

## Analysis

### Countries Implement Broad Forbearance Programs for Small Businesses, Sometimes with Taxpayer Support

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Original post [here](#).

The government-mandated lockdowns in many countries responding to the coronavirus pandemic have threatened the financial health of small businesses, who typically have sufficient cash on hand to cover just [one month](#) of fixed cash-flow needs. Banks, utilities, landlords, and other creditors responded early with temporary payment holidays and other forbearance efforts, often at the urging of regulators. Creditors can grant limited forbearance to assist debtors in normal times. As the lockdown continues, however, private-sector creditors won't be able to afford forbearance alone. To avoid widespread nonpayment from sparking a systemic financial crisis, governments are turning to taxpayers to help small businesses meet their fixed-cost obligations.

When designing a loan forbearance program for small and medium-sized enterprises (SMEs), policymakers consider:

1. Eligible institutions/obligations – Which creditors should offer forbearance, for which types of obligations?
2. Borrower eligibility – What borrowers will be eligible to participate?
3. Implementation – How will the program be implemented?
4. Duration – How long will the program last?
5. Support – Will the taxpayers foot the bill, and if so, how?

#### **Eligible institutions/obligations**

In a few cases, government programs have covered all types of fixed-cost obligations that distressed companies face. [Denmark](#) plans to directly pay 25% to 100% of the reported fixed costs for SMEs whose revenues fall by more than 25% during the coronavirus pandemic. More commonly, programs have targeted specific types of obligations to specific types of creditors. SMEs can have fixed-payment obligations to entities in the public sector, financial private sector, and nonfinancial sector.

Public-sector payment obligations can include government-owned utilities and other services, government-sponsored entities, and, of course, taxes. It may be relatively easy for a government to waive such payments for a short period. On March 18, for example, [Dubai and Abu Dhabi](#) reduced 15 different customs fees, taxes, and other costs for businesses, including an across-the-board 10% reduction in water and electricity bills owed to the government-run utility.

Banks typically have procedures for working with borrowers who are experiencing temporary financial stress. In this crisis, some of the largest banks voluntarily created [forbearance](#)

[programs](#). A broad, government-initiated moratorium on loan payments to banks and other financial institutions could effectively protect small businesses during a crisis. Several governments [encouraged bank forbearance on loan principal or interest payments](#). But U.S. banks, though well-capitalized compared to the beginning of the last global financial crisis, may not be able to bear the cost of an unprecedented number of nonperforming loans for very long. And nonbank financial institutions are typically less prepared than banks for a surge in nonpayment by SME debtors.

SMEs also may have obligations to creditors in the nonfinancial private sector, such as landlords, employees, and suppliers. Government programs to help SMEs with these costs are rare, to date. Denmark's direct financial support program pays a proportion of eligible SMEs' bills regardless of the type of creditor. [France's](#) current program allows SMEs to apply to defer rent and utility payments. Programs that target employees, by using government funds to prop up SME payrolls, can become difficult to distinguish from unemployment insurance. In the context of COVID-19, they have become more common. Three examples are the UK's [Coronavirus Job Retention Scheme](#), the Republic of Ireland's [COVID-19 Wage Subsidy Scheme](#), and Germany's [Emergency Aid Grants](#).

### **Borrower eligibility**

While past forbearance programs typically responded to natural disasters just in [affected regions](#), most programs this year have been national, reflecting the nature of the current crisis. Eligibility can be extended very broadly or limited to borrowers meeting specific criteria.

On March 19, Korea's Financial Services Commission (FSC) announced a fixed-cost forbearance program that appears to offer blanket eligibility. Under the [program](#), SMEs can access a six-month minimum extension on existing loans and guarantees from both banks and nonbanks. Blanket eligibility may be most efficient in a pervasive crisis such as the current one, in which the sheer number of affected SMEs is so large as to challenge systematic efforts to distinguish the truly needy. However, blanket eligibility, as seen in [some of India's farm loan waiver programs](#), can also be susceptible to abuse due to the [moral hazard](#).

Recent small-business programs in Europe have tended to limit eligibility to borrowers that meet certain criteria. Greece's [loan principal-repayment holiday](#) restricts participation to businesses in sectors directly impacted by the pandemic that were [current on their obligations when the program was announced](#). [France](#) and [Denmark](#) link eligibility to lost revenues. Denmark's program determines how much support to offer a given business by looking at that business's expected decline in revenues. France conditions eligibility for its [rent forbearance program](#) on a company having less than €1 million in turnover and having either been ordered closed by the government or losing over 70% of turnover in March 2020 compared to March 2019.

[Parts of Denmark's program are only available](#) to companies with 10 or fewer employees. But strictly using a business's number of employees to determine eligibility may encourage some SMEs to lay off employees before joining the program. Perhaps for this reason, Denmark's program disqualifies businesses that fire workers before joining the scheme.

Implementing restrictive eligibility requirements can impose a significant administrative burden on government resources, which can limit the speed and effectiveness of a program. European governments can track sales that are subject to the value-added tax, which can help businesses

illustrate their need, as in the case of [Denmark's program](#). A sufficiently detailed quarterly income tax system could provide similar information.

### **How does a government implement such a program?**

Creditors sometimes [voluntarily decide to grant forbearance](#), even in normal times. This happens when the creditor believes a borrower is viable as a going concern, but can't meet payments due to temporary difficulties. In response to the COVID-19 pandemic, many individual creditors and [creditor associations](#) like the Thai Bankers' Association have announced forbearance programs for SMEs unilaterally.

Government [supervisory authorities \(like the ECB\)](#) can incentivize forbearance. As noted, several authorities have advised banks not to be too quick to mark a loan as nonperforming when the borrower has been affected by the COVID-19 crisis. This can free bank capital for lending in the short run. In the long run, though, it can drain bank capital. Supervisors are faced with a [dilemma](#): "On one hand, protecting the financial system by forcing banks to correct weaknesses in how they assess and manage their loans[;] ...on the other hand, causing a credit crunch for the real economy by being too strict with banks." Credit crunches can be especially dangerous for forbearance programs that do not protect the credit ratings of participating borrowers. Participants in those programs will already have a more difficult time accessing credit with a poor credit rating, and a credit crunch would make this problem worse.

Authorities can outright require forbearance. In some cases, governments pass [laws](#) that require creditors to restructure SMEs loans. The Japanese government passed [such a law](#) during the GFC. The law stipulated: "When debtors asked financial institutions to ease repayment conditions (e.g., extend repayment periods or bring down interest rates), the institution would have an obligation to meet such needs as best as possible." Finance ministries are often responsible for implementing these programs. This was the case with [Italy's year-long debt moratorium](#) during the GFC and [Germany's current program](#). Moratoria are sometimes accompanied by subsidies to the financial institutions for the cost of deferring payments ([Saudi Arabia](#)) or providing some of the funds directly to SMEs ([Denmark](#)).

A government can order related organizations, like state-owned development banks or agencies, to offer forbearance on their loans to businesses. After the natural disasters in 2006 and 2011 the [SME Development Bank of Thailand](#) provided six-month debt moratoria to SMEs in the affected regions.

Governments can also negotiate forbearance programs with creditor associations for institutions like [banks](#) and non-banks, then bind them to the program. The Central Bank of Ireland [announced](#) one such agreement in response to the COVID-19 pandemic. [France](#) and [Belgium](#) have government credit mediation programs that individual creditors can use, [put in place](#) in 2008 during the Global Financial Crisis. The credit mediator helps distressed businesses negotiate with banks, credit insurers, supplier credit companies, and other financial institutions.

### **Duration**

Typically, payment forbearance programs operate for a short and specified time period tied to the nature of the crisis. In cases of natural disasters, like destructive floods in [Thailand](#), these programs can last for just a few months, as affected regions return to normalcy. These programs rarely extend beyond six months.

Financial crises are different. Governments that introduce programs as only temporary can end up extending them under political pressure or simply because the economic stress has continued longer than expected. During the GFC, the Italian government, in collaboration with a creditor association, imposed a [loan forbearance program for SMEs](#) in August 2009.

The [program](#) accepted 200,000 applications and rolled over €13 billion in SME debt by December 2010. But as the economic situation did not improve, [Italy continued to extend and modify the program through at least 2014](#). Japan extended its 2009 SME Financing Facilitation Act for several years. Some critics say the government's ongoing forbearance helped perpetuate [Japan's problem of "zombie" SMEs](#).

## **Taxpayer Support**

Some programs directly subsidize the costs of SMEs. A government can seek to limit these costs by only covering losses the SME may suffer due to COVID-19. [Denmark's](#) programs do this. But predicting these impacts is extremely difficult. Governments might make a program less generous if they find an SME's actual performance is better than expected.

[Northern Ireland](#) offered some amount of taxpayer support as well, although it narrowed eligibility to three sectors especially affected by COVID-19: hospitality, tourism and retail. [Germany](#) and the US have tried a more blanket approach to providing taxpayers support. In Germany's program, employers with up to five employees receive a grant of €9,000 and employers with up to fifteen employees receive a grant of €15,000. The [CARES Act](#), as passed by the US Senate on March 25, provides \$10 billion for Small Business Administration (SBA) emergency grants of up to \$10,000 to provide immediate relief for small business operating costs and appropriates \$17 billion to cover six months of payments for current SBA borrowers.

Other programs, like [Saudi Arabia's](#) recent program and India's [farm loan waiver system](#), provide support to SMEs indirectly. They subsidize banks and other creditors for the losses they bear in supporting SMEs. Programs that put losses on banks and other creditors can be costly to financial stability in the long run. Taxpayers may end up footing the bill if the financial and economic distress caused by the coronavirus response is protracted and affects confidence in bank solvency.