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COVID-19 Crisis Business Continuity and Trade Working Group

Communique #6: For resilient re-opening, test, trace and target support

To help Canadian governments confront the public health and economic crisis resulting from COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Business Continuity and Trade is co-chaired by Dwight Duncan (Senior Strategic Advisor at McMillan LLP and former Ontario Minister of Finance) and Jeanette Patell (Vice-President of Government Affairs and Policy for GE Canada). Its membership includes industry experts and economists. Daniel Schwanen, Vice-President, Research, and Grant Bishop, Associate Director, Research, at the Institute support the group. Meeting weekly, it identifies and prioritizes policy challenges and communicates members' views in published communiques. The group's sixth meeting was held on Tuesday, April 28, 2020.

At this meeting, the working group emphasized the need for:

- Greater detail in provinces' restart/recovery playbooks, including clear thresholds and indicators for decision-making about the easing of restrictions;
- Rapid ramp-up of testing and contact tracing, as well as transparency around data and models, to manage public health risks during restart;
- Modification of rules for federal wage and commercial rental support to include businesses that may otherwise face layoffs and closure;
- Targeted business credit to "bridge" companies over immediate liquidity needs; and
- A principled approach for government support for long-term restructuring of key distressed sectors and companies.

The working group noted that a growing list of provinces are publishing frameworks and roadmaps for easing restrictions and re-opening their economies. While still requiring more detail and target dates, such frameworks help anchor expectations for businesses and households.

Based on international experience, governments must increase widespread testing and robust contact tracing to support the reopening of the economy. Widely available testing and effective tracing are essential to manage risks for health system capacity and workplace transmission. While balancing individuals' privacy rights, employers and governments must be able to rapidly identify risks to specific workplaces and public health. Governments should regularly publish granular epidemiological data



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and modeling so that the civil society can participate in informed discussions about the pace of restart, easing of restrictions and the balance of risks.

The re-opening is likely to be gradual and many headwinds may slow the pace of economic recovery. Businesses' revenues have plunged as the crisis has inflicted an unprecedented shock to demand for consumption, exports and capital investment. No business could self-insure against this present shock, and imminent failure of many businesses – particularly small and medium-sized enterprises – could severely impair the pace of recovery.

The working group recommends that policymakers distinguish between “backstops” and “bailouts.” Providing temporary “bridge” financing for immediate liquidity needs is distinct from government participation in long-term support for the restructuring of distressed companies. While governments must be conscious of taxpayer exposure, ensuring access to near-term credit is essential for businesses to be able to cover fixed costs. Widespread business failures would “scar” the economy and substantially impair the pace of recovery. As an option for rapid financial support, certain members recommend expanded use of partial guarantees for credit through commercial banks and other lenders. This would allow governments to leverage the existing credit infrastructure to channel the necessary financing.

The federal government should also address rules around the Canadian Emergency Wage Subsidy (CEWS) and the recently announced (but not yet detailed) Canada Emergency Commercial Rent Assistance (CECRA) program. For CEWS, rules on revenue recognition from non-arm's length corporate affiliates risk excluding domestic employers that are integrated in multinational enterprises' production chains. For CECRA, the requirement for landlord consent to rent reduction is likely to exclude many commercial tenants.

Even with near-term credit support, governments should expect a wave of corporate distress. For certain sectors, the downturn in demand is likely to be protracted. Governments will face political pressure to support specific failing companies and distressed sectors. Although the present crisis is distinct from the 2008-09 “credit crunch,” governments should draw on past experience (e.g., restructuring of major auto-manufacturers) to define rigorous and principled criteria for decision-making and design of long-term, company-specific support. In the present crisis, governments lack internal capability for adequate due diligence in the face of the likely scale of impending corporate distress and restructuring. Therefore, governments should leverage due diligence by the private sector and should not let politics supersede objective evaluations of companies' long-term commercial viability. The working group agreed that bailouts should be a last resort and have strict conditions, including a clear plan for long-term viability and an exit for taxpayers.

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Ramp Up Widespread Testing and Contact Tracing

Countries are now publishing plans for the graduated easing of restrictions and re-opening of activities. These plans provide examples that Canada can leverage.¹ From a survey of restart frameworks internationally, a series of common practices emerge (Table 1).

Table 1: Common Practices for Restart

Common Practices	Observed Application
Clear pre-conditions for restart staging based on four principles	1. Spread under control: trend of declining new cases over two weeks, or very low and manageable numbers, typical before reopening
	2. Health system “buffer” capacity: Indicators include sufficient ICU beds for COVID-19 cases (bed utilization now low in parts of EU and Canada); health system can meet non-COVID needs (e.g., surgeries) even with surge
	3. Ramp up of testing and contact tracing capabilities to identify new clusters/spread and contain transmission
	4. Confirmation of “steady state” for each stage before further easing
New or continuing restrictions during restart	<ul style="list-style-type: none"> • Required social distancing in public places and shops (occupancy limits) • Facemasks required where crowding unavoidable (e.g., public transit) • Limits/screening for contact with vulnerable populations (e.g., elderly)
Regional and local calibration	<ul style="list-style-type: none"> • Maintenance of local quarantines on specific regions or cities while gradually easing for regions where local risk meets pre-conditions • Differential pace of easing between regions requires limits on individual movement between different regions
Complementary measures	• Opening of daycares and elementary and secondary schools to enable parents to attend work
	• Electronic tracking (generally non-compulsory) integral to many countries re-opening plans
	• Anonymity and eventual data destruction is key to public acceptance.
• Coordination with border and immigration officials for mobility and isolation controls for foreign workers in essential sectors	
Activity- and workplace-specific health and safety measures	<ul style="list-style-type: none"> • Employers required to take specific workplace measures based on character of work • Staggering of shifts and rotation of employees in office to minimize exposure
Protocol for rapid response to new cases	<ul style="list-style-type: none"> • Quarantine for individuals with probable or confirmed infection • Workplace and school closure when a case is confirmed

1 Schwanen, Daniel, and Bill Robson. 2020. “The best lessons from abroad about reopening our economies are in Europe.” *Globe & Mail*. April 27. Available online: <https://www.theglobeandmail.com/opinion/article-the-best-lessons-from-abroad-about-reopening-our-economies-are-in/>

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This working group has recommended that government prescribe transparent pre-conditions for each stage of re-opening – in particular, specifying the thresholds for spread of the virus and health system capacity for each stage of easing restrictions.² As regions and cities re-open to differing degrees, international experience also highlights the need to calibrate restrictions locally and consider inter-regional mobility restrictions to prevent spread.³

As an immediate priority, the working group emphasized the need to expand testing and tracing to improve data on caseload across the population. Without a sufficient sample of the population, the confirmed caseload will understate the extent of transmission. From data as of April 23rd, Ontario and Quebec continued to lag peers, having relatively high ratios of confirmed cases to testing and relatively low per capita testing (Figure 1).

The ramp-up of testing and contact tracing must engage employers – particularly those with large workplaces that could be settings for transmission. As part of the return to work, employers must have clarity on pathways and procedures for screening employees and ensuring that employees are not exposed in the workplace. This will be essential for worker confidence for a safe return to work. Governments should consider what access employers should have to private testing to safeguard workplaces. Working group members also highlighted that workplace-level health and safety measures and clear protocols for addressing new cases will be critical for resilient reopening.

Distinguish “Backstops” from “Bailouts”

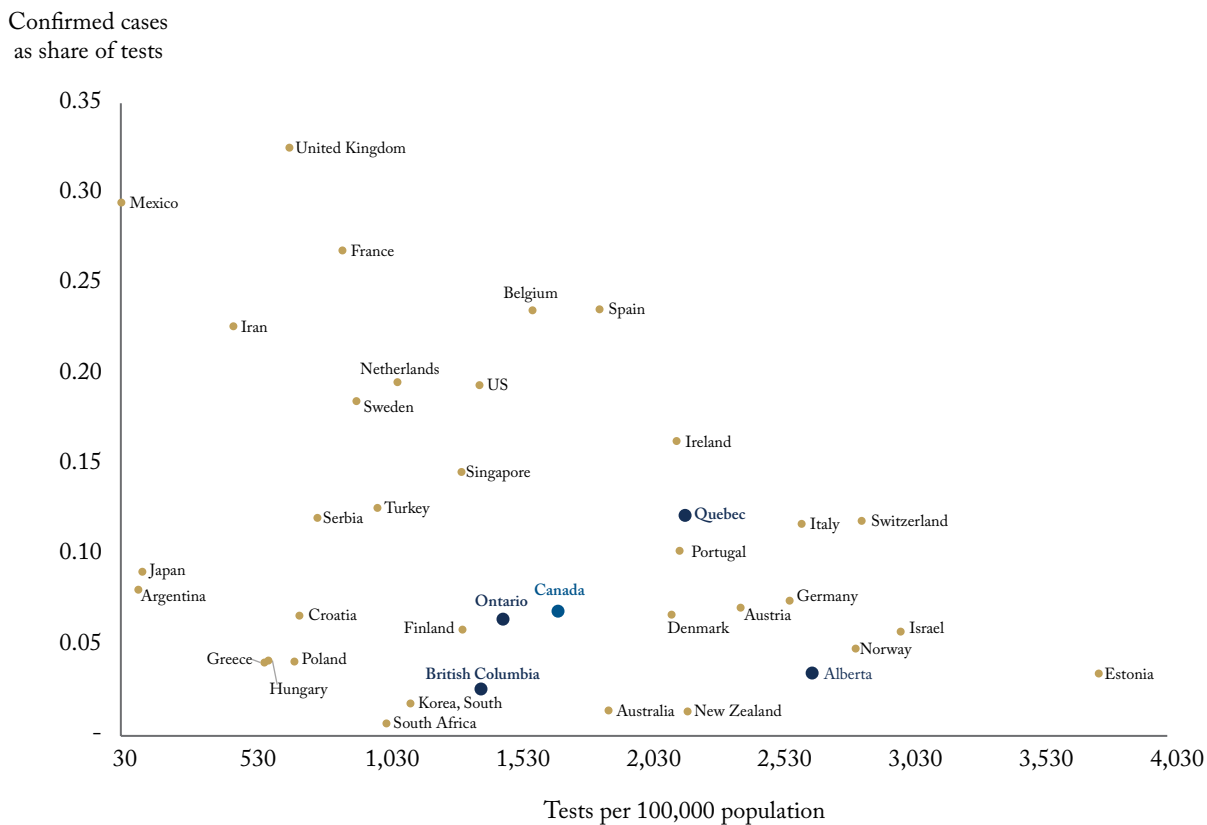
Working group members emphasized the magnitude of revenue downturn for many businesses and, without access to credit, the likelihood of financial distress and business failure for many businesses – in particular, small and medium-sized enterprises.

Members believe governments should distinguish between categories and staging of support for companies. Specifically, response to financial constraints from the crisis will involve two distinct stages:

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- 2 Business Continuity and Trade Crisis Working Group. 2020. Restart Playbook Must Balance Risk with Economic Cost. Available online: <https://www.cdhowe.org/council-reports/restart-playbook-must-balance-risk-economic-cost-crisis-working-group-business-continuity-and-trade>
 - 3 Schwanen, Daniel, and Rosalie Wyonch. 2020. *Local Removal of Restrictions Imposed to Fight the Spread of COVID-19*. C.D. Howe Institute Intelligence Memo. April 29. Available online: <https://www.cdhowe.org/intelligence-memos/schwanen-wyonch-%E2%80%93-local-removal-restrictions-imposed-fight-spread-covid-19>

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Figure 1: Comparative Extent of Testing (as of April 23, 2020)



Sources: John Hopkins, provincial governments, Statistics Canada, CIA World Factbook.

- (1) “Bridge” financing to support many businesses over the next 60 to 90 days; and
- (2) Restructuring of an impending wave of financially distressed companies.

For the first stage, government must continue to leverage existing commercial banks and other lenders, supplemented by credit through agencies like Export Development Canada (EDC) and the Business Development Bank of Canada (BDC). Governments can further leverage private lending channels by expanding guarantees or interest payment support.

For the second stage, governments must define a principled framework for selecting companies and designing support. Such a framework will be critical to de-politicize the selection of support for particular companies and sectors.

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Bailouts Should be a Last Resort and Have Strict Conditions

Working group members emphasized that governments lack institutional capability for due diligence of individual companies. Private investors have greater expertise for evaluating companies' long-term viability and creating restructuring plans. Moreover, a government could confuse its own role and displace private-sector discipline by providing at-risk capital to specific companies. Certain sectors face great uncertainty about future market conditions, and Working Group members believe that governments are generally poorly equipped to assess long-term commercial risks.

Group members stressed the differences between the 2008-09 "credit crunch" and the current crisis. In particular, during the credit crunch, financial institutions faced paralyzed financial markets and wholesale funding constraints. Additionally, the focus of government support during the credit crunch involved a relatively small number of large companies. In contrast, the present crisis is likely to trigger widespread insolvency and the restructuring of potentially hundreds of significantly sized firms.

Experience during the 2008-09 financial crisis – specifically, support for certain auto manufacturers – provides some lessons for criteria and design of government support.⁴ Requirements for support would be:

- Systemic impact from failure on the wider economy – for example, an operator of a critical network or a lynchpin customer/supplier for a given sector.
- Market failure in the availability of financing on the required scale – for example, an impairment in financial markets or institutions that inhibits the availability of credit.
- Rigorous, commercially driven evaluation of a company's long-term viability.
- Capability for effective due diligence by government or commercial partners.
- Clear and robust plan for viability post-restructuring.
- Appropriate loss-sharing by existing equity-holders and creditors.
- Rigorous limits on management (e.g., pay and perquisites).
- Clear "exit plan" and limits on taxpayer exposure.

Members emphasized that government should only intervene where and to the extent that an identifiable market failure would hinder private investors and regular restructuring processes (e.g., through the *Companies Creditors Arrangement Act*) from operating effectively.

4 For example, see: Paul Boothe 2020. "Taxpayer bailouts for big corporations should be a last resort." Maclean's. April 27. Available online: <https://www.macleans.ca/economy/economicanalysis/taxpayer-bailouts-for-big-corporations-should-be-a-last-resort/>

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Refine Support Measures Based on Business Feedback

Working Group members expressed appreciation for the unprecedented pace at which the federal government has established important new measures to support businesses and workers through the crisis. However, they emphasized unintended consequences – particularly where rules unintentionally or irrationally exclude certain businesses or workers.

For example, members highlighted rules concerning the treatment of sales to non-arm's length foreign affiliates in determining whether an employer had experienced the required decline in revenue to qualify for the wage subsidy under CEWS. Specifically, under the legislation for CEWS, revenue from non-arm's length affiliates may be excluded when determining whether a Canadian employer has experienced the required decline in revenue of 15 percent for March and 30 percent for April and May. This can result in excluding Canadian employers from the wage subsidy who both sell finished products and are also part of internationally integrated manufacturing operations.

Many Canadian manufacturers sell all production to foreign affiliates, which then integrate the parts or finish the given product. However, these Canadian companies often also sell finished goods to non-arm's length customers. Such Canadian employers will be ineligible for CEWS even though their recognition of revenue from their non-arm's length affiliates must meet rigorous transfer pricing requirements for other tax purposes. Excluding such major employers from the wage subsidy is likely an unintended consequence of the legislation. Working group members recommend that the federal government rectify the exclusion in order to safeguard employment by these companies.

As well, while the federal government announced assistance for commercial rent, many businesses are confused about the qualifying criteria and concerned about the requirement for a landlord's consent to rent reduction in order to qualify for the support. Businesses fear that failure to negotiate the required rent reduction will exclude them from support.

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* denotes not in attendance at April 28st meeting.