companies cannot be simply woken up from their coma. Many will have to change what they do and how they do it. A number will be unviable.
The cost of indefinite support will strain even the best-placed governments. The US Congressional Budget Office estimates that, given current plans, the country’s sovereign debt will hit 108 per cent of gross domestic product by fiscal end 2021 — up from 79 per cent at the end of 2019. High levels of public debt will constrain any further relief and stimulus needed before the shock abates. Higher uncertainty about where the taxes to repay it may fall will hold back private investment.

Such indefinite support could also hurt business. Easy credit could make companies overly indebted, with little ability or incentive to invest. Grants could keep value-destroying companies alive, zombifying them and, if demand is weak, dragging down healthy firms.

It made economic sense to support everyone when the pandemic was expected to be shortlived and its effects mild. Now we must make hard choices. For instance, small enterprises, such as restaurants and craft shops, give neighbourhoods character but they start up and shut down constantly. Public money should not be used to freeze the current cohort in place, paying rent, salaries and interest for unused resources.

It might be better to taper off public support instead. Some enterprises will survive by renegotiating terms with landlords and banks. Others will not. Bar staff who lose their jobs should get unemployment benefit while the venerable pub they work for is shuttered for now. It can reopen, rehiring its workers when social distancing ends or, if demand has changed by then, repurpose itself as an e-sports parlour. As the lockdowns stretch on it is more important to protect the worker, not the job, especially if the job is easily recreated.

Governments should aid renegotiation between small businesses and landlords (who should accept lower rents) or lenders, for instance by creating official low-cost mediation or bankruptcy structures where none exist. Credit, possibly subsidised, should be easily available to those wanting to start fresh.

Large companies, by contrast, have more organisational capital. Embedded in them are valuable, complex relationships between stakeholders, such as employees and suppliers, built over years. Once liquidated, they may not be recreated quickly even if needed. This does not imply they should be bailed out, for their size and value gives them their own survival possibilities.
Big companies often have more ability to access financial markets. Central banks should support credit markets in times of panic, if they would otherwise shut down. But a rise in credit spreads should not alone be cause for intervention; it may indicate market concerns about corporate leverage given the risks ahead. By obscuring such signals, central bank intervention increases a need for intervention and even bailouts later.

Large companies are also more able to survive bankruptcy proceedings than small ones, again as there is more value to save. Some bankruptcy codes are biased towards liquidating and these should be amended quickly. Emerging markets should be especially focused on clarifying their often-murky bankruptcy laws and speeding up legal proceedings. They should push out-of-court renegotiations where possible, so stretched courts only bless a final deal.

A caveat: valuable midsized firms may find accessing credit tough and bankruptcy hard to survive. Support should be channelled to these, although designating them as more deserving of help than tiny ones is politically tricky.

Lenders will have to absorb big losses. Financial companies should be building buffers to absorb future losses and support lending when economies start back up. Those who can, should raise more capital, even at depressed prices. No one should be paying dividends. A mandate from regulators to stop payouts would make that easier for all.

If recovery will take time, possibly delayed by further waves of infection, we should be preparing for what comes next. The helping hands of governments and central banks were needed when the crisis hit, but now they may have to pull back to enable more natural market mechanisms. This will conserve public resources for when we really need them again. As, almost surely, we will.