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The Impact of COVID-19 on Regional Economies and Policy Responses

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1 Among the ten member states of the Association of Southeast Asian Nations, and China; Hong Kong, China; Japan; and Korea, only nine countries were selected and covered in this paper due to the availability of data and experts at the beginning of the project. The selected nine countries are: Brunei Darussalam, Cambodia, China, Indonesia, Republic of Korea, Lao PDR, Malaysia, The Philippines, and Vietnam.

Glossary of Abbreviations and Acronyms

ADB	Asian Development Bank
AMRO	ASEAN+3 Macroeconomic Research Office
ART	Antigen Rapid Test
ASEAN	Association of Southeast Asian Nations
BI	Bank Indonesia
BND	Brunei Dollar
BOK	Bank of Korea
BOR	Bed Occupancy Rate
BSP	Bangko Sentral ng Pilipinas
CIT	Corporate Income Tax
CMCO	Conditional Movement Control Order
COVID-19	Coronavirus Disease 2019
CPI	Consumer Price Index
CREATE	Corporate Recovery and Tax Incentives for Enterprises Act
CSPS	Centre for Strategic and Policy Studies
DSA	Debt Sustainability Analysis
ECQ	Enhanced Community Quarantine
EPF	Employees Provident Fund
EU	European Union
FDI	Foreign Direct Investment
FMIS	Financial Management Information System
FY	Fiscal Year
GDP	Gross Domestic Product
GNI	Gross National Income
GSO	General Statistics Office
ICT	Information and Communications Technology
ICU	Intensive Care Unit
IDR	Indonesian Rupiah

IMF	International Monetary Fund
IPP	Independent Power Producer
KHR	Cambodian Riel
KRW	Korean Won
LAK	Lao Kip
LGU	Local Government Unit
LPR	Loan Prime Rate
MAS	Monetary Authority of Singapore
MCO	Movement Control Order
MECQ	Modified Enhanced Community Quarantine
MLF	Medium-term Lending Facility
MSME	Micro, Small, and Medium Enterprise
MTFF	Medium-Term Fiscal Framework
NCDs	Noncommunicable Diseases
NCR	National Capital Region
NPL	Non-Performing Loan
OECD	Organisation for Economic Cooperation and Development
PBoC	People's Bank of China
PCR	Polymerase Chain Reaction
Lao PDR	Lao People's Democratic Republic
PFM	Public Financial Management
PHP	Philippine Peso
PIT	Personal Income Tax
PMI	Purchasing Managers' Index
PPP	Public-Private Partnership
RM	Malaysian Ringgit
RMB	Renminbi
RMCO	Recovery Movement Control Order
RRR	Reserve Requirement Ratio
SAP	Social Amelioration Program
SCP	Supplementary Contribution Pension
SME	Small and Medium Enterprise
SOE	State-Owned Enterprise
TVET	Technical and Vocational Education and Training
US	United States
USD	United States Dollar
VAT	Value-Added Tax
VND	Vietnamese Dong
WHO	World Health Organization

Chapter

1

COVID-19 Development and the Economic Impact of the Pandemic

Chapter 1

COVID-19 Development and the Economic Impact of the Pandemic[2]

1. COVID-19 development

1. **The first COVID-19 cases in the analyzed countries occurred in Q1 of 2020 and, with the exception of China, these occurred due to overseas inflows.** The COVID-19 virus spread rapidly across the globe after it was first discovered in China in late December 2019. In Cambodia, Malaysia, the Republic of Korea, and Vietnam, the first cases occurred due to overseas inflows towards the end of January 2020. In Brunei Darussalam and Indonesia, the first cases occurred in March 2020, relatively late compared with other countries, likewise due to inflows from overseas, but the disease then spread to the local community from May 2020 onwards.

2. **The cumulative number of confirmed cases by country increased rapidly as the Alpha, Delta and Omicron variants developed. Each country experienced several pandemic waves depending on their specific quarantine situation.** Looking at the number of newly confirmed cases per million population provided by Our World in Data, each country experienced several waves. In Brunei Darussalam, Indonesia, Cambodia, Malaysia, and the Philippines, the number of newly confirmed cases increased sharply in the summer of 2021, and then again in February 2022. In Korea and Vietnam, the number of newly confirmed cases increased sharply in February and March 2022. The sharp increase in newly confirmed cases in early 2022 came as a result of the rapid spread of the Omicron variant across the globe. The cumulative death toll per million population also increased markedly across all countries after the summer of 2021 and rose sharply once again in early 2022 (Figure 1, Figure 2, and Figure 3).

3. **Countries' quarantine systems generally followed the guidelines recommended by the World Health Organization (WHO), but the details were adjusted according to the circumstances of COVID-19 development in each country.** The key measures that were implemented included: the wearing of facemasks, social-distancing measures, and test-trace-treated (3T). In the early days of the COVID-19 pandemic, it became mandatory to wear masks both indoors and outdoors, as the situation worsened. Social distancing comprised various stages according to each country's COVID-19 situation, and within each country the stages were adjusted based on COVID-19 development. COVID-19

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testing began in February 2020, and the number of tests continued to increase. Looking at the cumulative number of tests per thousand population, Malaysia and Korea had the highest number of tests at more than 1,800 as of May 2022, while Vietnam exceeded 800. The number of tests increased with the spread of the Delta and Omicron variants, particularly with the spread of the latter. Some countries introduced self-testing kits because it became difficult to respond only with polymerase chain reaction (PCR) tests due to the highly contagious nature of the Omicron variant. Quarantine measures for confirmed patients and their contacts were also implemented according to the COVID-19 situation in each country.

4. **The COVID-19 vaccine first began to be supplied in February 2021 and, by the summer of 2021, the vaccination rate in most of the countries exceeded 50 percent.** Entering the fall of 2021, Brunei Darussalam, China, Cambodia, and Korea were the first countries to achieve vaccination rates of more than 80 percent, while other countries also achieved rates of over 80 percent in early 2022. Since the types of vaccines introduced by each country differed, the proportion of vaccinations completed also varied. The share of the population inoculated with booster shots struggled to exceed 50 percent in most countries (Table 1 and Table 2). Vaccination rates across analyzed countries display considerable variation. This difference seems to have been caused mainly by economic, social, and cultural differences between countries; not only economic differences, such as per capita GDP, but also education levels and religious backgrounds can affect vaccination rates. However, rigorous empirical analysis is required to understand the vaccination variations across countries.

5. **Comparison of the Stringency Index measured by the Oxford Coronavirus Government Response Tracker shows that China, Indonesia, Malaysia, the Philippines, and Vietnam had high quarantine responses to the COVID-19 pandemic, while Brunei Darussalam, Cambodia, Korea, and Lao PDR had relatively low responses.** The Stringency Index is an index comprising nine metrics corresponding to the COVID-19 pandemic, and the closer it is to 100, the higher the quarantine response. The nine metrics consist of: (i) school closures; (ii) workplace closures; (iii) cancellation of public events; (iv) restriction of public gatherings; (v) closures of public transport; (vi) stay-at-home requirements; (vii) public information campaigns; (viii) restrictions on internal movements; and (ix) international travel controls. This index continuously changed depending on the COVID-19 situation in each country. To determine the degree of response by country, the average index, from February 2020 to May 2022, was examined. China, Indonesia, Malaysia, the Philippines, and Vietnam showed an average index of 60 to 70, whereas Brunei Darussalam, Cambodia, Korea, and Lao PDR displayed an average index of 50.

2. The economic impact of the pandemic

6. **We analyzed the economic impact of the COVID-19 pandemic using various measures, but it was far from easy to provide a unified analysis because the industrial**

structure and economic status of the analyzed countries were too diverse. We focused on real GDP growth rates to examine the economic impact of the COVID-19 pandemic, together with the growth rates of the major industrial sectors of the countries being investigated, including agriculture, manufacturing, and services. All the data used in the analysis are from economic statistics provided by experts from each country participating in this study.

7. **Due to the pandemic, the real GDP growth rate fell by 1.7 percent on average in 2020, but the magnitude of the decline varied significantly from country to country.** Those countries with negative real GDP rates in 2020 were Indonesia, Cambodia, Korea, Malaysia, while the Philippines. Brunei Darussalam, China, Lao PDR, and Vietnam had real GDP growth rates 2 to 5 percentage points lower than the pre-pandemic level, although they remained positive in 2020. According to the IMF's World Economic Outlook, the growth rate of the world economy was -3.1 percent, that of emerging market economies was -2.1 percent, and that of the ASEAN-5[3] countries was -3.4 percent. Growth rates among ASEAN+3[4] member countries were relatively high compared with other regions of the world.

8. **One interesting outcome was that, while the COVID-19 pandemic continued into 2021, real GDP growth rates recovered in all the analyzed countries with the exception of Brunei Darussalam.** Unlike other countries, given that Brunei Darussalam entered a full pandemic situation only in 2021, its real GDP growth rate became negative in 2021. At the same time, other countries' growth rates started to turn positive in 2021. Nonetheless, in most countries, the rate of growth failed to return to its pre-pandemic level (Table 4).

9. **In the agriculture sector, the average growth rate in 2020 was 2.3 percent which, unlike the real GDP growth rate, did not fall significantly.** The countries that posted negative growth in the agriculture sector in 2020 were Korea, Malaysia, and the Philippines. Meanwhile, agriculture in China, Indonesia, and Lao PDR was not as hard hit by the pandemic at that time. Brunei Darussalam displayed a different pattern compared with the other countries; until 2019, its agriculture sector had experienced negative growth, but the growth rate in 2020 and 2021 increased significantly (Table 5).

10. **The industry sector saw its average growth rate fall to -1.2 percent in 2020, similar to real GDP growth rate declines.** China, Korea, Malaysia, and the Philippines showed negative growth in the industry sector. In particular, the Philippines' growth rate fell the most from 5.5 percent in 2019 to -13.1 percent in 2020. Indonesia and Lao PDR showed positive rates, but their growth rates were significantly lower than those seen in the pre-pandemic period. Similar to the real GDP growth rate, the industrial growth rate in Brunei Darussalam was positive in 2020, but then became -4.4 percent in 2021. With the exception of Brunei Darussalam, other countries showed a recovery in 2021, as did the

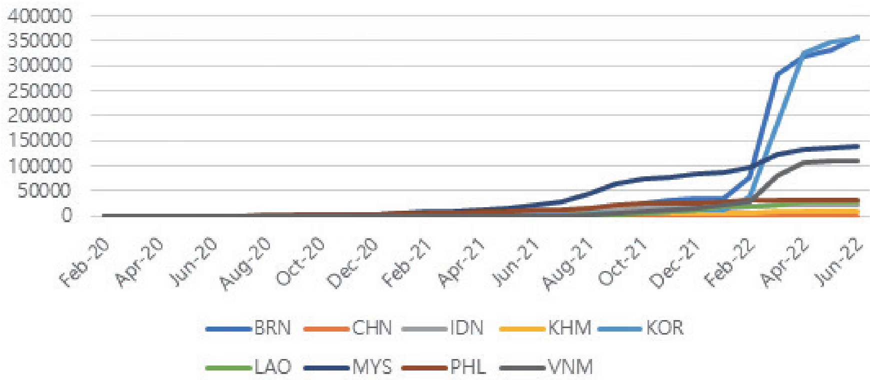
3 Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.
4 Myanmar, Lao PDR, Thailand, Cambodia, Vietnam, the Philippines, Malaysia, Brunei Darussalam, Singapore, Indonesia, Korea, Japan, and China.

real GDP growth rate (Table 6).

11. **Given that the services sector was directly hit by the quarantine policies such as social distancing and lockdowns, the sector's growth rate in 2020 was -3.2 percent, lower than the real GDP growth rate**. Negative growth in the services sector appeared in all countries, with the exception of Indonesia. The decline was also greater than the real GDP and growth rates in other sectors. In particular, the Philippines experienced the largest growth rate decline in the services sector; considering that pre-pandemic growth had been about 7 percent, the decline was even larger. Indonesia showed positive growth of 1.9 percent, but this was still a sharp contraction compared with the previous growth rate of 7 to 8 percent. Unlike other sectors, the services sector in Brunei Darussalam showed negative growth in 2020. Similar to other sectors, the growth rate in most countries turned positive once again in 2021, but the degree of the recovery was lower than in other sectors (Table 7).

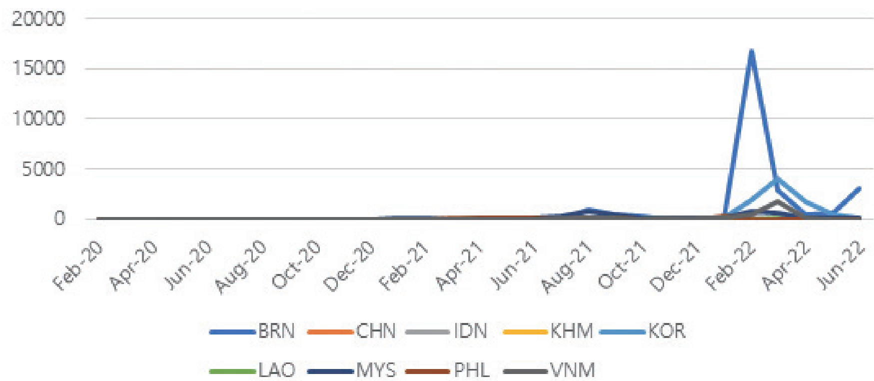
Appendix 1. Selected Figures

Figure 1 Total cases per million



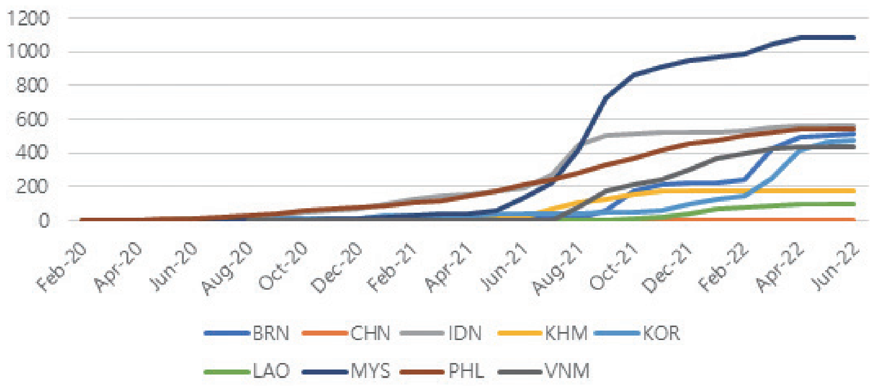
Source: Our World in Data.
Note: BRN=Brunei; CHN=China; IDN=Indonesia; KHM=Cambodia; KOR=Korea; LAO=Lao PDR; MYS=Malaysia; PHL=Philippines; and VNM=Vietnam.

Figure 2 New cases per million



Source: Our World in Data.
Note: BRN=Brunei; CHN=China; IDN=Indonesia; KHM=Cambodia; KOR=Korea; LAO=Lao PDR; MYS=Malaysia; PHL=Philippines; and VNM=Vietnam.

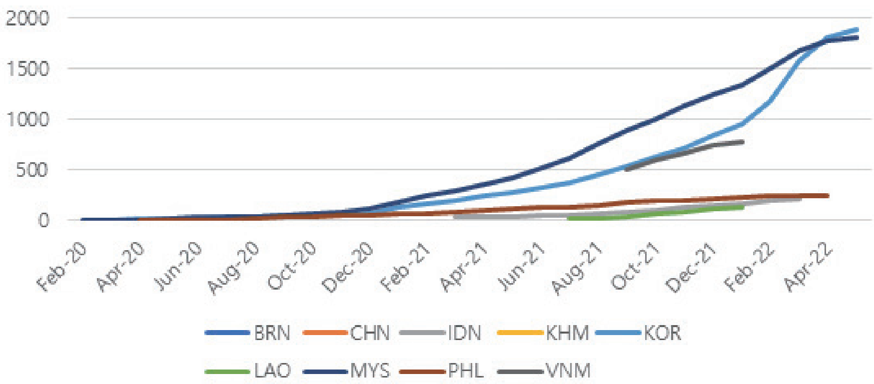
Figure 3 Total deaths per million



Source: Our World in Data.

Note: BRN=Brunei; CHN=China; IDN=Indonesia; KHM=Cambodia; KOR=Korea; LAO=Lao PDR; MYS=Malaysia; PHL=Philippines; and VNM=Vietnam.

Figure 4 Total tests per thousand



Source: Our World in Data.

Note: BRN=Brunei; CHN=China; IDN=Indonesia; KHM=Cambodia; KOR=Korea; LAO=Lao PDR; MYS=Malaysia; PHL=Philippines; and VNM=Vietnam.

Appendix 2. Selected Tables

Table 1 People vaccinated per hundred

date	BRN	CHN	IDN	KHM	KOR	LAO	MYS	PHL	VNM
Jan-21			0.2						
Feb-21			0.6	0.4	0.1		0.1	0.0	
Mar-21			2.9	2.4	1.8	0.6	1.5	0.7	0.1
Apr-21	3.3		4.5	7.9	6.7	1.7	2.8	1.5	0.5
May-21	9.4		5.9	15.5	11.5	8.7	5.9	3.6	1.1
Jun-21	15.8	43.1	10.6	24.8	30.2	12.0	18.2	7.0	3.7
Jul-21	30.5		17.1	43.1	38.3	16.0	43.3	10.4	5.7
Aug-21	52.5	74.3	22.8	63.7	57.5	33.1	61.8	16.8	17.8
Sep-21	67.3	76.2	33.0	78.9	77.1	40.4	73.8	25.1	33.7
Oct-21	79.9		43.3	80.9	80.5	44.1	78.5	29.7	58.4
Nov-21	91.4	84.8	50.4	83.5	83.2	50.8	79.0	36.5	72.5
Dec-21	91.9	87.2	58.3	84.2	86.4		79.4	50.5	79.0
Jan-22	92.2	87.7	66.8	84.7	87.2	63.1	79.6		80.5
Feb-22	92.3	87.9	69.1	86.1	87.5	66.5	82.4	61.8	80.9
Mar-22	92.4	88.5	71.1	87.5	87.7	76.0	84.0	63.2	81.5
Apr-22	93.3	89.0	72.1	88.1	87.8	78.1	84.8		83.4
May-22	100.4	89.3	72.5	88.6	87.8	78.7	85.5		86.1
Jun-22	100.6	89.5	72.7	88.8	87.8	78.8	85.5	67.5	87.1

Source: Our World in Data.
Note: BRN=Brunei; CHN=China; IDN=Indonesia; KHM=Cambodia; KOR=Korea; LAO=Lao PDR; MYS=Malaysia; PHL=Philippines; and VNM=Vietnam.

Table 2 People fully vaccinated per hundred

date	BRN	CHN	IDN	KHM	KOR	LAO	MYS	PHL	VNM
Jan-21			0.0						
Feb-21			0.4	0.0	0.0		0.0		
Mar-21			1.3	1.4	0.1		0.7	0.0	
Apr-21	0.1		2.8	5.6	0.6	0.8	1.7	0.3	0.0
May-21	2.5		3.9	11.7	4.4	3.1	3.3	1.1	0.0
Jun-21	3.3		4.9	18.0	10.1	7.2	7.2	2.4	0.2
Jul-21	6.6		7.4	28.2	14.3	13.4	21.1	7.1	0.6
Aug-21	21.8	61.6	13.0	50.3	31.1	24.3	46.8	12.6	2.8
Sep-21	44.5	72.6	18.5	65.3	50.5	28.2	63.8	19.2	10.0
Oct-21	57.7	74.1	26.7	77.1	75.8	37.6	75.7	24.6	21.4
Nov-21	78.8	76.9	34.6	78.8	80.3	42.0	77.7	32.8	
Dec-21	90.8	83.6	41.1	80.6	83.1		78.2	44.7	69.7
Jan-22	91.4	85.0	46.3	81.2	85.9	52.0	78.5	53.2	73.3
Feb-22	91.6	85.5	52.3	81.7	86.5	58.4	78.6	56.4	78.5
Mar-22	91.8	86.0	57.7	82.8	86.7	60.7	78.8	59.4	79.4
Apr-22	91.8	86.5	59.8	83.7	86.8	65.4	81.6	61.1	80.1
May-22	95.5	87.0	60.6	84.3	86.9	68.5	82.6	62.2	80.7
Jun-22	96.7	87.2	60.9	84.6	87.0	68.8	83.1	63.3	81.3

Source: Our World in Data.
Note: BRN=Brunei; CHN=China; IDN=Indonesia; KHM=Cambodia; KOR=Korea; LAO=Lao PDR; MYS=Malaysia; PHL=Philippines; and VNM=Vietnam.

Table 3 Stringency Index

date	BRN	CHN	IDN	KHM	KOR	LAO	MYS	PHL	VNM
Feb-20		75		0	31		19	25	47
Mar-20	50	79	45	46	56		73	97	47
Apr-20	58	57	72	57	44	96	79	100	88
May-20	53	82	72	57	40	56	69	96	69
Jun-20	49	78	68	41	53	40	55	83	58
Jul-20	49	78	63	39	53	20	51	81	56
Aug-20	41	78	60	47	53	36	65	72	77
Sep-20	35	82	69	37	50	36	66	69	77
Oct-20	35	62	50	37	57	36	66	69	58
Nov-20	35	76	64	43	51	33	80	72	47
Dec-20	35	78	63	62	58	30	67	65	55
Jan-21	35	78	68	47	64	22	77	63	56
Feb-21	35	78	68	49	64	17	77	63	65
Mar-21	41	51	72	64	58	17	68	78	63
Apr-21	41	78	72	72	58	17	62	68	51
May-21	41	69	72	63	50	80	81	68	77
Jun-21	41	78	72	73	50	69	79	72	77
Jul-21	38	71	72	69	49	48	85	72	79
Aug-21	77	71	72	72	51	50	68	75	73
Sep-21	77	76	69	69	47	75	65	75	73
Oct-21	77	71	61	62	47	75	59	75	64
Nov-21	77	65	63	58	47	87	55	33	67
Dec-21	55	71	66	46	51	71	56	65	69
Jan-22	57	79	69	36	51	71	65	65	69
Feb-22	57	64	69	30	46	84	54	71	67
Mar-22	54	64	57	30	41	79	54	71	64
Apr-22	54	79	50	24	17	60	54	38	44
May-22	46	79	56	15	17	63	44	38	26
avg.	50	73	65	50	49	53	66	70	64
min.	35	51	45	15	17	17	44	33	26
max.	77	82	72	73	64	96	85	100	88

Source: Our World in Data.
Note: BRN=Brunei; CHN=China; IDN=Indonesia; KHM=Cambodia; KOR=Korea; LAO=Lao PDR; MYS=Malaysia; PHL=Philippines; and VNM=Vietnam.

Table 4 Real GDP growth rate (%)

	BRN	CHN	IDN	KHM	KOR	LAO	MYS	PHL	VNM	Mean
2017	3.9	6.9	..	10.6	3.2	..	5.8	6.9	6.8	6.3
2018	0.1	6.7	5.2	10.8	2.9	..	4.8	6.3	7.1	5.5
2019	3.9	6.0	5.0	10.5	2.2	5.5	4.4	6.1	7.0	5.6
2020	1.1	2.2	-2.1	-3.7	-0.9	0.5	-5.6	-9.5	2.9	-1.7
2021	-1.5	8.1	3.7	4.4	4.0	2.5	3.1	5.7	..	3.8

Source: Selected Economic Indicators, Countries' report.

Table 5 Agriculture sector growth rate (%)

	BRN	CHN	IDN	KHM	KOR	LAO	MYS	PHL	VNM	Mean
2017	-1.4	2.6	4.0	..	2.3		5.9	4.2	..	2.9
2018	-1.6	3.3	3.5	..	0.2		0.1	1.1	..	1.1
2019	-1.4	4.5	3.1	..	3.9	1.2	2.0	1.2	..	2.1
2020	11.7	4.8	3.1	..	-4.0	3.2	-2.2	-0.2	..	2.3
2021	42.0	3.9	7.1	..	2.7	2.3	-0.2	-0.3	..	8.2

Source: Selected Economic Indicators, Countries' report.

Table 6 Industry sector growth rate (%)

	BRN	CHN	IDN	KHM	KOR	LAO	MYS	PHL	VNM	Mean
2017	4.2	5.5	5.9	..	3.7	..	6.0	7.0	..	5.4
2018	-0.4	3.9	5.8	..	3.3	..	5.0	7.3	..	4.2
2019	4.2	5.3	4.9	..	1.1	5.6	3.8	5.5	..	4.3
2020	2.9	-1.4	2.5	..	-0.9	4.0	-2.6	-13.1	..	-1.2
2021	-4.4	2.4	8.2	..	6.6	7.6	9.5	8.5	..	5.5

Source: Selected Economic Indicators, Countries' report.

Table 7 Services sector growth rate (%)

	BRN	CHN	IDN	KHM	KOR	LAO	MYS	PHL	VNM	Mean
2017	3.4	2.9	8.3	..	2.6	..	6.3	7.4	..	5.2
2018	0.8	3.2	8.0	..	3.8	..	6.9	6.7	..	4.9
2019	3.4	2.4	7.2	..	3.4	6.9	6.2	7.2	..	5.2
2020	-2.1	-3.2	1.9	..	-1.0	-3.5	-5.5	-9.1	..	-3.2
2021	2.5	-0.6	8.2	..	3.7	-2.2	1.9	5.4	..	2.7

Source: Selected Economic Indicators, Countries' report.

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2022 KIPF-AMRO Joint Research

The Impact of COVID-19 on Regional Economies and Policy Responses

Chapter

2

Fiscal Efforts to Cope with the COVID-19 Pandemic Crisis

Chapter 2

Fiscal Efforts to Cope with the COVID-19 Pandemic Crisis[5]

1. Fiscal policy responses across the region

1. **Faced with an unprecedented global crisis, governments across this region responded quickly to the COVID-19 pandemic.** Well before the WHO declared the COVID-19 outbreak to be a pandemic on 11 March 2020, most countries in the region had already reported their first COVID-19 cases and were quickly starting to deploy policy measures to contain the spread of the virus, such as travel restrictions and business closures (Table 1 and Figure 1). Strict containment measures, while helping to reduce the health risks of an uncontrolled large-scale pandemic outbreak, were also highly detrimental to economic activities and livelihoods in most economies.[6] Unemployment increased sharply and many businesses and households suffered sudden losses in their income. This required rapid government responses with various policy support measures to provide the necessary help to those affected by the pandemic, as well as strict containment measures.

2. **Such an unprecedented crisis required policy responses on an unprecedented scale.** The COVID-19 crisis is not the first economic crisis that the global economy has had to deal with. However, it was a very different one from the previous crises that many countries had experienced and overcome. Starting as a global health crisis, the COVID-19 crisis prompted policy advice from numerous health experts and a variety of policy measures were presented to mitigate the economic fallout. One interesting aspect of government responses was the massive size of the support measures. At the very beginning of the global pandemic, the size of announced above-the-line fiscal stimulus measures of G20 countries was about 3.5 percent of GDP, which is more than 80 percent of the size of the stimulus measures deployed during three years of the global financial crisis (from 2008 to 2010).[7] In the case of the ASEAN+3 economies, the size of announced economic stimulus packages varied widely across countries depending on the severity of the pandemic, as

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6 As the COVID-19 pandemic suppressed the economic activities, ASEAN+3 region's economic growth rate dropped from 4.6 percent in 2019 to 0.0 percent in 2020, while for 10 ASEAN countries, the average growth rate fell from 4.7 percent to -3.3 percent in the same period. (AMRO, 2020, 2021a)

7 This is based on the data available by 8 April 2020 (IMF, 2020). According to Almenfi et al. (2020), the pandemic stimulus package of 41 countries for 6 months in 2020 was about 9 percent of GDP, while the stimulus spending during 18 months of GFC was only 4 percent of GDP.

well as the policy buffers available.[8] In the initial fiscal responses, Japanese authorities announced the biggest stimulus package of about 55 percent of GDP, which was further increased to about 70 percent of GDP subsequently. Meanwhile, the initial fiscal support measures in Lao PDR were only 1.6 percent of GDP.[9] Announced stimulus packages showed that both budgetary and non-budgetary measures were extensively used to address the rapidly mounting challenges from the pandemic (Figure 2).

3. **The prolonged nature of the COVID-19 crisis necessitated extended policy support by governments.** When the pandemic first shook the global economy, many prominent international organizations put out policy recommendations to help government authorities effectively counter the economic challenges triggered by the global crisis. One important aspect of emergency fiscal policy recommendations was from the conventional notion of 3Ts, namely, timely, temporary, and targeted support across all levels of governments (IMF, 2020). As discussed, most governments were able to respond in a 'timely' manner, quickly announcing massive support programs. Regarding 'temporary' programs, although those emergency support measures were originally intended 'temporary' often with specific expiration dates, the COVID-19 pandemic turned out to be far more prolonged than initially expected. With continuing threats from new variants and the slow progress in vaccination rollouts,[10] strict containment measures had to be kept in place for a longer period, with the result that damage to economies continued to accumulate. As unfavorable domestic and external conditions continued, the impact of sizeable initial emergency support gradually dissipated and more businesses were pushed to scale down or close their businesses without additional or extended policy support to help them remain afloat.

4. **Evolving policy needs led to multiple policy responses.** Amid continuing challenges from the COVID-19 pandemic, economies in the region went through other global challenges such as geo-political tensions, supply-chain disruptions, and trade tensions, etc. Combined with the country-specific economic environment, these global challenges exposed new vulnerabilities, while the continuing COVID-19 crisis extended the need for existing support measures. For example, strict containment measures at some ports and oil price increases caused significant delays and price increases in the overall shipping industry,[11] which led to substantial damage to businesses in agricultural exports and some manufacturing assembly lines with sizeable backlogging. These evolving support needs were often met by additional support packages or regulatory measures with more targeted policy support.

5. **Elevated uncertainties around the evolution of the COVID-19 pandemic and the prospects for economic recovery tended to increase the uncertainties of future policy**

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8 According to IMF (2021), the size of fiscal support measures tended to be larger in advanced economies, than emerging market economies and LIDCs with more reliance on the budget financing measures.

9 Based on the data available by February 2022 (AMRO, 2022a).

10 By end September 2021, only three countries (Singapore, Cambodia, and Malaysia) out of the 10 ASEAN member countries were able to vaccinate over 70 percent of population with at least one dose (AMRO, 2021b).

11 Carrière-Swallow et al., (2022).

directions. Since the WHO's declaration of the pandemic in March 2020, initial success stories of strict containment measures quickly faded as more countries succumbed to additional outbreaks on a larger scale. The failure to fully contain outbreaks and the repeated emergence of new variants indicated that the health risk from the pandemic was far from over, and the authorities could face a worse outbreak if they relaxed emergency health protocols prematurely. Although a high level of vaccinations proved to be effective in lowering the public health risks, this did not provide full-proof protection against all variants and the risk of another wave remained. Meanwhile, more countries started to relax containment measures to restart their economies by leveraging their high levels of vaccination and expanded public health capacity. Although this move helped to boost economic activities and support businesses to regain growth momentum, major uncertainties in governments' policy decisions remain. For example, economic recovery prospects are still subject to major uncertainties related to the evolution of the pandemic, other global risks, and domestic country-specific factors, where sudden changes in economic prospects could lead to substantial policy changes at any time. This high level of policy uncertainty tends to feed back negatively into the prospects for economic recovery.

6. **Narrowed fiscal policy space will become increasingly binding as new priorities emerge.** Economies in this region had relatively sufficient policy space when they were hit by the COVID-19 crisis, which enabled them to provide sizeable emergency stimulus packages at the start of the crisis (AMRO, 2020). However, slow economic recovery from sharp contractions and massive emergency support measures rapidly undermined the fiscal situation of many economies. In addition, the need for additional fiscal resources is expected to continue for extended pandemic support and strengthening the momentum of economic recovery, pushing up government debt levels in the medium term (Figure 3). Meanwhile, the COVID-19 pandemic exposed and exacerbated some existing structural vulnerabilities, such as rising socioeconomic inequalities, and also brought forward some new long-term structural issues, such as climate change and digitalization (OECD, 2021). Addressing these issues will require more policy actions and resources, and simply returning to the pre-pandemic fiscal policy package will not be sufficient to address these issues properly. Therefore, it is critical for fiscal authorities to undertake prudent assessments of their narrowed fiscal space. This will allow them to develop suitable medium-term plans to support different evolving policy priorities prior to making major decisions on how to use their now more limited fiscal resources for different policy priorities over the medium and longer terms. This long-term perspective in fiscal decision-making will become increasingly critical in addressing long-term structural issues, while gradually replenishing the narrowed fiscal policy buffer in the medium term (Ekapirak et al., 2020).

2. Policy measures to meet diverse needs

7. **Policy support focused on saving people's lives and preserving long-term economic potential.** The COVID-19 pandemic and accompanying containment measures has led

to enormous economic damage across the globe. Faced with rapidly rising health risks of the COVID-19 virus, many countries were in a hurry to implement adequate emergency policy measures to safeguard public health and to contain the economic fallout. At the onset of the COVID-19 pandemic, without an appropriate vaccine or any internationally approved treatments, authorities had to rely heavily on drastic containment and mitigation measures to contain the spread of the virus.[12] On the other hand, a suite of policy measures to counter economic crises was available from previous crises, including the global financial crisis. Given the unique nature of the COVID-19 crisis—public health and economic crises combined—policy makers added a vast array of policy tools to their emergency support packages (Table 2).[13] The policy advice from many international organizations was similar, with the IMF (2020) suggesting large, timely, temporary, and targeted fiscal measures to protect the most-affected people and viable firms, while spending on health and emergency services should be the first policy priority. Under these general guidelines, an emphasis was placed on the overarching goal of saving lives and protecting people's livelihoods and viable firms, with the aim of preventing a health crisis from creating long-lasting demand weaknesses and reducing the well-being of people.

8. **Policy measures had to consider the differentiated economic impacts of the COVID-19 pandemic.** Although the initial drastic containment measures were applied with few if any exceptions, their effectiveness and economic repercussions varied across countries, economic sectors, regions, and demographic groups.[14] For example, countries with stronger public health systems and faster response times did better in containing the economic damage from the COVID-19 crisis, allowing for smaller fiscal support packages (Hosny & Pallara, 2022). It is also well reported that minority groups and those who were already struggling before the COVID-19 pandemic were often more severely affected by the pandemic.[15] Especially in those countries with less developed social protection systems, fast increasing inequality and poverty rates required immediate policy attention with substantive measures (ILO, 2020). Also, the wide application of strict containment measures was more harmful to some contact-intensive services sector businesses, especially the tourism industry. With strict social distancing and border closures, the tourism industry, especially those depending on international tourists, totally collapsed together with the passenger airline industry. Although the urgency of initial policy responses in such an extraordinary scale allowed less stringent targeting at an early stage of the pandemic response, containment measures and fiscal support measures needed

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12 These measures were found effective to contain the public health risks but also found substantial heterogeneity across countries and depending much on pre-conditions. (OECD, 2020b; Deb et al., 2020b).

13 MAS (2020) argues that the nature of the COVID-19 shock is different from the previous traditional economic crises. As both aggregate supply and demand are affected simultaneously, and shock impact is more persistent, traditional crisis economic policies to manage aggregate demand could be insufficient, and could be very costly.

14 Type of containment measures also known to make a difference. Some 'smart/soft' measures are also known to improve the trade-offs between the effectiveness of containment measures and their economic repercussion. (Fotiou & Lagerborg, 2021; Deb et al., 2020a).

15 This include both health and financial aspects. The work and living environments of these groups tend to be more exposed to the COVID-19 infection. These groups are often hired in low-skilled contact-intensive service industry which were usually under stricter containment measures.

to be increasingly tailored to better target these more seriously affected parts of the economy, and enhance the effectiveness of support programs as they continued.

9. **Various policy measures were employed to meet massive but differentiated support needs.** In response to wide-ranging economic repercussions of the COVID-19 pandemic, countries offered diverse emergency support measures to various target groups. Based on their financing sources, fiscal measures are often classified into three groups: (i) tax-based measures; (ii) spending measures; and (iii) balance-sheet measures.[16] Tax-based (or revenue-based) measures were widely used to support the cashflows of businesses and households, by providing tax deferrals and tax relief, or reductions in social security contributions, and reductions in certain fees and charges. Spending measures were more widely used to support affected households and workers through direct subsidies (income subsidies, cash transfers, etc.) and expanded social protection systems. Balance-sheet measures, such as government loans and guarantees, and equity injections, were widely adopted in many COVID-19 stimulus packages, often taking a larger share than the traditional spending and revenue measures.[17] While tax-based and spending measures are explicitly shown in budget documents and fall under parliamentary scrutiny, balance-sheet based measures are often off-budget and less explicit. Therefore, although the balance-sheet measures were useful in providing an essential lifeline to businesses (especially SMEs), their long-term fiscal risks need to be carefully assessed with higher transparency standards (OECD, 2022).

10. **The choice and design of policy tools in support packages should reflect the needs of target groups and the policy environments of specific countries.** After reviewing about 4,000 policy measures included in the stimulus packages of 203 economies around the world, Lacey et al. (2021) report that the support for businesses tended to be focused on tax-based measures, and the support for households or individuals relied mostly on spending measures.[18] Tax-based support to individuals was less common than spending measures for businesses, such as direct subsidies to businesses, particularly those in more seriously affected sectors, namely tourism-related services sector and labor-intensive manufacturing. Interestingly, credit support to businesses was the second-most-popular support measure next to the deferral of tax payments among all measures, with 64 percent of economies adopting preferential loans to businesses. Countries in this region were no different. On-budget expenditure measures focused on household support, while helping businesses was undertaken mostly through revenue-based measures. With a significant economic presence of state-own enterprises (SOEs), stimulus measures through SOEs were another popular policy option among ASEAN+3 economies (Table 3). For example, state-owned commercial banks expanded their loan programs to

16 This is following OECD (2022). IMF (2020) grouped them similarly into (i) revenue-side measures, (ii) spending-side measures, and (iii) government-supported liquidity measures. Other studies on fiscal measures adopt similar classification.

17 Balance-sheet measures are similar to those measures classified in 'off-budget financed' in Figure 2, which shows significant portion of stimulus package in some countries.

18 Among tax-based support measures, deferral of tax payments was predominantly favored by all countries followed by tax exemption and waiver. Meanwhile, direct cash transfers and supplementary ad-hoc programs were most common in spending support measures for individuals.

micro, small, and medium enterprises (MSMEs), supplementing traditional cashflow support such as tax relief or deferral. This credit support to MSMEs was reported as being particularly helpful, as MSMEs were disproportionately more affected by the pandemic, while their access to financial services was limited even before the COVID-19 crisis and in countries with less developed capital markets. Also, electricity tariff reductions or fuel price reductions by non-financial SOEs were often popular support measures in this region, which could provide better opportunities to target specific groups and without explicit (short-term) fiscal burdens for governments.[19]

11. **Tax-based measures tended to play a limited role in mitigating the pandemic shock.** Tax-based support measures were designed mainly to help businesses by allowing them to delay or forgive (part or all of) their tax payments. As business revenues declined substantially due to strict containment measures, such support provided at least a 'temporary' lifeline for affected businesses to remain in business, until they depleted their operating capital. Although credit support measures allowed them to borrow operating capital, they simply increased the liabilities of businesses and delayed bankruptcy unless businesses could rebound quickly. In addition, since tax liabilities are based on the 'past' performance, which meant pre-pandemic performance, and only an incomplete proxy for the current support needs, the actual support needs based on the current business situation were hard to identify. Furthermore, newly established businesses, as well as informal sector businesses, which are often large in numbers in low-income countries, are not eligible for such support, although they are among those businesses that were most severely damaged by the COVID-19 crisis.

12. **The uneven speed of the recovery from the COVID-19 pandemic and elevated uncertainties warrant more flexibility in fiscal management and enhanced risk management.** Not only the economic impact of the COVID-19 pandemic but also the recovery from the crisis show sizeable differences across different countries, economic sectors, regions and demographic groups. Accordingly, policy support measures should be flexibly adjusted to address such changes in needs, which should be assessed regularly together with the effectiveness of those policy measures (Ekapirak et al., 2020). A major policy challenge to many authorities is the risk of premature withdrawal of support measures when the shifting of support targets is unavoidable due to fiscal constraints. In particular, the prospects for economic recovery remain subject to major uncertainties due not only to the evolution of COVID-19 variants[20] but also to diverse global risk factors, such as geopolitical tensions, volatilities in global financial markets, and policy actions in advanced economies, among others. To cope with all these uncertainties while supporting economic recovery, fiscal policy should be well prepared for the contingencies and ready for nimble policy actions to counter any materializing

19 Identifying specific target groups as well as designing policy tools to exactly target them could be very challenging in countries with less developed policy environment. With a narrow tax base, tax-based support measures were not effective, while large informal sector and small (or non-existing) social protection system could not help to identify appropriate target group for subsidies.

20 Fortunately, with successful progresses in vaccination in this region, the risk of another big outbreak with sizeable economic consequences has dropped substantially. However, we cannot exclude the risk of another more virulent or deadly COVID-19 variants resistant to existing vaccines. (AMRO, 2022)

risks. An important constraint to governments' flexible policy actions is the fiscal situation. Given the major deterioration of the fiscal situation in many countries, the size of fiscal policy space will be the key determinant to the speed and extent of flexible fiscal action that governments can take in the medium term. In particular, the extensive use of off-balance-sheet measures in stimulus packages may have increased the implicit or contingent liabilities of governments in many countries. A thorough assessment of the fiscal risks encompassing these measures should accompany fiscal policy decisions on the recalibration of support measures.

3. Fiscal implications of policy responses

13. **The fiscal situation quickly deteriorated as the COVID-19 crisis continued to weigh on economies.** "Whatever it takes" was the global mantra when fiscal authorities were announcing the first fiscal responses to fight the COVID-19 pandemic in early 2020. There seems to be general agreement that the large initial fiscal policy responses successfully prevented a far worse economic contraction in many countries and helped to preserve the economic potential for future economic recovery. However, such large initial fiscal responses, as well as the subsequent additional fiscal support measures, turned out to be very costly to fiscal authorities. The IMF (2021) reported that large fiscal support and output contractions led to an unprecedented rise in government deficits, raising the global average public debt by 13 percentage points of GDP in 2020.[21] Similarly, countries in this region experienced sizeable increases in their fiscal deficits in 2020. This was mainly due to the direct pandemic impacts on economic activities, as well as the large stimulus measures deployed to contain the impact of the COVID-19 crisis,[22] pushing up government debt by 8.6 percentage points of GDP on average in 2020 (Figure 3). While the demand for fiscal support continued into 2021 with no clear end of the pandemic in sight, the fiscal situation of regional economies started to display differing trajectories. Those countries still under the high risk of severe COVID-19 outbreaks tended to continue to expand fiscal deficits to cope with the crisis, while those with more successful COVID-19 containment policies were able to slow down or reverse fiscal expansion.[23] Successfully containing the public health risks helped improve the fiscal position not only by reducing the need for additional large fiscal support, but also by improving revenue collection from the rebounding economic activities with an improving business environment and public confidence. However, despite improving economic activities and revenue collection in some economies, none of the ASEAN+3 economies, with the exception of Singapore, was able to reduce its debt-to-GDP ratio in 2021 (Figure 4).

21 If we combine public and non-financial private debts, the ratio rose by 28 percentage points in 2020 to 256 percent of global GDP, of which 40 percent is government debt (IMF, 2022).

22 In addition to the increase of fiscal deficit itself, GDP contraction also contributed to the increase in the ratio of deficit to GDP (Figure 5).

23 Regardless of the pandemic situation, some countries with very tight fiscal space were forced to consolidate their fiscal positions and transition to off-budget measures to provide the necessary support.

14. **Amid continued spending support measures, rebounding revenue collection contributed to fiscal deficit improvement in 2021.** In 2020, the deterioration in revenue collection, as well as expanded government spending, contributed to fiscal deficit increases across this region (Figure 5).[24] The decline in revenue collection was less significant in Korea and Vietnam, as Korea's on-budget stimulus package mostly focused on spending measures, and Vietnam's stimulus package in 2020 was relatively small, with its successful containment of the COVID-19 outbreak at an early stage.[25] In other countries, the reduction in revenue collection came from both revenue-reducing stimulus measures, as well as a sharp contraction in economic activities, i.e., the tax base.[26] Meanwhile, spending support measures also increased fiscal deficits, but only partly, as the authorities tried to reprioritize the existing fiscal resources to finance fiscal stimulus, by cutting unnecessary or less urgent spending.[27] In 2021, the region was hit by larger COVID-19 outbreaks and many containment measures remained in place with occasional relaxation between major outbreaks, prompting the authorities to continue to roll out fiscal support measures (Figure 1 and Table 2). Despite continued fiscal support in 2021, improved revenue collection allowed for a reduction in fiscal deficits in many countries, as economic activities started to rebound helped by rapid progress in vaccinations (Figure 5 and Figure 6).

15. **The financing of large stimulus packages was a major policy challenge for many emerging-market and low-income countries.** As the low global interest rate environment had lasted for more than a decade prior to the COVID-19 pandemic, many governments kept accumulating their debt levels,[28] while their interest payments continued to decline. This low interest rate environment continued during the pandemic, with further rate cuts to support economies, providing favorable conditions for governments to finance their large stimulus packages at an affordable price. In addition to lower policy rates, central banks' sovereign debt purchase programs greatly facilitated the advanced economies in securing funds for their fiscal support measures.[29] However, many low-income countries and emerging-market economies faced difficulties in securing extra financing sources, especially those with less developed domestic capital

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24 This is rather different from the average features reported by the IMF (2021), which summarized that collapsing revenue was the major source of fiscal deficit increases in emerging market and developing economies.

25 In addition, Vietnam's revenue-based measures were more on deferral of payments rather than reduction or exemption of payments.

26 In particular, strict containment measures such as lockdowns, travel restrictions, border closures and social distancing, posed fundamental challenges to tourism industry, contact-intensive service businesses as well as some economic activities such as old-fashioned labor-intensive factories, which were hard to accommodate strict social distancing measures.

27 Due to strict containment measures, travel and meeting related budget items were among the first spending items to cut, while other spendings constrained by the pandemic, including some capital spending, were also cut to increase health and stimulus spendings.

28 In particular, the gross debt level of emerging market economies (EMEs) increased by almost 13 percentage points of GDP from 40.3 percent in 2010 to 53.2 percent in 2019. During the same period, the gross debt levels of advanced economies and low-income developing countries increased by less than 4 percentage points and less than 1 percentage point of GDP respectively.

29 Some developing countries like Indonesia and the Philippines also relied on their central bank's intervention in sovereign bond market to meet their financing needs.

markets, larger gross financing needs, and a higher reliance on external financing.[30] [31] Before borrowing to finance their fiscal stimulus packages, all governments actively reprioritized and restructured their spending to save some resources, while some countries with available special funds (state reserves, fiscal savings, contingency funds, etc.) used them for additional resources. Meanwhile, the international community also played an important role in providing financial and in-kind support to low-income and developing countries. For example, the World Bank Group committed over US$200 billion for tailored support in various areas to support both the public and private sectors.[32] As a regional development bank, the Asian Development Bank (ADB) committed US$22.8 billion from its own resources in 2021 and mobilized US$12.9 billion in co-financing to help governments address the impacts of the pandemic and support structural reforms for long-term development.

4. Challenges and lessons

16. **Immediate delivery of large fiscal support packages brought many challenges to the authorities.** As the global economy and the lives of billions of people were threatened by the spread of the COVID-19 pandemic, the adoption of strict containment measures and their enormous economic repercussions needed swift policy action to mitigate the negative impacts. However, the speed and size of the required policy actions tended to challenge many aspects of traditional government fiscal policy processes, especially as these processes were constrained by the strict containment measures as well. Although the policy responses were assessed as being timely in general, pandemic preparedness was relatively poor in most countries and the sudden imposition of containment measures brought large-scale economic disruptions, including to government activities. As some government offices were closed due to health concerns, internal policy discussions and coordination were slow, and often insufficient compared with the usual pre-pandemic policy drafting and implementation processes. Without proper information and communication technology (ICT) capacities and sufficient experience in working under strict containment measures, government officials had to introduce time-bound fiscal stimulus packages, sometimes without undertaking adequate internal processes. The implementation of support measures was also challenged by travel restrictions and strict social-distancing measures, which often delayed implementation and discouraged many deserving people and businesses who needed immediate help.

30 According to Almenfi et al. (2020), the share of domestic financing varied a lot, from nearly 0 percent among low-income countries, and to almost 100 percent in high-income countries.

31 In addition, accessing global capital market tends to become harder during times of crisis, further constraining fiscal space and posing greater financing challenges to these countries (Allen, 2022).

32 As of the end of 2021, Cambodia, Indonesia, Lao PDR, Myanmar, the Philippines, and Vietnam received the World Bank's support in the form of COVID-19 Emergency Response Projects and additional financing (Source: https://www.worldbank.org/en/region/eap/brief/world-banks-operational-response-to-covid-19-coronavirus-in-east-asia-and-the-pacific).

17. **The rapid scaling-up of spending programs required a proportional increase in human resources, as well as an enabling institutional environment**. Large-scale support programs can be administered with a lower public sector burden if they are based on some smaller, but easily scalable, programs.[33] For example, advanced economies with more developed social protection systems can leverage their existing policy infrastructure, such as ICT systems and payment systems, as well as the identification and management of beneficiaries, to swiftly implement the larger-scale emergency support programs. Therefore, the availability of existing programs, as well as supporting policy infrastructure, is a key factor that can facilitate speedy delivery of large stimulus packages. Another important constraint is the capacity of public institutions in charge of stimulus package delivery. Although the scaling-up of direct transfer programs and other support measures such as tax payment deferral should be relatively more straightforward if they are based on existing programs, this still requires proportionally more government officials with the appropriate skills and sufficient public resources to properly administer these programs. Despite the temporary nature of the programs, public sector human resources cannot be adjusted quickly due to the long-term fiscal implications, as well as the public sector's accountability. Expanding the supply of experts with specific skills is also hard to do quickly, and this caused difficulties in enhancing public healthcare capacities in some low-income and developing economies at the beginning of the pandemic. Despite large increases in medical supplies and financial resources, the lack of medical professionals was a binding constraint in those countries that needed to rapidly strengthen their public healthcare systems against the pandemic.

18. **Higher accountability and transparency standards without proper institutional capacity can also lead to implementation challenges.** Transparency and accountability are important building blocks for efficient and effective public financial management (PFM) systems. These are often supported by a suite of well-defined procedures to ensure the proper recording, reporting and auditing, which takes time to comply with. Given the urgency of policy responses and the size of the mobilized fiscal resources, these necessary procedures became administrative bottlenecks at different stages of policy responses, especially when procedural rules dominated the transparency and accountability standards. In particular, being responsible for public spending, government officials in spending ministries have to follow all procedures strictly with appropriate records and documents. Although political discretion allowed for expedited decision-making and fast-track implementation in some cases and helped speed up the policy response, these government activities remain subject to ex-post audits, and needed to be supported by appropriate reporting and information disclosure.[34] This additional administrative burden from the enlarged fiscal resources to be processed within the government system can be reduced by making use of a well-functioning financial management information system (FMIS). Improved accounting and information processing through the FMIS can alleviate the human resources burden and expedite the implementation of stimulus measures,

33 Scalability means the extent to which the instrument can be expanded or replicated for additional groups of beneficiaries in accordance with needs (Lacey et al., 2021).

34 GIFT (2020) emphasizes a user-centered and purpose-oriented view on fiscal transparency, and provides a practical tool to identify the datasets required for informed decision-making and for meaningful fiscal transparency in emergency responses.

while maintaining good transparency and accountability standards.

19. **Swift and flexible fiscal responses also require flexible fiscal frameworks and management.** Fiscal policy frameworks are typically composed of a set of components and procedures, clearly coded in various legal documents due to transparency and accountability considerations. This clarity in procedures, however, could become a rigidity in government processes, ending up with belated government policy actions in important policy issues. A higher flexibility in PFM often collides with accountability and transparency standards, but may not be exactly incompatible. For example, formalizing more contingency rules, such as crisis emergency financing rules and temporary emergency funds, could be considered and coded into the fiscal framework, so that expedited decision-making can be undertaken within the fiscal framework rather than through ad-hoc discretion by some politicians.[35] Of course, these contingency rules and procedures need to be well balanced by accountability and transparency standards, and should be reviewed for their continued viability after the COVID-19 crisis.

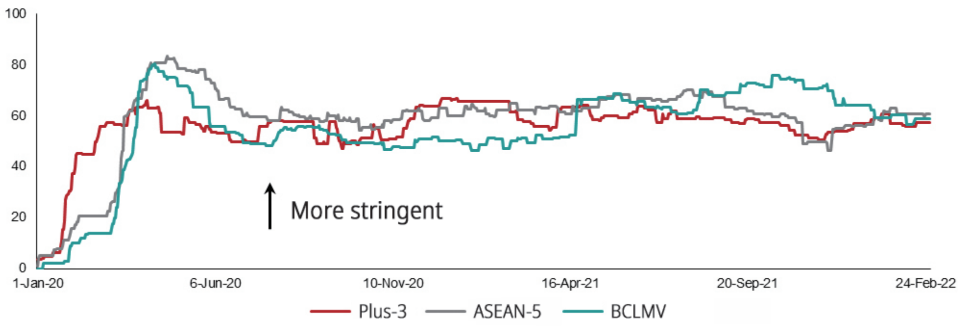
20. **Improving the public recognition and accessibility of government policies can enhance the effective implementation of support programs.** Even with well-designed government programs, implementation can be slow and the overall effectiveness of the program can remain low due to non-policy factors, such as poorly communicated government policies received little public attention and led to no meaningful change, especially when these are related to public health measures during the pandemic. Supporting the public to be fully aware of government policies is an important element in the successful implementation of government policies, including support measures. This also helps to reduce the administrative burden on governments by reducing the number of mistaken applications to government support programs by non-eligible applicants. Another important aspect is improving the accessibility of government support measures. Accessibility is often constrained by geographic factors and eligibility conditions related to policy targets, while those in greatest need of support are often those who have the greatest difficulties in accessing that support. For example, the poor in remote areas tend to be less aware of support programs, have less opportunities to apply for support programs, and have less chance to have the required documents to prove their eligibility for support programs. Also, workers and businesses in the informal sector tend to have no proper tax payment records and, as a result, they were excluded from those support measures based on tax payments or wage records, even though they were more adversely affected by the COVID-19 crisis containment measures.

35 Some existing flexibilities, such as in-year virements, contingency reserve funds, supplementary budgets, and end-year carryover, should be reviewed for their benefits and costs, as well as their implications on fiscal risks (Allen, 2022).

Appendix 1. Selected Figures

Figure 1 ASEAN+3: Government Response Stringency Index

(0 = no restrictions, 100 = tightest restrictions)

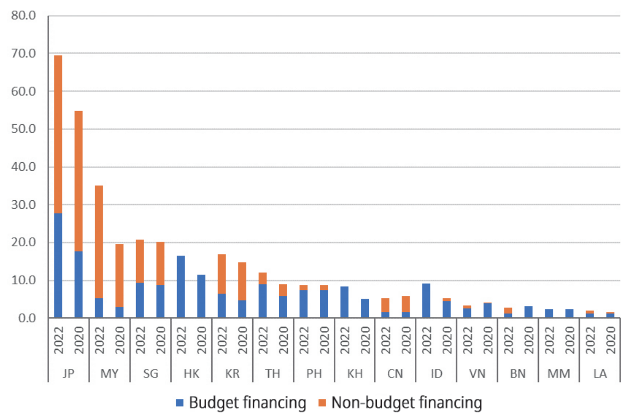


Sources: AMRO (2022a), Our World in Data via Haver Analytics.

Note: The stringency index records the strictness of "lockdown-style" policies that primarily restrict people's behavior. The index is a composite measure based on nine response indicators: (i) school closing; (ii) workplace closing; (iii) cancellation of public events; (iv) restrictions on gatherings; (v) closure of public transport; (vi) stay-at-home requirements; (vii) restrictions on internal movement; (viii) international travel controls; and (ix) public information campaigns. The indicators are scaled to a value from 0 to 100 (100 = tightest). ASEAN-5 = Indonesia, Malaysia, Philippines, Singapore, and Thailand; BCLMV = Brunei, Cambodia, Lao PDR, Myanmar, and Vietnam; Plus-3 = China, Hong Kong (China), Japan, and Korea.

Figure 2 ASEAN+3 economies' fiscal stimulus

(Percent of GDP, February 1, 2020–February 28, 2022)

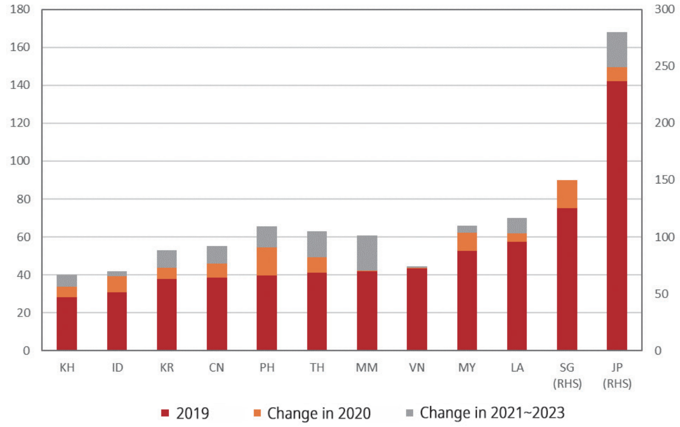


Sources: AMRO (2022a); National authorities via Haver Analytics and CEIC; and AMRO staff estimates.

Note: Based on governments' announced economic relief/stimulus packages, "Budget financing" refers to the fraction of the announced package financed from the budget. "Non-budget financing" refers to the fraction of the announced package financed from non-budget resources, e.g., public funds, public financial institutions or entities, or fiscal reserves. BN = Brunei; CN = China; HK = Hong Kong; ID = Indonesia; JP = Japan; KH = Cambodia; KR = Korea; LA = Lao PDR; MY = Malaysia; MM = Myanmar; PH = Philippines; SG = Singapore; TH = Thailand; and VN = Vietnam.

Figure 3 Projected debt increase in selected economies

(Percent of GDP, 2021–23)

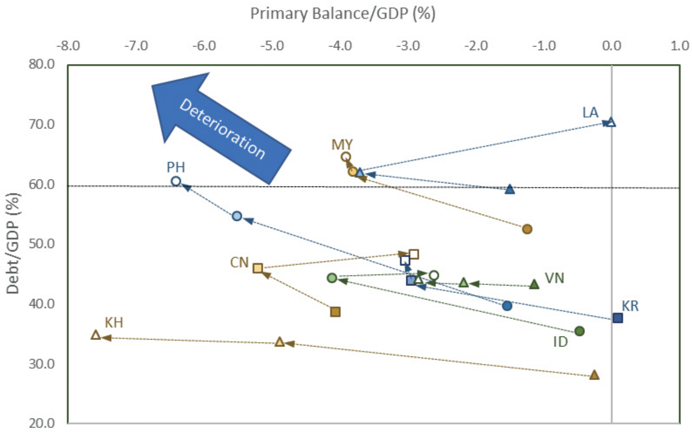


Sources: AMRO (2022a); National authorities via Haver Analytics and CEIC; and AMRO staff estimates.

Note: BN = Brunei; CN = China; HK = Hong Kong; ID = Indonesia; JP = Japan; KH = Cambodia; KR = Korea; LA = Lao PDR; MY = Malaysia; MM = Myanmar; PH = Philippines; SG = Singapore; TH = Thailand; and VN = Vietnam.

Figure 4 Changes in public debt and primary balance of selected economies

(Percent of GDP, 2019–21)

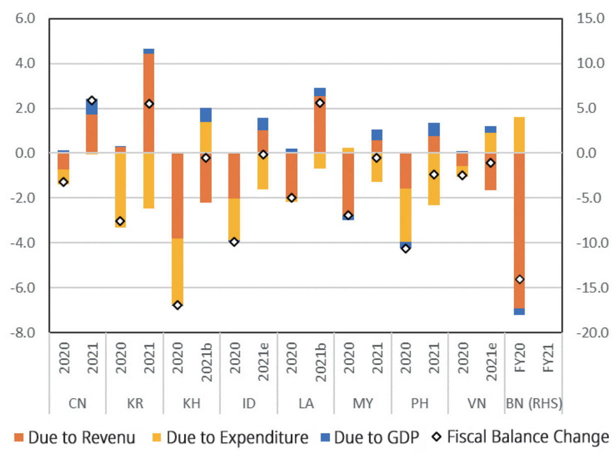


Sources: AMRO (2022a); National authorities via Haver Analytics and CEIC; and AMRO staff estimates.

Note: Some 2021 ratios are based on AMRO staff estimation. BN = Brunei; CN = China; ID = Indonesia; KH = Cambodia; KR = Korea; LA = Lao PDR; MY = Malaysia; MM = Myanmar; PH = Philippines; and VN = Vietnam.

Figure 5 Changes in fiscal balance by contribution: selected economies

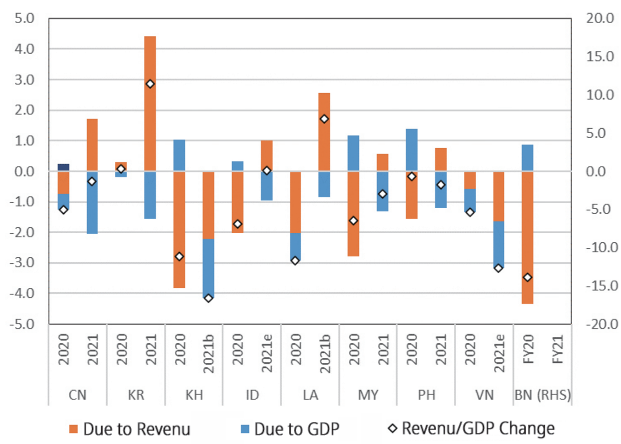
(Year-on-year change, Percent of GDP)



Sources: National authorities via Haver Analytics and CEIC; and AMRO staff estimates.
Note: 'e' and 'b' stand for AMRO's estimate and the national authorities' budget, respectively. Brunei's fiscal year starts from April. BN = Brunei; CN = China; ID = Indonesia; KH = Cambodia; KR = Korea; LA = Lao PDR; MY = Malaysia; MM = Myanmar; PH = Philippines; and VN = Vietnam.

Figure 6 Changes in revenue by contribution: selected economies

(Year-on-year change, Percent of GDP)



Sources: National authorities via Haver Analytics and CEIC; and AMRO staff estimates.
Note: 'e' and 'b' stand for AMRO's estimate and the national authorities' budget, respectively. Brunei's fiscal year starts from April. BN = Brunei; CN = China; ID = Indonesia; KH = Cambodia; KR = Korea; LA = Lao PDR; MY = Malaysia; MM = Myanmar; PH = Philippines; and VN = Vietnam.

Appendix 2. Selected Tables

Table 1 COVID-19 cases and policy reactions of ASEAN countries

	First confirmed case	First policy responses (announcement)	
		First containment/ border measures	First economic stimulus measures
Thailand	13 Jan 2020	17 Mar 2020	5 Feb 2020: MP 28 Feb 2020: RF 10 Mar 2020: FP
Vietnam	23 Jan 2020	3 Feb 2020	13 Mar 2020: RF 16 Mar 2020: MP 8 Apr 2020: FP
Singapore	23 Jan 2020	7 Feb 2020	19 Feb 2020: FP 19 Feb 2020: MP 31 Mar 2020: RF
Malaysia	25 Jan 2020	16 Mar 2020	27 Feb 2020: FP 3 Mar 2020: MP 25 Mar 2020: RF
Cambodia	27 Jan 2020	14 Mar 2020	21 Feb 2020: FP 17 Mar 2020: MP 17 Mar 2020: RF
Philippines	30 Jan 2020	12 Mar 2020	13 Mar 2020: RF 16 Mar 2020: FP 19 Mar 2020: MP
Indonesia	2 Mar 2020	31 Mar 2020	20 Feb 2020: MP 25 Feb 2020: FP 13 Mar 2020: RF
Brunei Darussalam	10 Mar 2020	15 Mar 2020	19 Mar 2020: RF 21 Mar 2020: FP
Myanmar	23 Mar 2020	14 Mar 2020	12 Mar 2020: MP 17 Mar 2020: FP 9 Apr 2020: RF
Lao PDR	24 Mar 2020	30 Mar 2020	20 Mar 2020: MP 26 Mar 2020: RF 2 Apr 2020: FP

Source: OECD (2020a), AMRO (2022b), Author compilation.
Note: MP = monetary policy; FP = fiscal policy; RF = regulatory forbearance.

Table 2 Main policy measures to address the COVID-19 pandemic in ASEAN+3

Policy	BN	KH	CN	HK	ID	JP	KR	LA	MY	MM	PH	SG	TH	VN
Virus containment policies														
Domestic mobility restrictions *e.g., social distancing, work closures, school closures*	●	◎	●	●	●	●	◎	●	●	●	●	●	●	●
Border closure *e.g., entry restrictions for foreign travellers*	●	◎	●	●	●	●	●	●	●	●	●	●	●	●
Fiscal policy support														
Support for households *e.g., cash handouts, personal income tax exemptions*	◎	●		●	●	●	○	◎	●	◎	●	○	●	●
Support for businesses *e.g., wage subsidies, tax cuts, fee waivers*	◎	●	●	●	●	●	●	◎	●	●	●	●	●	●
Targeted to specific domestic sectors (food and beverage, retail, and entertainment outlets, transport operators, etc.)	◎		●	●	●	●	●		●	●		●	●	
Targeted to specific export sectors (travel and tourism, export-manufacturing)		●		●	●	●	●	●	●	●		●	●	
Monetary policy support *e.g., policy rate reduction, reduction in required reserve ratio*		●	●		●		◎	●	●	●	●			●
Financial/macroprudential policy support *e.g., looser regulations on banks' capital or liquidity buffers, loan classification, etc.*		●		●	●	●	●	●	●	●	●	●	●	●
Targeted to households *e.g., loan guarantees, loan restructuring for low-income individuals*	●	●		●	●	●			●	●	●	◎	●	
Targeted to businesses *e.g., special lending facilities, loan restructuring for small businesses*	●	●	●	●	●	●	●	●	●		●	●	●	
Pandemic support from international donors (e.g., Asian Development Bank, World Bank)		●			○			●		◎	●			●

Source: AMRO (2022a).
Note: ● indicates support still in place at the end of 2021; ◎ indicates support expired on or before December 31, 2021; ○ indicates support expired on or before December 31, 2020.

Table 3 Major fiscal policy measures by policy tools and target groups: ASEAN+3 economies

	On-budget measures		**Off-budget / Balance-sheet measures**	
	Revenue	**Expenditure**	**Non-financial SOEs**	**Financial SOEs**
Households	Reduction in SSC and tax, increase tax exemption/ allowance	Cash transfer; wage subsidy; skill training	Reduction of electricity tariff; vocational training	Loan restructuring; financial support (new loans, retirement fund, etc.)
Businesses	Reduction or deferral of SSC, Taxes (CIT, duties, etc.), and charges/ fees; advance tax return	Subsidies; wage subsidies	Reduction of electricity tariff, other charges/ fees	SME loan/financial support; loan restructuring
Health	Tax exemption for medical supplies	Enhancing public health system; vaccine purchase		
Economic Stimulus	Tax cut on durable good purchase, new investment	Infrastructure; expanding LGs financing capacity	Support for specific groups (fresh graduate, internet users, etc.); *capital injection and credit guarantee of SOEs*	Capital injection and credit guarantee of SOEs

Source: Authors' compilation from various sources.
Note: SSC = Social Security Contribution; CIT = Corporate Income Tax.

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2022 KIPF-AMRO Joint Research

The Impact of COVID-19 on Regional Economies and Policy Responses

Chapter

3

Brunei Darussalam

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Brunei Darussalam[36]

Brunei Darussalam's success in swiftly containing its first COVID-19 wave in 2020 owes much to early and stringent public health measures. Economic activity gradually recovered following the easing of restrictions, supported by fiscal measures that were centered on providing financial assistance, as well as tax, utility, and social security deductions or deferments. However, after recording nearly 460 days without any locally-acquired infection, and despite strict border controls, a second wave, fueled by the Delta variant, began in August 2021. Sustained community transmission led to the re-imposition of stringent measures, including new mask-wearing mandates and stay-at-home orders. These interventions, in addition to accelerated vaccinations, were effective in slowing virus transmission and reducing the severity of the disease. Economic relief packages were reinstated to provide support to affected sectors and vulnerable groups. With more than 90 percent of the population having received at least two vaccine doses, Brunei Darussalam had intended to allow international travel in early 2022, but this plan was delayed by the outbreak of the Omicron variant. The number of new cases on a per capita basis reached a global high in early March 2022. Nonetheless, the case fatality ratio continued to trend lower, owing to very high vaccination rates. With this third COVID-19 wave seemingly under control, borders reopened in early April 2022. Brunei Darussalam's experience shows that early pandemic preparedness and swift deployment of economic support measures can help to avert a dual public health and economic catastrophe.

1. COVID-19 development

1. **Early and stringent public health measures helped to swiftly contain the first COVID-19 wave.** Brunei Darussalam identified its first positive COVID-19 case on 9 March 2020, linked to an international super-spreader event in Kuala Lumpur, Malaysia (Chaw et al., 2020). Within 15 days, 100 additional cases were detected in the country. An initial estimate of the effective reproduction number—the expected number of secondary cases generated by an index case—was 2.3. This indicated that a sustained outbreak would be likely. Cognizant of the potential for uncontrolled community transmission, social-distancing measures were swiftly implemented over a 10-day period, including

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international travel bans, school closures, the prohibition of mass gatherings, cinema and museum closures, the prohibition of restaurant dine-ins, and unprecedented mosque closures (Figure 1). These timely measures, in addition to a "test, trace, and isolate" strategy, transparent daily public communications, and multi-agency coordination, were successful in containing the outbreak, bringing the effective reproduction number to below 1—suggesting that the outbreak is under control—in just over one week (Koh et al., 2020a; Wong et al., 2020). Over a period of four months (from 9 March to 8 June), only 141 confirmed cases and three deaths were reported. Brunei Darussalam's pandemic response accords with international evidence showing the importance of the early implementation of a combination of social-distancing measures to control viral transmission (Koh et al., 2020b).

2. **Zero local COVID-19 transmission for nearly 460 days.** The last locally-acquired infection during the first COVID-19 wave was detected on 6 May 2020. Brunei Darussalam's successful containment of the outbreak allowed for a planned de-escalation of stringent restrictions. The first phase started on 16 May, followed by the second phase on 15 June, the third phase on 6 July, and the fourth phase on 27 July. Further de-escalations were announced throughout the year, including a reciprocal green lane with Singapore for short-term business and official trips, and allowing foreigners to enter Brunei Darussalam for essential purposes on a case-by-case approval basis. Social and economic activities began to normalize, but complacency gradually crept in as adherence to precautionary measures, such as wearing face masks, social-distancing measures, and scanning in and out of premises using the contact-tracing mobile application, began to wane (Abu Bakar, 2021). Meanwhile, the number of imported cases gradually increased, and then increased markedly in July 2021. After recording nearly 460 days without any community infection, and despite strict border controls, seven local confirmed cases were reported on 7 August 2021—presumably acquired due to a lapse in protocols at designated quarantine facilities for incoming travelers—marking the start of the second COVID-19 wave.

3. **Progress of the National Vaccination Programme was slowed by initial vaccine hesitancy.** The national COVID-19 immunization program commenced on 3 April 2021, with the aim of inoculating at least 80 percent of the population. The Ministry of Health (MoH) approved five vaccine candidates, namely, Pfizer BioNTech, Moderna, AstraZeneca, Sinopharm, and Johnson & Johnson. The first batch of vaccines to arrive in Brunei Darussalam were Sinopharm, donated by the Chinese government, and AstraZeneca, obtained through the COVAX facility, the vaccine pillar of the WHO Access to COVID-19 Tools Accelerator. The first phase of the vaccination program covered frontline workers, adults aged 60 and above, and students who would be studying abroad. Following the slower-than-expected pace of vaccination, owing to vaccine hesitancy and exacerbated by concerns over unusual blood clots associated with the AstraZeneca vaccine reported in other countries, the MoH ran an opt-in program from 6 to 29 May for those who wanted to be vaccinated early (Bandial, 2021a). The second phase began on 21 June with the arrival of the Moderna vaccine, with eligibility reserved for teachers, childcare workers, and adults at higher risk from the COVID-19 virus. Since 5 July 2021, all individuals aged 18 and above have been eligible to receive the vaccine under the third phase of the program. At the end of July 2021, about 30 percent of the population had received at

least one dose of the COVID-19 vaccine, which was lower than expected (Figure 2).

4. **Severe outbreak fueled by the Delta variant.** The scale and severity of the second COVID-19 wave, which began in early August 2021, was unanticipated, presenting the country with a much sterner test of pandemic preparedness and resilience than in 2020. The number of cases grew rapidly, many of which had unknown epidemiological links. The largest clusters included schools, offshore oilfields and related vessels, and shopping malls, but most infections were acquired in household settings, where multi-generation households are common and social interactions center on strong family and religious relationships. The initial effective reproduction number was estimated at around 5, suggesting high transmissibility that is characteristic of the Delta variant, which was confirmed by the MoH following genomic sequencing (Figure 3). Public health measures were immediately reinstated, including introducing new measures on mask mandates, allowing only two people from each household to buy groceries, and stay-at-home orders between 8:00pm and 4:00am. Enforcement on compliance to health measures was strengthened, including introducing heavy compound fines under the Infectious Disease Act and displaying photos of those caught violating the stay-at-home directive during daily press conferences. Due to the sheer volume of new cases, several schools and army camps were converted to makeshift isolation facilities. A new mobile inflatable virology laboratory was set up to increase the national capacity to process swab tests, which averaged more than 4,000 per day compared with fewer than 300 per day during the first wave. In mid-October, the number of new daily cases surpassed 600 per 1 million people, higher than most countries in Asia. The number of patients who required oxygen supplementation or were critically ill also peaked in October 2021 (Figure 4). Over a period of four months (7 August to 6 December 2021), 14,863 cases and 54 deaths were reported, dwarfing the tally of the first COVID-19 wave in 2020.

5. **The accelerated pace of vaccination slowed viral transmission.** Following a slow initial rollout of the national COVID-19 vaccination campaign stalled by vaccine hesitancy and temporary supply issues, sustained community transmission since August 2021 led to a rapid uptake in vaccination, aided by clearer public communications on the benefits of vaccine protection against infection and severe disease. At the end of December 2021, more than 93 percent of the population had received the two-dose regimen, and boosters had been rolled out. Consequently, the number of infections declined sharply to fewer than 40 per 1 million population, after peaking in mid-October 2021.

6. **The pandemic exit plan was delayed due to the Omicron outbreak.** On 25 October 2021, the Brunei government unveiled a three-phase COVID-19 pandemic exit strategy to facilitate a safe and orderly transition from a pandemic to an endemic phase, based on the population's vaccination coverage. In the early endemic phase, that is when 80 percent of the population have received at least two vaccine doses, international travel restrictions would be eased to allow quarantine-free travel to countries on the "Green Travel List" for fully vaccinated individuals without the need for approval. This was slated to take effect on 1 January 2022. However, the plan was delayed following concerns globally around the spread of the highly infectious Omicron variant. Brunei Darussalam's first case of the Omicron variant was detected on 17 December 2021, sparking a much

larger outbreak (Han, 2021).

7. **The number of new cases on a per capita basis reached a global high.** The surge in COVID-19 cases, ignited by the Omicron sub-lineage BA.2, was unprecedented, even at the global level. In early March 2022, Brunei Darussalam recorded more than 9,500 new cases per 1 million people—the highest level in the world during that period. More than 20 percent of polymerase chain reaction (PCR) tests were positive (Figure 5). Despite the record number of cases, the number of critically ill patients and deaths remained very low in comparison. In just February and March 2022 alone, an astounding 118,000 cases were reported, but there were only 34 deaths due to the COVID-19 disease. As of 31 March 2022, Brunei Darussalam had recorded a total of 134,412 cases, equivalent to 31 percent of the total population (Figure 6). Brunei Darussalam's ultra-high vaccination rate has effectively saved hundreds, if not thousands, of lives. More than 94 percent of the population have received at least two vaccine doses, and nearly 62 percent have received a booster dose. The case fatality ratio has continued to decline amid the surge in cases.

8. **Major shift in COVID-19 management.** Due to the Omicron variant's rapid spread, on 14 February 2022, the Brunei government announced a change in diagnostics to allow self-administered antigen rapid tests (ART) to confirm COVID-19 infections, with hefty fines for those caught not reporting positive test results. The shift in testing strategy also alleviated the burden on PCR swabbing centers and laboratories, which had been experiencing long queues and processing bottlenecks amid soaring cases. Following the announcement, prices of ART kits rose as supply was insufficient to meet the sudden jump in demand. In early March 2020, the government began to sell ART kits to the public at a fixed price of B$3.00 each and sought to secure sufficient supplies for the public. Since then, market prices have dropped below the government-imposed ceiling. COVID-19 positive patients with no or only mild symptoms have also been allowed to self-isolate at home due to limited capacity at isolation centers.

9. **Further relaxation in pandemic restrictions.** In a further change in policy, all individuals, regardless of their vaccination status, can now participate in activities in the country, including returning to work or entering any premises. After a two-year restriction on international travel, fully vaccinated individuals are now permitted to travel in and out of the country by air starting on 1 April 2022, but cross-border travel by land and sea remains closed. Following the vaccine rollout to teenagers between ages 12 and 17 on 8 November 2021, vaccines began to be given to children between ages 5 and 11 on 2 April 2022 on a voluntary basis. Schools for this age group had been closed since August 2021, but reopened in mid-May 2022.

2. The economic impact of the pandemic

10. **GDP growth remained positive in 2020 amid the first COVID-19 wave.** The COVID-19 pandemic triggered a global economic shock of historic proportions, leading to a contraction of global GDP by 3.4 percent in 2020—the deepest global recession since

World War II (World Bank, 2022). Commodity markets were roiled by the pandemic. Crude oil prices fell almost 70 percent between January and April 2020 as pandemic control measures resulted in markedly lower demand for travel and transport, which accounts for two-thirds of oil consumption (World Bank, 2020). Nonetheless, Brunei Darussalam's economy, which is heavily reliant on oil and gas for exports and government revenues, remained relatively resilient, registering positive growth in 2020, at 1.1 percent (Figure 7). Growth was largely supported by the downstream oil and gas sector following the commencement of a large refinery and petrochemical plant in November 2019. On the other hand, the upstream oil and gas sector contracted by 4.9 percent due to the decline in crude oil and natural gas production. The services sector contracted by 2.1 percent as the imposition of stringent containment measures hampered business activity.

11. **Containment measures severely disrupted economic activity, particularly services reliant on face-to-face interactions or travel.** Tourist arrivals to Brunei Darussalam, which had been trending upwards before the pandemic, fell by 70 percent year-on-year in March 2020, and there were virtually no tourist arrivals after April 2020 due to travel bans (Figure 8). The hotel industry was also adversely affected, with hotel occupancy rates plunging to 18 percent in June 2020, but subsequently recovering after the easing of restrictions. With limited cross-border movements, domestic tourism benefited from more resident spending, with hotel occupancy rates surging to 49 percent during the December holidays. For 2020 as a whole, the air transport sub-sector contracted by 76 percent while the hotel sub-sector shrank by 18 percent.

12. **Shifts in consumer demand due to school closures and work-from-home.** Demand for telecommunication services and computer and electronic products surged in 2020 due to the transition to remote learning and working from home. More time spent at home also contributed to higher purchases of groceries and essential items, as sales at supermarkets, pharmacies, and household appliance stores soared (Figure 9). Online transactions for banking services and retail purchases also increased, partly due to temporary fee waivers. Meanwhile, sales of fuel declined as demand for land transportation fell.

13. **The economy was severely impacted by the second COVID-19 wave.** Brunei Darussalam's economy contracted by 2.2 percent year-on-year (y/y) in 2021 Q3, following negative growth in Q2 (-2.1 percent), Q1 (-0.8 percent), and 2020 Q4 (-1.4 percent). Crude oil and natural gas production continued to fall as the sector was plagued by manpower shortages due to mobility restrictions. Unanticipated production disruptions owing to ageing oil and gas fields also hampered the sector's output, which had been trending lower since 2006 (Figure 10). Meanwhile, production of petroleum and chemical products was lower than expected. The construction sector was particularly weak in 2021, reflecting ongoing shortages of foreign labor due to travel restrictions and a lack of new infrastructure investment.

14. **The recovery in the services sector was held back by the re-imposition of stringent pandemic measures.** After four consecutive quarters of contraction, the services sector staged a strong recovery in H1 of 2021, as an easing of pandemic-related restrictions

allowed a return to somewhat normal economic and social activities. However, the re-imposition of stringent public health measures during the second COVID-19 wave slowed the recovery in services activities. Retail sales declined sharply in Q3 of 2021, by 5.2 percent y/y, with contractions across almost all retail activities, reflecting the impact of lockdown measures that forced people to remain at home in the evenings. Food and beverage services also fell sharply, by 12.3 percent y/y, as dine-in at restaurants and other food premises was prohibited. After a partial recovery since December 2020 that had been supported by domestic tourism campaigns and staycation promotions, the hotels sub-sector contracted by 7.1 percent y/y in Q3 of 2021. Hotel occupancy rates had broadly held up well prior to the second wave, but fell to around 30 percent in September 2021. The air transport sub-sector continued to be severely affected due to border closures. In 2021, only 3,543 tourist arrivals by air were recorded—about 1 percent of the total in 2019.

15. **Smaller businesses were more severely affected.** A survey of micro, small, and medium enterprises (MSMEs) in August 2021 showed substantial business sustainability issues.[37] More than half of the surveyed firms projected revenue losses of at least 50 percent that month, including 35 percent that anticipated revenue losses of more than 80 percent. In addition, three-fifths of firms reported having less than three months of cash flow to survive (Figure 11). Liquidity problems were most acute in micro firms (one to four employees), with nearly 70 percent having less than three months' worth of cash flow. Most firms had difficulty in paying large fixed costs, especially staff salaries and rent, similar to survey responses during the first outbreak in April 2020. The cost-cutting measures implemented included temporarily shutting the business, reducing or delaying salary payments, imposing compulsory leave without pay, and dismissing employees. Businesses that were more nimble could pivot their strategies by offering new products and services, or using online distribution channels. However, businesses that were heavily reliant on physical customer interaction or those that lacked digital skills had difficulty in adjusting to the new operating environment.

16. **Incoming data point to a recovery of economic activity in Q4 of 2021, but a subsequent deterioration in Q1 of 2022.** Due to delays in publishing official GDP statistics, it is difficult to quantify the economic impacts after Q3 of 2021.[38] Alternative indicators of economic activity based on high-frequency data, such as internet searches, suggest that service activity partially recovered after a steep fall in August 2021 (Figure 12). This reflected the gradual lifting of pandemic-related restrictions since the first week of December 2021 as the country entered the early endemic phase. However, given the contractions in the first three quarters, GDP growth for the whole of 2021 was estimated to be -1.5 percent (CSPS, 2022; Table 1). This outturn would be the lowest since 2016 when GDP growth was -2.5 percent. Although restrictions have not been tightened in 2022, activity appears to have fallen in 2022 in line with the progression of the Omicron

37 There is currently no official definition of MSMEs in Brunei. Guidelines by the Department of Economic Planning and Statistics for micro is 0 to 4 employees, small is 5 to 19 employees, and medium is 20 to 99 employees.

38 At the time of writing in early April 2022, the latest available GDP data was for the third quarter of 2021.

outbreak, due to voluntary social distancing and fears of contracting the virus.

17. **Consumer price inflation rose sharply during the pandemic.** Headline inflation continued to edge higher, increasing to 2.0 percent y/y in Q4 of 2021 (Figure 13). Inflation had been within the 1 to 2.5 percent range since January 2020 (average inflation during 2000–19 was 0.3 percent). But the headline inflation rate masks considerable heterogeneity in the price changes of certain goods and services. The prices of durable goods increased sharply during the pandemic due to the shift in consumer preferences away from services towards goods such as consumer electronics and household appliances, as more people stayed at home. Following the reopening of economies around the world, demand for motor vehicles has rebounded but supply has not kept pace owing to the global shortage of semiconductors—a key component of new car models. As a result, prices of both new and used cars have risen significantly globally and in Brunei Darussalam. On the other hand, prices of non-durable goods, such as clothing and footwear, have declined due to weak demand.

18. **The trade balance mirrored swings in international oil and gas prices.** A marked increase in the value of exports led to an improvement in the goods trade balance since H2 of 2021 (Figure 14). The recovery in external demand is in line with the global economic recovery. An easing of travel restrictions in major economies led to higher demand for jet fuel, diesel, and gasoline. Global demand for aromatics has also increased, in part driven by rising downstream demand for raw materials used in food packaging and household goods. As a result, energy and petrochemical prices have risen sharply, amid supply disruptions that have been exacerbated by the Russian Federation's invasion of Ukraine. Brent crude oil prices averaged nearly US$100 per barrel in Q1 of 2022—a four-fold increase from the troughs in April 2020—while Japan liquefied natural gas prices reached near all-time highs and petrochemical prices doubled over the same period (Figure 15).

19. **The fiscal position improved markedly in 2021 due to higher oil and gas revenue.** Brunei Darussalam's fiscal deficit is estimated to have narrowed to 7.4 percent of GDP in FY2021/22, from 20.1 percent of GDP in FY2020/21, largely driven by a near doubling in oil and gas revenues (Figure 16).[39] Meanwhile, government expenditure remained flat, reflecting a conscious reining-in of spending following fiscal consolidation efforts that had been in place after the 2014–15 oil price collapse.

3. Policy measures in response to COVID-19

20. **Early and decisive policy interventions helped to stem the outbreak and provide economic support.** Since the onset of the first COVID-19 wave, the Brunei government has prioritized public health measures to contain the outbreak, while rolling out

39 Brunei's fiscal year (FY) runs from April to March.

economic relief packages to mitigate the impact on vulnerable groups and MSMEs in heavily-affected sectors such as tourism, hospitality, restaurants, and transportation. The measures taken focused on three main components: (i) maintaining the well-being of the public; (ii) protecting jobs and providing support for individuals; and (iii) supporting and assisting businesses (MoFE, 2020).

21. **The key elements of the public health response were diagnostic testing, surveillance and contact tracing, treatment and care, procurement of medical supplies, and risk communications.** Brunei Darussalam was an early adopter of testing in the absence of symptoms, and has routinely conducted random testing in community centers and among its large foreign worker population. A sports complex was converted into a testing facility and a new virology laboratory was built in two weeks during the first COVID-19 wave. This capacity was further increased during the second wave with new testing facilities, including drive-through swab sites and a mobile virology laboratory, bringing the total capacity of processing up to 8,000 COVID-19 swab specimens daily. A mobile application integrated with artificial intelligence and advanced data analytics (BruHealth) was developed to allow enhanced surveillance and contact tracing.[40] The surveillance system leverages on digital patient records in the national health information management system database that links all health-care facilities with almost complete coverage of the population. An extension of the National Isolation Centre was completed in three weeks during the first wave, while several schools and army camps were converted into makeshift isolation facilities in record time at the start of the second wave. Brunei Darussalam's strong bilateral and multilateral ties helped to secure and procure supplies of personal protective equipment, testing kits, medical equipment, vaccines, and therapeutics. Daily press conferences broadcast live on national television, radio, and social media platforms have played a key role in providing accurate information to prevent widespread panic and quell misinformation. The government's apt handling of the outbreak has earned public trust, which is critical in securing compliance with social-distancing measures and vaccine take-up.

22. **Fiscal measures were centered around providing financial assistance, as well as tax, utilities, and social security deductions or deferrals.** The Ministry of Finance and Economy (MoFE) announced several temporary fiscal measures on 21 March 2020, focusing on supporting the private sector, particularly MSMEs, and ensuring the job security of locals (Table 2). These measures took effect on 1 April 2020 and were valid for six months (i.e., until 30 September 2020) as the first COVID-19 outbreak was well-contained. The targeted measures included the deferral of payments of social security contributions for employees in MSMEs with monthly earnings of B$1,500 and below, corporate income tax discounts of 50 percent for MSMEs, rental discounts of 30 percent for MSMEs operating in government buildings, 15 percent discounts on utilities bills, and exemptions from customs and excise duties for personal hygiene products.[41] Additional measures were announced on 28 March 2020, such as a wage subsidy of 25 percent to

40 Further details on the features of BruHealth can be found here: https://www.moh.gov.bn/bruhealth/SitePages/Features.aspx

41 The prevailing corporate income tax in Brunei is 18.5 percent. There is no personal income tax.

local workers in MSMEs with 100 employees and below and rental payment exemptions for markets and stalls. Other measures included expanding the i-Ready apprenticeship program to diploma and technical and vocational education training (TVET) graduates, initiatives to encourage upskilling and reskilling, and assisting businesses to utilize e-commerce platforms.[42] On 14 April 2020, His Majesty the Sultan of Brunei announced a special allowance of B$400 per month to be provided to health-care workers until the eradication of the COVID-19 virus in the country, as well as financial assistance to market stall vendors and taxi drivers. On 7 May 2020, the government announced that commercial property tax would be slashed by up to 50 percent for business landlords who gave rental discounts to their tenants.

23. **Most fiscal measures were reinstated during the second COVID-19 wave.** In response to the second and more serious COVID-19 outbreak, most fiscal measures were reinstated, effective 1 August 2021 and ran until 31 December 2021. Moreover, on 2 October 2021, the government announced that locals in the private sector earning less than B$1,500 a month would become eligible to apply for financial assistance if their income or employment was adversely affected from September to November 2021. Employees who had been laid off during the second COVID-19 wave were entitled to B$250 a month with an additional B$50 for up to four dependents. Employees who had been put on unpaid leave could obtain a salary subsidy of 30 percent for three months. Meanwhile, self-employed individuals could apply for monthly welfare assistance if their businesses had been severely affected or had ceased operations.

24. **Monetary measures were mainly on the deferment of principal repayments of loans.** The Brunei Darussalam Central Bank announced several temporary monetary measures on 19 March 2020 to alleviate the financial burden on hard-hit sectors (Table 3). The relief measures, which took effect on 1 April 2020, included six-month deferment of principal repayments of financing and loans for selected sectors, and waivers of all bank fees and charges for financing facilities, as well as online interbank transfers. Additional measures were announced on 30 March 2020, such as extending the deferral of principal repayments to all sectors for up to one year, including the option of restructuring of loans and financing facilities, as well as outstanding credit card balances. These measures had been initially due to expire on 30 September 2020, but were continuously extended until 30 June 2022. A total of 2,014 applications were approved from April to December 2020, while 1,192 applications were approved from August to November 2021. The majority of the applications that were granted assistance were for the temporary deferral of monthly loan financing repayments.

25. **Announced economic relief measures amounted to B$450 million, or 2.7 percent of GDP.** Brunei Darussalam's fiscal and monetary stimulus package was sizeable, but was relatively smaller than most other Southeast Asian economies (Figure 17).[43] This could reflect less need for a larger package since the outbreaks had been contained relatively

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42 The i-Ready scheme is a government-funded program for unemployed jobseekers to gain industry experience. Eligibility was originally open to university graduates only.

43 As of end September 2021, the IMF estimated Brunei's fiscal measures at around B$195 million (IMF 2021).

swiftly, particularly during the first COVID-19 wave in 2020. Moreover, Brunei Darussalam has an extensive social protection system, provided through various programs such as welfare assistance, old age pensions, Zakat distribution, subsidies for education, health, housing, utilities, and staple foods, and other safety nets.[44] In FY2020/21, actual government expenditure on COVID-19-related expenses was estimated to be about B$80 million. As this spending was unplanned, it was likely financed through a reduction in other spending, particularly capital expenditure, which was much lower than in previous years.[45] During FY2021/22, the MoFE reported that government spending during the second COVID-19 wave amounted to B$138.5 million, which included the procurement of vaccines, supplies of ART kits, and meal rations for individuals under self-isolation, among others. The bulk of the fiscal spending during the first and second COVID-19 waves was on health measures, followed by household support and business support (Figure 18). For FY2022/23, the government has budgeted B$124.5 million to combat the COVID-19 pandemic, including purchases of vaccines and therapeutics, enhancements to BruHealth, supplies of medical and laboratory equipment and ART kits, and special allowances for frontline staff, among others.

4. Assessment of policy responses and future challenges

26. **Despite specific challenges faced by small countries, Brunei Darussalam has implemented a successful public health response operation.** Many small countries lack experience in crisis management, and response capacities are often untested in real-life events. However, Brunei Darussalam has leveraged on its small population and centralized government to operationalize effective incident management, surveillance and testing, and risk communication strategies. During the initial stages of its first COVID-19 outbreak, ad-hoc multi-agency arrangements at the technical and operational levels allowed for more formal mechanisms to emerge naturally over the course of the outbreak, culminating in the establishment for a National COVID-19 Steering Committee with clear lines of accountability. Enhanced surveillance and rigorous epidemiological investigations played a key role in controlling transmission of the virus. Surveillance mechanisms were established as early as January 2020 after the first COVID-19 cases were reported in Wuhan, China. As such, Brunei Darussalam was able to recognize and alert the global community of an international super-spreader event, the source of the first COVID-19 wave in the country. Dedicated contact-tracing teams comprising trained public health officers and field workers, supplemented by police officers, worked diligently on time-intensive contact-tracing activities, including case investigations and activity mapping. Mass testing was also a focus, with more than 1 million PCR tests conducted as of end March 2022—about 2,400 tests per 1,000 people, among

44 Zakat is a religious obligation, where all Muslims who meet the necessary criteria donate a certain portion of their wealth each year to charitable causes. The Zakat is then distributed to eligible people, which includes poor and vulnerable groups.

45 Brunei does not have any external debt. Public debt (from domestic Sukuk bond issuances) stood at 1.5 percent of GDP in 2021. Government revenue is primarily derived from oil and gas revenue, and budget shortfalls are financed from saving/reserve funds.

the highest level in the world. A significant risk communications strategy was also established, and the government has been more transparent and responsive than usual, through daily live press conferences led by the Minister of Health and frequently joined by other ministers to provide updates and address queries from the press and public.

27. **Pandemic containment measures helped to flatten the COVID-19 curve and prevent an overwhelming of the health system.** Although the social-distancing measures implemented were stringent, such as international travel bans and school and workplace closures, they prevented the need for large-scale lockdowns. The approach to social-distancing measures has been non-binary. High-risk settings and activities such as mass gatherings, particularly in enclosed spaces, were restricted. However, lower risk activities such as outdoor recreational activities that can be conducted with relevant safety measures were permitted. No movement restrictions were imposed in the country during the first COVID-19 wave, although there were curfews in place from 8:00pm and 4:00am during the second COVID-19 wave. These measures averted a collapse of the health system by allowing the isolation and treatment centers to cope with rising cases and prioritize severely ill patients. Even at its peak, the bed occupancy rate at the National Isolation Centre (NIC) was below 40 percent.

28. **Compliance with public health measures diminished over time, as complacency set in following the country's initial success in handling the outbreak.** The cause of the second COVID-19 wave could be attributed to a lapse in pandemic protocols and social-distancing fatigue. Brunei Darussalam earned international praise for its outbreak control in 2020, and normal economic and social activities had resumed within the country, with no locally-acquired infections, until early August 2021. The surge in cases and deaths during the more serious second COVID-19 wave was exacerbated by low vaccination rates, hampered by initial vaccine hesitancy in part because many had mistakenly perceived the risk of infection to be negligible.

29. **Deploying mass testing using ART kits during the second COVID-19 wave could have enabled faster detection and isolation of positive cases and close contacts to slow disease spread.** Due to the Delta variant's higher infectiousness and shorter serial interval—the time between disease symptom onset of a case and that of its infector—compared with the earlier variants, the common practice of diagnostic testing using PCR and manual contact tracing may be too slow and inefficient for case ascertainment and quarantine to limit virus transmission (Hart et al., 2022). In hindsight, providing ART kits to every household could have identified positive cases earlier and prevented a rapid rise in cases. This could in turn have allowed a quicker de-escalation of pandemic measures to kick start the economy.

30. **The critical success factor in containing the Delta and Omicron outbreaks has been the accelerated uptake in vaccination.** Vaccination rates gained pace during the second COVID-19 wave, solidified by public trust in the government's crisis response. In early August 2021, only 30 percent of the population had received one dose of the vaccine and only 7 percent had received two doses. In early October 2021, the share of the population with at least one dose increased to 70 percent and those with at least

two doses rose to 45 percent. By mid-December 2021, more than 90 percent of the population had received at least two vaccine doses. Adult booster shots were also given starting in mid-December. Vaccines for teenagers commenced in early October 2021, while those for children aged 5 to 11 began in early April 2022. Brunei Darussalam's vaccination rate is among the highest in the world, which has been instrumental in driving down fatality rates.

31. **Early resource planning and sizeable fiscal spending on health measures enabled sufficient procurement of vaccines.** The government had set up a technical committee to develop and implement a national vaccination strategy in the later part of 2020, to identify effective and safe vaccine candidates and secure access to these vaccines. Both multilateral arrangements via the COVAX facility and bilateral arrangements with specific vaccine manufacturers were held. These early plans paved the way for a steady supply of vaccines, albeit that supply briefly lagged in August 2021 when demand surged, to combat the pandemic. Fiscal expenditure on health measures was the largest spending category, totaling more than B$100 million.

32. **Swift economic support and relief measures helped to alleviate the burden on hard-hit sectors.** Fiscal and monetary stimulus packages were announced less than two weeks after the first COVID-19 case was identified, and took effect almost immediately. The decisive emergency measures were extensive, targeted, and time-bound, which supported business cash flows, household incomes, and employment. In terms of the size of the stimulus package, a larger proportion was spent on household support in the form of financial assistance and wage subsidies. Business support measures were mostly in the form of discounts (e.g., corporate income tax, commercial property tax, utilities bills) and the deferral of social security contribution payments of employees.

33. **Disbursements of financial support were occasionally slow due to administrative burdens.** Individuals and businesses seeking to obtain financial aid from the government had to provide sufficient evidence that their incomes were adversely impacted by the pandemic through an application and approval process. This could be very time-consuming and, although efforts were made to streamline and expedite the process, such as through the online National Welfare System, applications still took an average two months to process (Bandial, 2021b). Similarly, those who sought assistance from financial institutions to temporarily delay principal loan repayments had to wait for banks to manually review and validate their applications.

34. **Measures aimed at preserving jobs for locals led to a large exodus of foreign workers, which resulted in labor shortages and in turn hampered the economic recovery.** The size of the labor force declined due to a large reduction in foreign workers, as they were the first to be laid off during the pandemic, with the largest declines in accommodation and food services, and the wholesale and retail trade. Acute manpower shortages are expected to weigh on the recovery of the services sector. A progressive loosening of border restrictions and a relaxation of foreign employment restrictions are important factors for a strong economic revival.

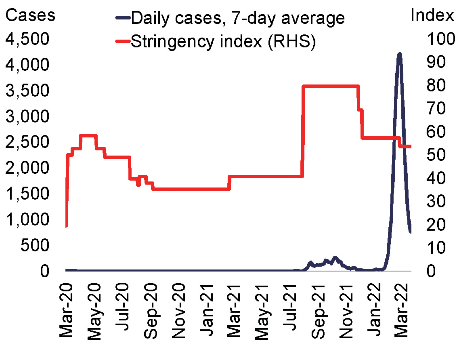
35. **The size of the fiscal response to the COVID-19 pandemic has been constrained by diminished fiscal space.** In comparison to regional peers, Brunei Darussalam's fiscal response appears to be relatively muted. This in part reflects the country's fiscal position, which has been in deficit for seven consecutive years since 2015. The government has exercised restraint and especially prudent spending in recent years. Government expenditure is estimated to have declined to 29.2 percent of GDP in 2021 from 32.6 percent of GDP in 2020.

36. **Looking ahead, the government should focus on driving economic recovery especially in the worst-hit sectors and enhancing fiscal space to ensure fiscal sustainability.** In the near term, it is essential to avoid a premature unwinding of economic support and relief measures to ensure that recovery remains on a strong footing. The travel and tourism sub-sectors have been badly hit by the pandemic. The government can help to revitalize these sub-sectors by promoting domestic tourism, working with regional partners to establish travel corridors with harmonized standards around the recognition of vaccination certificates and digital contact tracing, and extending financial or fiscal measures to support operating at lower capacities. Targeted social spending for vulnerable and disadvantaged households should also remain in place until their financial situation improves. The short-term priority for fiscal policy is to contain the pandemic, stimulate the economy, and provide relief to firms and households. Over the medium term, ensuring sustainability is the primary focus. The revenue base has to be broadened beyond oil and gas. Immediate tax actions can include raising or introducing excises on products with a negative health or environment impact, which would be more feasible than other tax options. Enhancing spending efficiency should also be continued, which may include containing the high public wage bill, improving the targeting of social spending, and reviewing policies on blanket subsidies to make them more targeted.

37. **This crisis will not be the last.** Strengthening national resilience should start with the public health system. In addition to ensuring the availability of vaccines, therapeutics, and medical supplies in preparation for any future COVID-19 waves, it is essential to also make the prevention and control of noncommunicable diseases (NCDs) a top priority. The incidence of NCDs in the Brunei population remains at a very high level, and the COVID-19 pandemic has highlighted that people with underlying health conditions, such as NCDs, run far higher risks of severe disease. The pandemic has also shown that digital preparedness can help firms to navigate and adapt to changes in the operating environment. To prepare for future disruptions, digital transformation should be intensified. MSMEs should be encouraged to adopt digital solutions and the government can facilitate and provide the necessary support for the transition. It is also vital to equip the workforce with digital and technological skills to secure decent jobs in the digital era. Lifelong learning through reskilling and upskilling is particularly important.

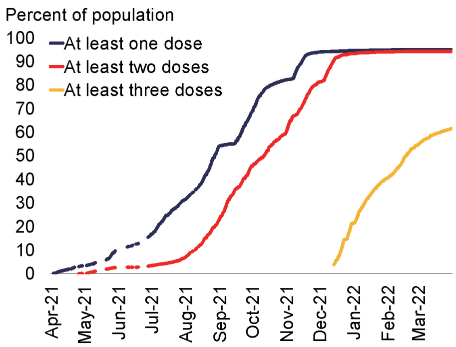
Appendix 1. Selected Figures

Figure 1 COVID-19 cases and stringency of restrictions



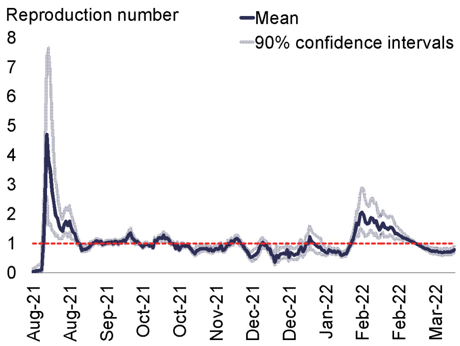
Source: Ministry of Health, Oxford COVID-19 Government Response Tracker.

Figure 2 COVID-19 vaccination rates



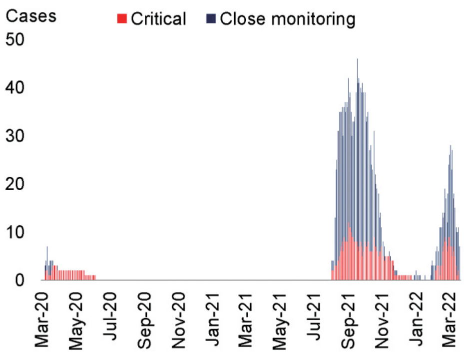
Source: Ministry of Health.

Figure 3 Reproduction number



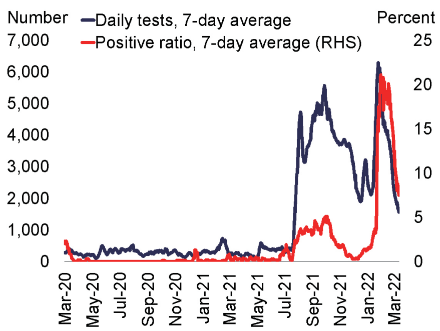
Source: Ministry of Health, authors' calculations.

Figure 4 COVID-19 cases in intensive care unit



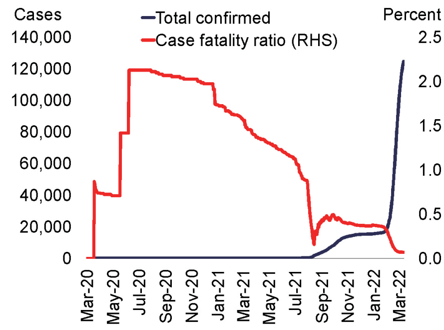
Source: Ministry of Health.

Figure 5 Daily PCR tests and positive ratio



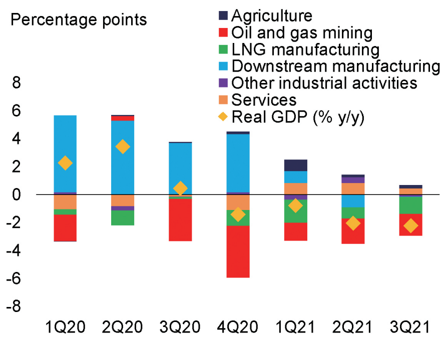
Source: Ministry of Health.

Figure 6 Cumulative cases and case fatality ratio



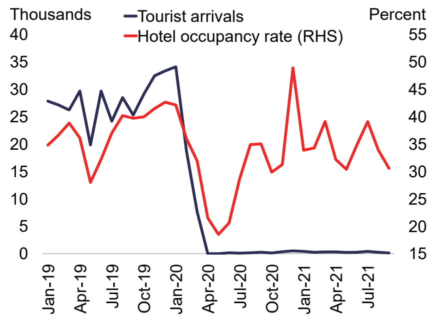
Source: Ministry of Health.

Figure 7 Contribution to GDP growth by economic sector



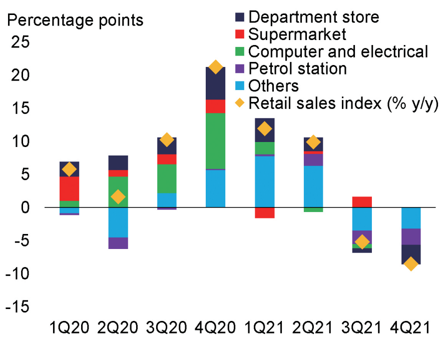
Source: Ministry of Finance and Economy.

Figure 8 Tourist arrivals and hotel occupancy



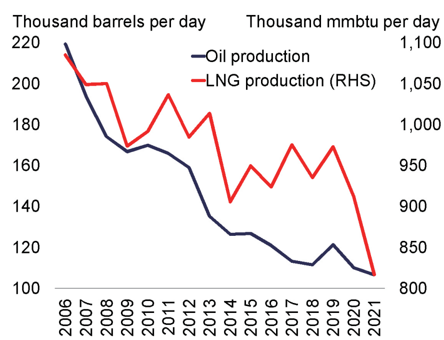
Source: Ministry of Primary Resources and Tourism

Figure 9 Contribution to retail sales growth by activity



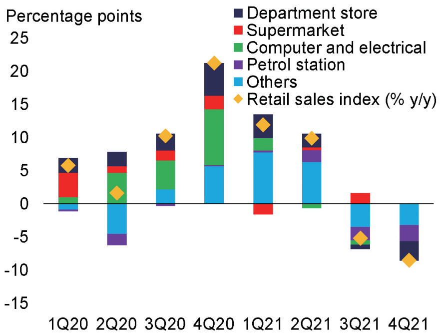
Source: Ministry of Finance and Economy.

Figure 10 Crude oil and liquefied natural gas



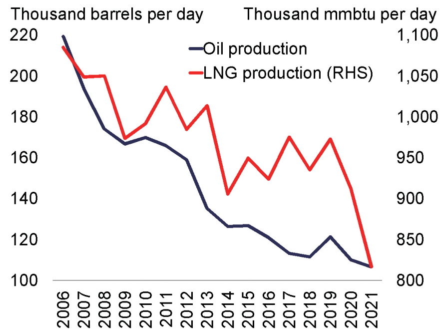
Source: Ministry of Energy.

Figure 9 Contribution to retail sales growth by activity



Source: Ministry of Finance and Economy.

Figure 10 Crude oil and liquefied natural gas

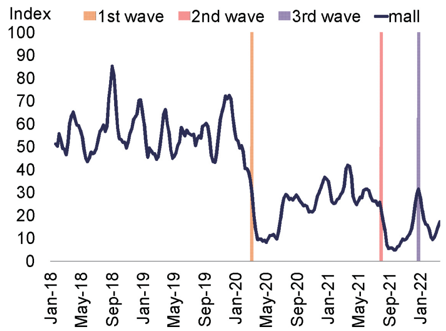


Source: Ministry of Energy.

Figure 11 Cash flow sustainability in MSMEs

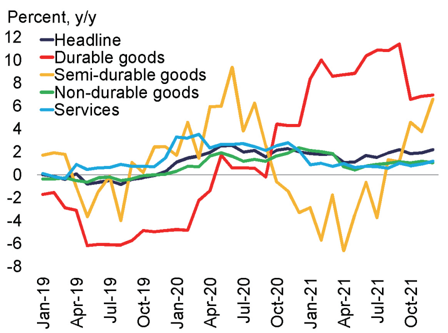
Source: Darussalam Enterprise.

Figure 12 Google search for "mall"



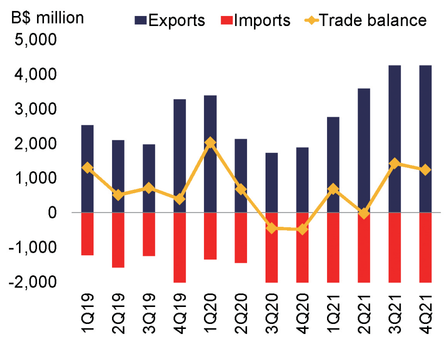
Source: Google Trends.

Figure 13 Consumer price inflation by goods durability and services



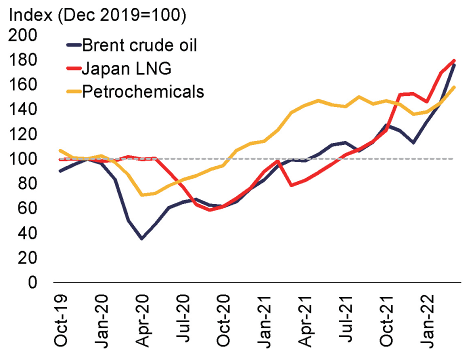
Source: Ministry of Finance and Economy.

Figure 14 Merchandise trade balance



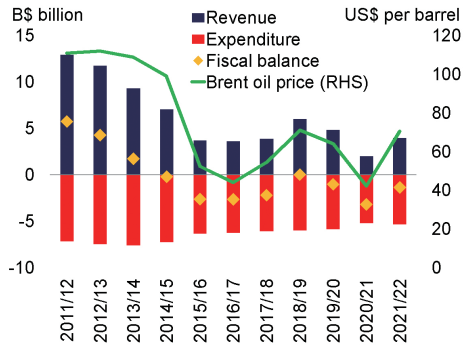
Source: Ministry of Primary Resources and Tourism.

Figure 15 Global benchmark prices of key exports



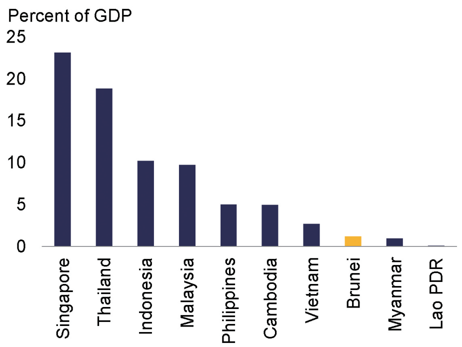
Source: ICIS, World Bank.

Figure 16 Government finance and oil price



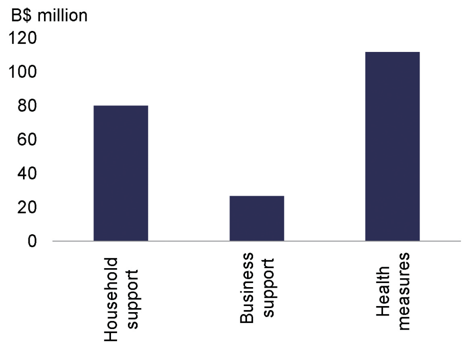
Source: Ministry of Finance and Economy, World Bank, authors' estimates.

Figure 17 Size of COVID-19 fiscal stimulus in ASEAN member states



Source: International Monetary Fund.

Figure 18 Estimated COVID-19 fiscal spending by category



Source: Ministry of Finance and Economy, authors' estimates.

Appendix 2. Selected Tables

Table 1 Selected economic indicators

	2017	2018	2019	2020	Estimate 2021
Real Sector and Prices	(Annual percentage change)				
Real GDP	1.3	0.1	3.9	1.1	-1.5
Agriculture	-1.6	-1.6	-1.4	14.4	42.0
Industry	1.5	-0.4	4.2	2.9	-4.4
Services	1.1	0.8	3.4	-2.1	2.5
GDP deflator	5.0	9.2	-3.3	-10.8	12.0
CPI inflation (average)	-1.3	1.0	-0.4	1.9	1.7
External Sector	(BND million, unless otherwise specified)				
Current account balance	2,742	1,255	1,214	748	2,091
(In percent of GDP)	16.4	6.9	6.6	4.5	11.4
Trade balance	3,319	3,184	3,012	1,911	3,336
Exports	7,556	8,734	9,831	9,027	14,855
Imports	4,237	5,550	6,820	7,117	11,519
Services, net	-962	-1,360	-1,622	-1,179	-1,166
Primary income, net	995	113	493	499	496
Secondary income, net	-610	-683	-668	-483	-575
Financial account balance (+ indicates net outflows)	1,984	95	-553	364	-8
Foreign Direct Investment (net)	-635	-698	-511	-797	-721
Other investment (net)	2,619	793	-42	1,161	713
Overall balance	758	1160	1838	385	2,100
Gross international reserves	4,817	4,596	5,829	5,515	5,861
(Months of imports)	9.7	7.2	7.5	7.5	5.5
External debt	N/A	N/A	N/A	N/A	N/A
(Percent of GDP)	N/A	N/A	N/A	N/A	N/A
Fiscal Sector	(Percent of GDP)				
Revenue	22.7	32.7	26.4	12.6	21.8
Oil and gas revenue	17.5	26.4	19.8	7.7	16.4

	2017	2018	2019	2020	Estimate 2021
Non-oil and gas revenue	5.3	6.3	6.5	4.9	5.4
Expenditure	35.7	32.5	31.9	32.6	29.2
Current expenditure	30.5	29.8	29.5	31.3	28.3
Capital expenditure	5.2	2.7	2.4	1.3	0.9
Overall fiscal balance	-12.9	0.1	-5.6	-20.1	-7.4
Public debt	2.6	1.9	1.8	2.2	1.5
Monetary and Financial Sector	(Annual percentage change, end-period)				
Domestic Credit	-5.4	5.0	1.1	-1.8	1.6
Credit to private sector	-5.3	-3.0	2.3	0.2	1.8
Broad money	-0.4	2.8	4.3	-0.4	2.7
Memorandum Items					
Nominal GDP (BND million)	16,748	18,301	18,375	16,654	18,285
Nominal GDP (US$ million)	12,128	13,567	13,469	12,006	13,627
GDP per capita (US$)	28,572	31,628	31,086	27,443	31,690
Exchange rate (BND/US$, average)	1.38	1.35	1.36	1.38	1.34

Source: National Authorities, International Monetary Fund, World Bank, authors' estimates.
Note: Fiscal data are in fiscal year, which runs from April to March.

Table 2 Fiscal measures in response to COVID-19

Date announced	Fiscal measures
21 March 2020	• MSMEs to defer social security contributions (Employee Trust Fund [TAP] and Supplementary Contribution Pension [SCP]) for local employees earning B$1,500 per month and below (for MSMEs with employees fewer than 100) • Government to finance the SCP contribution of self-employed individuals • 30 percent discount on the rental rates of government buildings for MSMEs in the tourism, hospitality, restaurants, and transportation (air and water) sectors • 50 percent tax discount on the corporate income of MSMEs in the targeted sectors for the year of assessment 2020 • 15 percent discount on water and electricity bills for MSMEs in the targeted sectors • Assist MSMEs to participate on e-platforms to market their products and services • Six-month contract extension for i-Ready apprentices in the public and private sectors with contracts expiring before September 2020 • Temporary exemption of custom and excise duties for personal hygiene products

Date announced	Fiscal measures
28 March 2020	• Provide online learning and hands-on learning courses to encourage upskilling or reskilling of locals • Assist MSMEs to join e-commerce platforms to advertise products, make payments, and facilitate logistics • Provide co-matching grants to businesses in e-commerce and logistics services • 25 percent wage subsidy to local workers in MSMEs with 100 employees and below for a duration of three months • Six-month exemption of rental payment for markets and stalls provided by the Ministry of Home Affairs, effective March 2020 • Expand the i-Ready Apprenticeship Programme to Diploma and Technical and Vocational Education Training (TVET) graduates. Graduates with a Bachelor's degree and above will be paid B$800 a month, Diploma $600 a month, and TVET $400 a month. Duration of the i-Ready scheme is shortened from 3fs to 18 months.
14 April 2020	• Special monthly allowance of B$400 for health-care workers • Financial assistance to market vendors and drivers (land and water taxi)
7 May 2020	• Commercial property tax discount of up to 50 percent for building owners who give rental discounts to tenants
12 August 2021	• MSMEs with fewer than 100 employees can defer social security contributions for local staff earning less than B$1,500 per month • Government to finance the SCP contribution of self-employed individuals • 30 percent discount on the rental rates of government buildings • 20 percent discount on water and electricity bills • 50 percent tax discount on corporate income for the year of assessment 2022 • Temporary exemption of custom and excise duties for personal hygiene products • Contract extension for i-Ready apprentices
2 October 2021	• Local employees in the private sector earning less than B$1,500 per month whose income or employment was affected between September and November 2021 are eligible for financial assistance • Local employees laid off are entitled to B$250 per month; additional B$50 for up to four dependents • Local employees put on unpaid leave can obtain a salary subsidy of 30 percent for three months
25 October 2021	• Commercial property tax discount of up to 50 percent for building owners who give rental discounts to tenants

Source: Ministry of Finance and Economy.

Table 3 Monetary measures in response to COVID-19

Date announced	Monetary measures
19 March 2020	• Deferment of principal repayment of loans or financing for the tourism, hospitality, restaurants, and air transportation sectors for a period of six months • Deferment of principal repayment of loans or financing for food and medical supplies importers for a period of six months • Waiver of all bank fees and charges, except for third party charges, related to trade and payment transactions for companies in these sectors for a period of six months
30 March 2020	• Deferment of principal amount repayment of loans or financing for all sectors • Restructuring and deferment of principal amount repayment for personal loans and hire purchase facilities such as car loans or financing for not more than 10 years • Provision of deferment of principal amount repayment for real estate loans or financing • Restructuring of credit card outstanding balances into a loan for a period not exceeding three years for those in the private sector, including self-employed individuals • Waiver of all bank fees and charges, except for third-party charges
13 August 2021	• Reinstatement of all monetary measures

Source: Brunei Darussalam Central Bank.

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Chapter

4

Cambodia

Chapter 4

Cambodia[46]

The COVID-19 pandemic was first detected in Cambodia on 27 January 2020, when the country's first positive case. The COVID-19 virus returned in three further waves over the next two years, with the second COVID-19 outbreak starting on 28 November 2020, and the third starting on 20 February 2021. Towards the end of 2021, the fourth wave, the Omicron variant, entered Cambodia, on 26 December, without major effects on the community due to the high rate of vaccination. Cambodia continued to successfully overcome the outbreaks, despite the high cost to government, society and local communities. Thanks to its vaccination policy, Cambodia remained largely unaffected by the Omicron variant. The national budget was cut twice in 2020, first by US$443million and then by US$475million, by the Prime Minister.[47] Many workers were allowed to switch from working to vocational training, but they received only 40 percent of the minimum wage.[48] All kinds of services sector businesses were forced to close by government regulations issued by the relevant ministries. The capital city, Phnom Penh, went into lockdown causing supply shock inflation. Furthermore, with the reduction[49] of tourist arrivals, the government supported all tourist-related businesses by imposing zero income tax. The government also offered tax holidays for the garment sub-sector, together with co-support of US$40 from the government and US$30 from the employer to garment sub-sector workers.

1. COVID-19 development

1. **The COVID-19 virus was first detected in Cambodia on 27 January 2020,** in a 60-year-old Chinese man and four of his family members who had traveled from Wuhan, China, to Preah Sihanouk Province, Cambodia on 23 January 2020**.** However, the first infection of a Cambodian citizen50 was detected on 7 March 2020 in Siem Reap Province. This was an individual who had had direct contact with a Japanese traveler who had left Cambodia on 3 March 2020, transiting in Tan Son Nhut (Ho Chi Minh City) airport, and whose infection was detected on 4 March 2020 in Japan. Besides this person, seven

46 Sereyvath Ky, Institute of China Studies in Cambodia; email: kysereyvath@gmail.com
47 The office of council ministers, https://pressocm.gov.kh/archives/65566
48 Government Instruction of Ministry of Labour and vocational training issued by 28 February 2020.
49 Tourist visited Cambodia reduced by 60 percent in general and by 90 percent for Chinese tourist.
50 Prime Minister Hun Sen, Speech on official Facebook page on 7 January 2020.

other people were detected with the disease from this first case.[51] The number of new COVID-19 cases subsequently increased to 122 by 12 April 2020. This meant that Cambodia was unable to celebrate the Lunar New Year festival in 2020 due to restrictions on gatherings.

2. **The second COVID-19 wave in Cambodia took hold on 20 May 2020.** The first new COVID-19 case was detected in a Cambodian citizen returning from Korea by transiting through the Philippines before arriving in Cambodia. On 20 and 24 July 2020, significant increases in case detections were registered, with 26 cases[52] and 23 cases,[53] respectively, on each day. As a result of the second wave of virus detections, in mid-May 2020, all educational institutes in Phnom Penh were closed by the government. By the end of 2020, the total cases in Cambodia that had been imported by foreign passengers stood at 361 (Figure 1).

3. **Over the course of 2020, Cambodia succeeded in keeping the three COVID-19 waves under control.** Since the first few COVID-19 cases detected in early January 2020, Cambodia managed to keep the situation under control, with the number of new cases limited to under 15 a day, even up until the third COVID-19 wave started from 28 Novermber 2020 (Figure 2). While the infection was less severe, it nonetheless adversely affected the lifestyles of people, especially those living in Phnom Penh. The total number of cases rose to 516 by 20 February 2021.

4. **But ultimately the Delta-variant wave broke through the efforts to control the spread of the pandemic.** Unfortunately, Cambodia was confronted with successive waves that were increasingly more severe, especially from 20 February 2021 onwards (Figure1), which was named the 20 February 2020 event. The rate of daily infection increased slightly to around 55 cases on average from 21 February to 7 April 2021.[54] There was a big jump in the number of new cases from 8 April 2022 onwards, as the total rose to 579 cases. The COVID-19 virus continued to spread until the number of cases reached to 1,130 in June 2021. The average infection rate during the community transmission outbreak between 8 April and 29 October 2021 was 563 cases.[55]

5. **The most recent COVID-19 outbreak was the Omicron variant, which was first detected in Cambodia on 26 December 2021.** This came just one week after the announcement of high transmissibility of the Omicron variant by Soumya Swaminathan, Chief Scientist at the World Health Organization (WHO). This outbreak registered 479 new cases on 24 February 2022, after Lunar New Year celebrations in Cambodia. Then the number of new cases detected by PCR tests declined gradually until 10 April 2022, when there were just 16 cases recorded.

51 Ministry of Health, Official announcement on the first Cambodian infection on 7 January 2020.
52 Ministry of Health, Official announcement on New infection cases on 21 July, 2020 by official Telegram Channel.
53 Ministry of Health, Official announcement on New infection cases on 25 July, 2020 by official Telegram Channel.
54 Author's calculation bases on data from the Ministry of Health, COVID-19 Daily Notification, Cambodia.
55 Author's calculation bases on data from the Ministry of Health, COVID-19 Daily Notification, Cambodia.

6. **The first death of a COVID-19 patient was recorded on 11 March 2021.** A 50-year-old man who became infected on 27 February 2021 was a driver for a Chinese investor in Preah Sihanouk Province, and he died on 11 March 2021 at 10:40am in Khmer-Soviet Friendship Hospital.[56] Following this first death, until 8 April 2021, there was an average of one death per day, and this increased to an average five deaths per day by 15 June 2021. Due to the 20 February 2021 event, the number of deaths increased to an average 18 per day. However, in the last week of October 2021, the number of new cases decreased from a three-digit figure to a two-digit figure, while the number of deaths decreased from two digits to one digit, or an average of four deaths per day (Figure 3).[57]

7. **The successful treatment of patients with the COVID-19 virus was provided on all 122 cased infected up to 7 March 2020.**[58] In total, there were 132,639 recovered cases and 3,049 fatalities by 10 April 2022. The total recoveries were 362 cases, and 116,929 cases, respectively, by the end of 2020 and the end of 2021.[59] The daily average recovery was 164.77 cases from 27 January 2020 to 10 April 2022.[60]

8. **The government imposed several intervention responses to control the COVID-19 pandemic.** The Government of Cambodia, learning from WHO guidance and global best practice, used two approaches in response to the COVID virus and to restrict COVID-19 transmission: an international cut-off approach and a local cut-off approach.

9. **The first was an international ban of travelers from affected countries.** The international travel ban on affected countries, such as Italy, Germany, Spain, France, and the United States, was imposed on 10 March 2020. Since most COVID-19 cases in Cambodia were imported cases, the government issued a directive on 14 March 2020 to all Cambodian public and civil servants, as well as citizens, not to travel to European countries, Iran, and the United States.

10. **The local responsive approach started on 15 March 2020, whereby every province had to establish a committee to fight against the COVID-19 pandemic.** Ministry officials were required to start working from home, while students were required to study from home in high-risk areas, especially Phnom Penh and Kandal Province. All business entities with a high risk of COVID-19 virus transmission were forced to close, as well as all religious activities. In accordance with the seven pillars recommended by the WHO, the nationwide lockdown, wearing of facemasks, social-distancing measures, the implementation of standard operating procedures, testing, contact tracing and quarantine activities were implemented across Cambodia.

11. **A nationwide lockdown started during the Lunar New Year Festival in 2021.** On 14

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56 Ministry of Health, Government notification on COVID-19 1st Death cases in Cambodia.
57 Authors' calculations based on data from the Ministry of Health, COVID-19 Daily Notification, Cambodia.
58 Prime Minister Hun Sen, official announcement on no COVID-19 cases in Cambodia, on official Facebook page.
59 Ministry of Health, Official announcement on new cases on 31 December 2020 and 31 December 2021, by official Telegram Channel.
60 Authors' calculations based on data from the Ministry of Health, COVID-19 Daily Notification, Cambodia.

April 2021, Phnom Penh announced a two-week lockdown, which came after two months of a slow but steady increase in the number of COVID-19 cases in different areas of the city. Many of these cases were connected to the 20 February 2020 event, leading to the previous closure of several buildings and areas within the city with a high incidence of COVID-19 positive tests. By 18 July 2021, there were 12 provinces in lockdown, especially those provinces that bordered Thailand.

12. **Food shortages caused some food prices to triple during the first week of the lockdown.** Ministry of Commerce intervened as a result by supplying food to all people in lockdown areas (red zones) at reasonable and affordable prices. However, about 70 percent of households reduced spending on food and other housing expenditure by 20 to 50 percent. This situation caused a 39 percent increase in the incidence of child malnutrition in 2020.[61]

13. **The government pushed for an acceleration in vaccine procurement as a first priority.** The first vaccinations had started on 10 February 2021 and were reserved for government leaders. This was followed by vaccinations for frontline officials, and then citizens (Figure 4). The number of vaccinations increased from 7,091 doses by 15 February 2020 to 7,251,656 doses by 30 June 2021. Cambodia was successful in its vaccination program due to the support received through supplies of vaccines from China, the United States, Australia, and Japan, which provided 30,456,720 doses of vaccine for 14,262,170 people (including a first dose for 14,262,170 people, a second dose for 6,864,754 people, and a third dose for 1,810,743 people).[62] According to the Telegram channel of Dr. Or Vandine, President of the COVID-19 Committee for Cambodia, by 10 April 2022 the total number of vaccinations was 102.72 percent of the target population of 10 million. Vaccinations can be categorized by age group, as shown in Table 1. The COVID-19 vaccines utilized in Cambodia are SinoPharm, SinoVac, AstraZeneca, Johnson & Johnson, Moderna, and Pfizer.

2. The economic impact of the pandemic

14. **The COVID-19 outbreak hit Cambodia's GDP hard, causing a 3.1 percent contraction in 2020,** while GDP per capita fell even further, by 4.4 percent.[63] The contraction caused rising stagflation during that year (Figure 7). The sectors that were most badly affected by the pandemic were garments, including textiles and footwear, together with construction, hotels and restaurants, and transportation and communication. During the pandemic, the output of the garment sector including textiles and footwear declined by 13.1 percent due to a decrease in export demand by 20.1 percent (Table 2). The construction sector, which had grown rapidly in 2019, contracted by 10.6 percent due to a decrease in project approvals by 24 percent. Furthermore, output in the hotels and restaurants sector declined

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61 https://angkorhospital.org/repairing-nutrition-during-COVID19-kh/

62 Ministry of Health, Official announcement on new infection cases on 31 December 2021 by official Telegram Channel

63 Asian Development Bank, ODA 2022 data.

by 13.3 percent because of a reduction of number of international tourist arrivals by 42 percent and domestic tourists by 30 percent. For transportation and communication, output declined by 1.5 percent.[64] The economy is expected to continue to recover amid a rollback of COVID-19-related restrictions. **Cambodia's real GDP growth is projected to reach 4.8 percent in 2022,** with GDP expected to reach US$30.544 billion and GDP per capita estimated to be US$1,842 this year.[65]

15. **Subdued transport costs helped to dampen headline inflation in 2020.** The inflation rate rose from 1.8 percent in 2019 to 2.8 percent in 2020, and then to 3.7 percent in 2021 (Figure 5), in which food and non-alcoholic beverages rose by 4.7 percent, followed by clothes and footwear, which rose by 3.9 percent. However, due to the city lockdown, transportation inflation decreased by 5.1 percent (Figure 6).[66] The prices of all items used in measuring consumer price inflation as result of increases in subitems are detailed in Table 3.

16. **To ensure the nation's food security during the pandemic, rice exports were frozen temporarily from 5 April 2020.**[67] Cambodia was not the only country to implement food protectionism, and was followed by Vietnam and Japan, among others. Given the uncertainties of the COVID-19 pandemic, it was seen as necessary to protect Cambodia's food security, even though the country normally exports around 500,000 tonnes of rice annually.

17. **The lockdown caused food shortages in Phnom Penh, the capital city, and a surplus of food supplies in producing areas (rural areas), creating price distortions, with prices falling in producing areas and prices rising in areas of high demand.** Cross-border trade and movements remained limited,[68] with imports down by 8.09 percent, while exports increased by 16.7 percent in 2020 (Figure 11). During the pandemic, Cambodia was still able to export garment products, including textiles and footwear. As a result, total exports increased from US$14.75 billion to US$17.22 billion and US$17.57 billion from 2019 to 2020 and 2021,[69] respectively. Furthermore, imports decreased due to lower incomes and curtailed economic activities, contracting from US$20.17 billion in 2019 to US$18.53 billion in 2020, but then increasing to US$28.70 billion in 2021, due to an increase in imports of vaccines and medical supplies.

18. **By 1 June 2020, 256 garment factories had suspended their operations, which caused 130,000 workers to become unemployed.** However, the government reserved US$3

64 UNDP Cambodia, COVID-19 Economic and Social Impact Assessment in Cambodia, Policy Brief 01, October 2020.
65 Ministry of Economy and Finance, Budget in brief 2022, Cambodia.
66 National Institute of Statistic, CPI table 2020, in www.nis.gov.kh
67 https://foreignbrief.com/daily-news/cambodia-to-ban-some-rice-exports-starting-today-to-ensure-local-food-security/
68 There are only few main border gates is open between Cambodia and neighboring countries (Vietnam and Thailand)
69 Ministry of Commerce, Trade statistics report 2020 and 2021, Cambodia.

billion to normalize the situation.[70] The unemployment rate increased dramatically in 2020 to 4.1 percent (accounting for 101,692 unemployed),[71] compared with only 1.3 percent in 2019.[72] According to a report by the Garment Manufacture Association in Cambodia, 130,000 garment workers lost their jobs out of a total of 800,000 workers. However, to respond to the pandemic, the government prepared between US$800 million and US$2 billion[73] to minimize the impact, including for economic recovery and support for garment workers who had lost their jobs due to the factory shutdowns as a result of increased uncertainty due to the pandemic.

19. **The contraction in the services sector disrupted economic activity.** According to a Tourism Statistics Report,[74] the number of tourist arrivals had increased annually by an average 7.8 percent from 2012 to 2019, with the number of Chinese tourist arrivals to Cambodia rising by 27.7 percent in 2019. By the end of 2020, the number of tourist arrivals had fallen by 80.2 percent, with Chinese tourist arrivals decreasing by 77.1percent. The number of international tourists visiting Cambodia decreased continuously from 6,610,592 tourists in 2019 to 1,306,143 tourists in 2020, and just 196,495 tourists in 2021 (Figure 10). The collapse in the numbers of international tourists caused the income of the tourism sector to decline from US$4,919 million in 2019 to US$1,023 million in 2020, and to a mere US$184 million by 2021.[75] Besides international tourists, visitors from China decreased by 86.1 percent to 45,775 visitors in 2021, while international business-related travel to Cambodia decreased by 66.5 percent to 91,138 visitors in 2021, where 49.3 percent of such travel originated from China.

20. **From the start of the second COVID-19 wave on 28 November 2020, the hotel industry was also adversely affected.** Hotel occupancy rates hit almost zero percent by 1 October 2020, but subsequently recovered after the easing of restrictions and the opening of cities in June 2021. Tourism revenue declined by 79.2 percent. For local tourism, the number of tourists fell by 36.1 percent, and 35.5 percent in 2020 and 2021, respectively (from 11,319,523 visitors in 2019 to 7,227,969 visitors in 2020, and 4,663,082 visitors in 2021).

21. **All flights from high-risk countries were banned from 18 March 2020.** Due to imported cases increasing on a daily basis, by 18 March 2020 all flights from high-risk countries such as Italy, Germany, France, Spain, and the United State, were banned. By August 2020, flights from the Philippines were also temporarily suspended. As a result, the number of visitors to Cambodia arriving by air decreased by 82.8 percent in 2020 and fell by 86.8 percent in 2021. In 2021, the airport in Siem Reap was almost closed due to the small

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70 Hun Sen, Speech to infrastructure construction officials in Preah Sihanouk province on 1 June 2020.
71 UNDP Cambodia, COVID-19 Economic and social impact assessment in Cambodia, Policy Brief 01, October 2020.
72 Ministry of Planning, National Census 2019, October 2020, Cambodia.
73 ASEAN Research Advocacy, COVID-19 Could cut growth by 0.1% to 0.4%: Cambodia, in https://www.cariasean.org/news/cari-captures-445-covid-19-could-cut-global-growth-by-0-1-to-0-4/#.YyLLGOxBw8E (retrieved on Aug 5, 2022)
74 Tourism Statistics Report 2020, issued by Ministry of Tourism, Cambodia.
75 Tourism Statistics Report 2021, issued by Ministry of Tourism, Cambodia.

number of flights (the number of visitors arriving through Siem Reap airport decreased by 99.5 percent in 2021).[76]

22. **Another impact on the Cambodian economy was the closure of all educational institutions from 16 March 2020 until 7 September 2020.** Then, on 8 November 2020, all public and private education institutions were closed again in Phnom Penh and Kandal Province. The temporary closure and reopening of educational institutions occurred numerous times in 2021 until 31 August 2021, when all educational institutions were fully reopened. During the closure of educational institutions, online learnings were introduced. Each family in Cambodia faced an increase in educational costs due to an increase in internet expenses, as well as learning guides for middle-income families and above. In low-income families, children were permitted to study by themselves without any supervision or guidance.

23. **Some transportation services switched to providing delivery services.** After remaining stagnant for two quarters in 2020, retail sales started to grow again due to development of delivery services. Transportation services such as Grab, Tada, and PassApp started to switch to delivery services for many items, in response to the curtailed provision of public transportation. In particular, food delivery services became most popular among the under 35-year-old generation, especially in Phnom Penh. Generally, all food delivery apps/websites require users to sign up and create a profile with some basic personal information. In addition, users also need to fill out their preferred payment methods and their delivery address. For mobile apps, these are accessible on both android and iOS devices. The delivery fee varies depending on the particular food delivery app or website.

24. **The small and medium enterprise (SME) sector was disrupted due to a decrease in local demand and the restrictions on factory work.** Due to the city lockdown, the decrease in aggregate demand caused a decrease in SME production, while factory work was not allowed due to the lockdown regulations. This affected the food, beverage, and cigarette sectors most, followed by the garment sector (Figure 12).[77]

25. **Disruptions to the government budget.** Slower revenue collection, along with increased fiscal support to offset economic and social impacts of the pandemic, is expected to widen the current account deficit to 6.1 percent of GDP in 2021, from 4.5 percent of GDP in 2020. The widening fiscal deficit required an increased drawdown of government deposits (fiscal reserves), which declined to 17.6 percent of GDP (KHR 19.7 billion) in September 2021 from 23.7 percent of GDP (KHR 24.9 billion) at the end of 2020. To mitigate the negative impacts on poor and vulnerable households, the authorities extended the COVID-19 cash transfer program until December 2021 under the program's seventh round, while introducing additional assistance. As of October 2021, 678,459 households, or 19 percent of all households in Cambodia, had received the cash transfer from the government. On average, each poor and vulnerable household (identified under the IDPoor initiative) covered by the program received about US$45 per month. In

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76 Tourism Statistics Report December 2021, issued by the Ministry of Tourism, Cambodia.
77 Small and medium garment sector.

addition, the government launched a one-off social assistance cash transfer to support non-IDPoor households affected by the COVID-19 pandemic. As of August 2021, about 121,397 eligible non-IDPoor households nationwide had received government support.

26. **Microfinance and debt defaults affected the standard of living.** The pandemic limited the capacity of low-income households to diversify their income sources. For example, it limited households' ability to make routine migrations to neighboring Thailand. The inability to make routine migrations, and the loss of employment in the tourism sector, created a labor surplus in the domestic labor market. The construction and agriculture sectors could absorb some of the excess labor supply but, at such high levels, these two sectors were unable to absorb all the job losses caused by the COVID-19 disruption. Cambodia Microfinance Association members restructured more than US$1.4 billion in loans for nearly 300,000 borrowers. The average household savings decreased by US$633 from January to June 2020, and increased by US$194 from June to October 2020.[78]

3. Policy measures in response to COVID-19

27. **Cambodia is now learning to live with the COVID-19 virus.** Since November 2021, the authorities have relaxed travel restrictions, reopening the country for business, while continuing to strictly enforce protective health measures.

28. **Reopening Phnom Penh has helped to reduce the output gap.** Real GDP is projected to grow by only a modest 2.2 percent this year due to a resurgence of COVID-19 cases, which slowed the recovery, especially in the tourism and the wholesale and retail sectors during Q2 and Q3 of 2021. Traditional growth drivers, especially the garment, travel goods, footwear, and bicycle manufacturing industries, as well as agriculture, continued to underpin the economic recovery. The electrical, electronic, and vehicle parts manufacturing industries also gradually started to recover, while the agro-processing industries, in particular food and wood processing, and furniture-making, also started to pick up. Despite a recovery of manufacturing exports and an expansion of agricultural commodity exports, Cambodia's trade deficit widened significantly. The economy is expected to continue to recover amid a rollback of COVID-19-related restrictions. Real GDP growth is projected to reach 4.5 percent in 2022.

29. **Financial conditions continued to be accommodative, supported by a relaxation of monetary policy.** As of October 2021, 678,459 households, or 19 percent of all households in Cambodia, had received a cash transfer from the government. Poverty remained higher than in the pre-pandemic period, given that the negative impacts of the pandemic on non-farm family businesses remained significant, caused mainly by weak consumer demand.

78 Nith Kosal and Summer-Solstice Tomas, the effect of COVID-19 on Household Saving and Debt in Cambodia, 2021.

30. **Financial institutions have implemented loan restructuring policies to support their clients whose incomes have been affected by the pandemic as shown in Figure 15.** However, our research identified several policy concerns over implementation. First, loan restructuring has not been available to all affected households. Second, there has been inadequate outreach to vulnerable and COVID-19-impacted households. Third, loan restructuring has been challenging to access in cases of proxy-borrowing, in which the people who take out a loan are different from those principally responsible for loan repayment. In some cases, borrowers were unable to access loan restructuring because their livelihood activities were not seen as being directly impacted by the pandemic, despite the fact that those helping them repay the loan were directly impacted. The boom in loan restructuring grew most rapidly from April to June 2020. During that period, about 240,000 debtors requested loan restructuring for a total amount of about US$1,200 million. However, data in Figure 15 shows that, from July onwards, the rate of loan restructuring was modest, indicating that most debtors were able to continue repaying their loans.

31. **Risks remain tilted to the downside.** The COVID-19 pandemic continues to be unpredictable. A slowdown in global demand could hurt export-oriented sectors of the economy, while the tourism sector may recover even more slowly than expected, as consumers may remain reluctant to travel far distances despite the easing of travel restrictions. In addition, high credit growth and a concentration of domestic credit in the construction and real estate sectors remain a key risk to Cambodia's financial stability.

32. **Given the impact of the pandemic, the government trimmed the 2021 state budget to around US$4 billion.** This was equivalent to a 50 percent decline, including an 11.3 percent decline for social affairs and 6.4 percent for general administration. This represents a reallocation of the budget in a revised budget plan for 2021, in which spending on COVID-19 interventions was US$1,291 million.

33. **A discretionary fiscal policy is important to boost the economy during the pandemic.** There are three pillars - Recovery, Reform, and Resilience - for living with the COVID-19 virus and boosting the economy. The government reduced the total expenditure by 5.4 percent in 2021 and capital expenditure by 1.9 percent. The economic package for capital expenditure was increased by 29 percent for the national level budget and 67.5 percent for public investment domestic financing in 2020 (Table 6), which financed 38 road construction projects in Siem Reap Province and 37 road construction projects in Preah Sihanouk Province.

34. **The government increased spending on some items to boost consumption.** To boost the consumption and spending of households, the government increased spending on several items such as skills investment, high-quality infrastructure investment, green investment, and digital infrastructure.

35. **There was enhanced budget expenditure on improving the quality of the health system, the development of a social support system, and the provision of professional and vocational training, and additional public services.** There were five stages for supporting and fighting the COVID-19 pandemic in Cambodia in 2020 and 2021, which

were categorized into two parts, namely health and social interventions, and economic interventions. For 2020, the spending on health and social interventions was US$494 million and this increased by 130.97 percent to US$1,141 million in 2021, while spending on economic interventions was US$330 million in 2020, which fell by 54.5 percent to US$250 million in 2021 (Table 7).[79]

36. **The spending on COVID-19 treatment rose dramatically in 2021 due to the third COVID-19 outbreak and the 20 February 2021 event, increasing from US$29 million in 2020 to US$747 million in 2021.** In response to the spending on COVID-19 interventions for the national level, the budget for social affairs contracted by 11.3 percent compared with 2020, or 6.1 percent of the GDP; general administration received 6.4 percent less, or 2 percent of the GDP; funds for the economic sector were reduced by 5.3 percent, or 6.4 percent of the GDP; and the budget for the national defense sector was trimmed by 4.3 percent, or 3.9 percent of the GDP. Expenditure implementation in 2021 was made manageable by minimizing unnecessary spending and shifting priorities to further combat the consequences of the pandemic. In 2021, the government executed spending on social benefits of US$929.89 million, equivalent to 16.3 percent of the 2021 budget, an increase of 50.2 percent, while spending on purchases and services decreased by 22 and 32.7 percent, respectively, compared with the same period in 2020. During the pandemic, the implementation of government financing was achieved as planned in the budget law, especially the disbursement of bilateral loans for budget support. In 2021, the total implementation of foreign financing at the central government level reached US$1,188.19 million, or 94 percent of the 2021 budget law, while total government deposits amounted to US$21.65 million. The total government budget deficit was US$1,730.85 million, equal to 6.1 percent of GDP in 2021.[80]

37. **In the early phase of the pandemic in 2020, the government supported workers who had been laid off from their jobs by moving them to a skills training program.** Government support for the program fell from US$58 million in 2020 to US$22 million in 2021, a reduction of 62.1 percent. For poor families, such as those with household heads who are motor-taxi drivers, informal traders, etc., or workers in the informal sector, the government provided support to protect their standard of living by financing US$306 million in 2020, which declined by 7.8 percent in 2021 to US$282 million (Table 7).

38. **Cash-for-work was another fiscal financing program used to support Cambodians living in rural areas.** This program was used for rural development and livelihood enhancement via: Component 1 - rural road construction under the cash-for-work program and civil works; Component 2 - quaternary canals construction under the cash-for-work program; Component 3 - providing low-cost electricity for supporting irrigation system; and Component 4 - project coordination and monitoring. Total spending on the cash-for-work program fell by 10 percent from US$100 million in 2020 to US$90 million in 2021 (Table 7).

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79 Ministry of Economy and Finance, Presentation on Government Budget 2022, at Hotel Sofitel Phoketra, Phnom Penh on 18 February 2022.

80 Ministry of Economy and Finance, State Budget Implementation Report, December 2021.

4. Assessment of policy responses and future challenges

39. **The Cambodian government's fiscal response to the prolonged COVID-19 pandemic can be evaluated by analyzing three affected sectors, namely tourism, manufacturing exports, and construction.** Together these sectors contributed more than 70 percent to the country's economy. By 2020, real growth had decreased by 3.1 percent, while it rebounded by 3 percent in 2022 due to the government's implementation policies to mitigate the negative impacts on businesses and people's incomes. A proportion of households that have been negatively affected by the COVID-19 pandemic continues to suffer from income loss, which could lead to an increase in poverty.[81]

40. **The vaccination rollout has been very successful in Cambodia.** Regarding fiscal policy of the US$1,141 million of government spending on health and social interventions, 89.1 percent of the total population are vaccinated, of which 14,262,170 people had received the first dose, while 13,659,518 people and 3,588,183 people had received the second and third doses, respectively, by the end of 2021. Data on vaccinations by age shows that adults over 18 years old received 101.5 percent vaccinations, teenagers (between 12 and 18 years old) received 99.1 percent, children between 6 and 12 years old received 105.2 percent, and children at 5 years old received 99.8 percent vaccinations. Moreover, by 15 May 2022, the number of vaccinated people stood at 93.8 percent of the total population, of which 15,000,782 were for the first dose, 14,258,682 people, 8,979,639 people, and 2,185,016 people were for second, third and fourth doses, respectively, while the number of new infections was zero since May 15, 2022.

41. **Economic activity increased with the reopening of the country in November 2021.** After fully opening the country on 1 November 2021, economic activity increased, including local tourism, retail sales, transportation, restaurants and services, and agriculture, as well as manufacturing. However, despite policy interventions, the tourism sector had still collapsed in 2021, especially in terms of international arrivals. For domestic tourism, the contraction was by 33 percent, while international arrivals decreased by 85 percent. Meanwhile, the trade sector (except for gold) and real estate sector registered decreases of 3.1 and 15.4 percent, respectively.

42. **In addition, industrial output grew by 7.4 percent in 2021.** Exports of garments, footwear, and travel goods recovered exceptionally well in 2021, particularly in H2 of 2021. Non-garment manufactured products continued their robust expansion, with exports rising by 30.7 percent. Agriculture exports rose by 19 percent in 2021 on solid growth in cassava, banana, and rubber exports. Restrictions in pig imports to prevent outbreaks of African swine fever also helped to support domestic prices in the local pig industry. The fisheries sector performed worse than expected due to low water levels. Agricultural output expanded by 1.1 percent. The services sector still contracted by 0.4 percent on a continued steep decline in demand for food, accommodation, transportation, and other in-person services, which was partially offset by stronger growth in communication services and a gradual recovery in the wholesale and retail

81 Nearly half of all households suffered declines in income between December 2020 and March 2021.

trade and real estate.

43. **The fiscal and monetary response has been more effective in H1 of 2022.**[82] GDP growth is expected to be 5.3 percent by the end of 2022,[83] while goods and services exports are forecast to grow by 17.8 percent in 2022 on strong external demand for Cambodian products supported by a recovery in tourism, albeit a slow one. Imports are expected to fall by 7.7 percent in 2022 on high base effects. The services sector is projected to rebound to 4.8 percent in 2022. Reopening the economy and the high level of vaccination coverage will allow for a gradual recovery in tourism which, in turn, will support demand for accommodation, food, transportation, and other in-person services. Industrial output is expected to grow by 8.1 percent in 2022. This growth will also be boosted by the implementation of the Garments, Footwear, and Travel Goods Development Strategy aimed at raising competitiveness in this segment.

44. **Fiscal policy will remain expansionary in 2022 and 2023, and will see a gradual reduction in pandemic-related interventions.** Socioeconomic interventions, however, remain a priority to support the implementation of the Strategic Framework and Programs for Economic Recovery in the Context of Living with COVID-19 in the New Normal, 2021-2023, launched in December 2021. The fiscal budget for general government operations has a planned deficit of 5.6 percent of GDP in 2022. Revenue is budgeted at 20.4 percent of GDP and expenditure at 25.9 percent. A gradual drawdown in government deposits from 24.2 percent of GDP in 2020 is expected to meet the financing gap in the medium term. Despite its high fiscal deficit, Cambodia remains at relatively low risk of debt distress, as total public external debt is projected to rise to a still manageable level of 36.2 percent of GDP in 2022 and 37.1 percent in 2023. The government plans to issue bonds in 2022 to help diversify its financing sources.

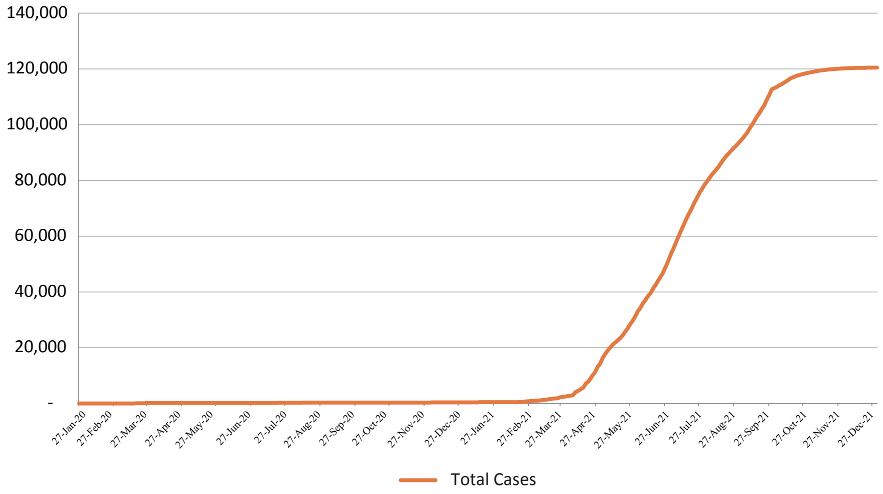
45. **The tourism sector remained mired through to Q2 of 2022.** While the tourism sector contributed about 17 percent to total GDP in 2019, it remained stuck until Q2 of 2022. However, according to the 2020-2022 Budget Law, government spending of the tourism sector decreased from US$25.33 million to US$18.35 million in the period. Given the government's strategy to develop infrastructure to better support local tourism, government spending on public works, transportation, and logistics (repairing and building of roads and bridges) increased by 60 percent in 2022, reaching US$161.19 million. The government should consider making use of international marketing and service development for the tourism sector in the post-COVID-19 era.

46. **Future challenges to the country's fiscal policy are the uncertainties regarding new COVID-19 variants and a global economic downturn as a result of the Russia-Ukraine crisis.**

82 Lagging effect of fiscal policy in Keynesian model.
83 Reported by Asian Development Bank on 6 April 2022.

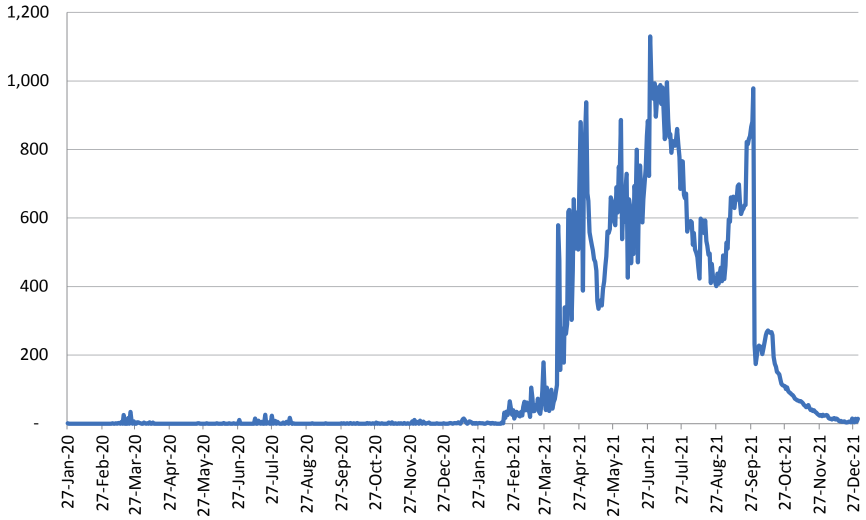
Appendix 1. Selected Figures

Figure 1 COVID-19 development in Cambodia



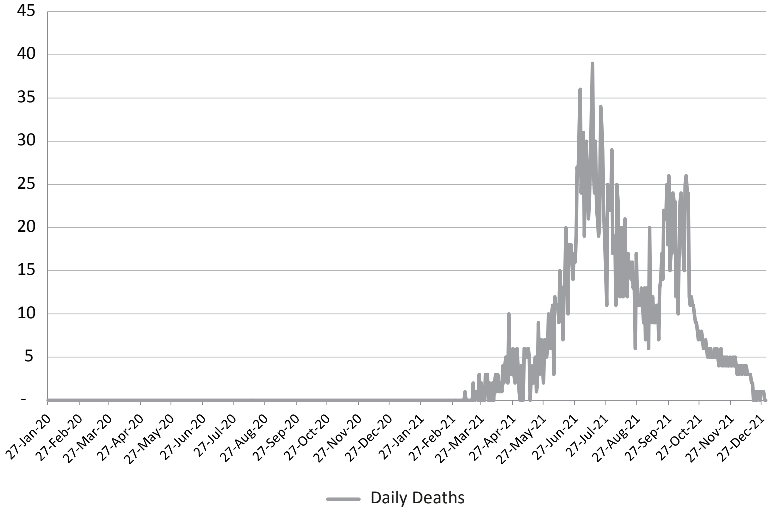
Source: COVID-19 Daily notification; Ministry of Health, Cambodia.

Figure 2 COVID-19 daily cases in Cambodia



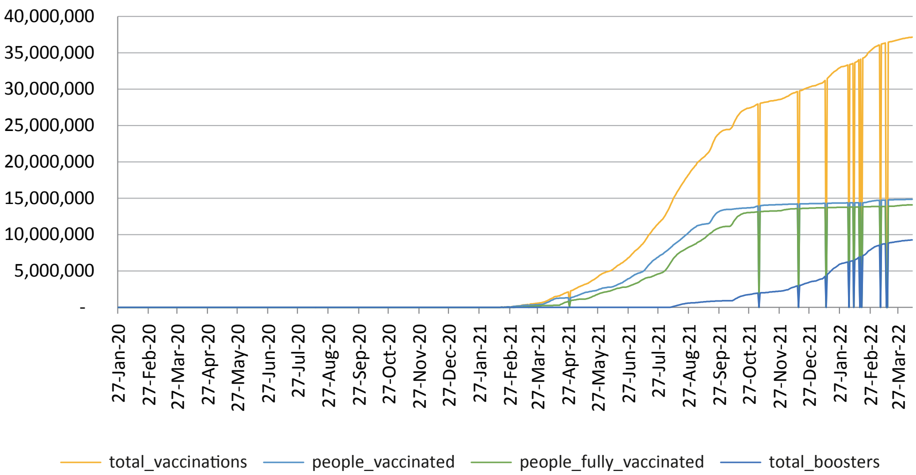
Source: COVID-19 Daily notification; Ministry of Health, Cambodia.

Figure 3 COVID-19 daily deaths in Cambodia



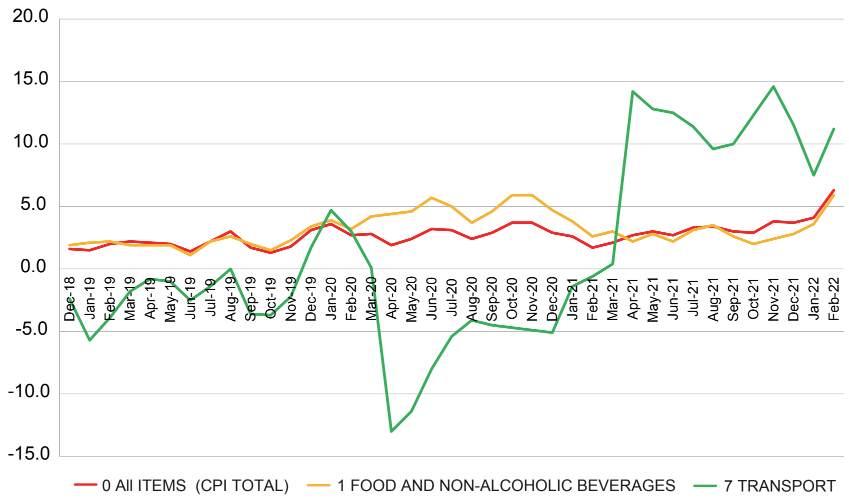
Source: COVID-19 Daily notification; Ministry of Health, Cambodia.

Figure 4 COVID-19 vaccination in Cambodia



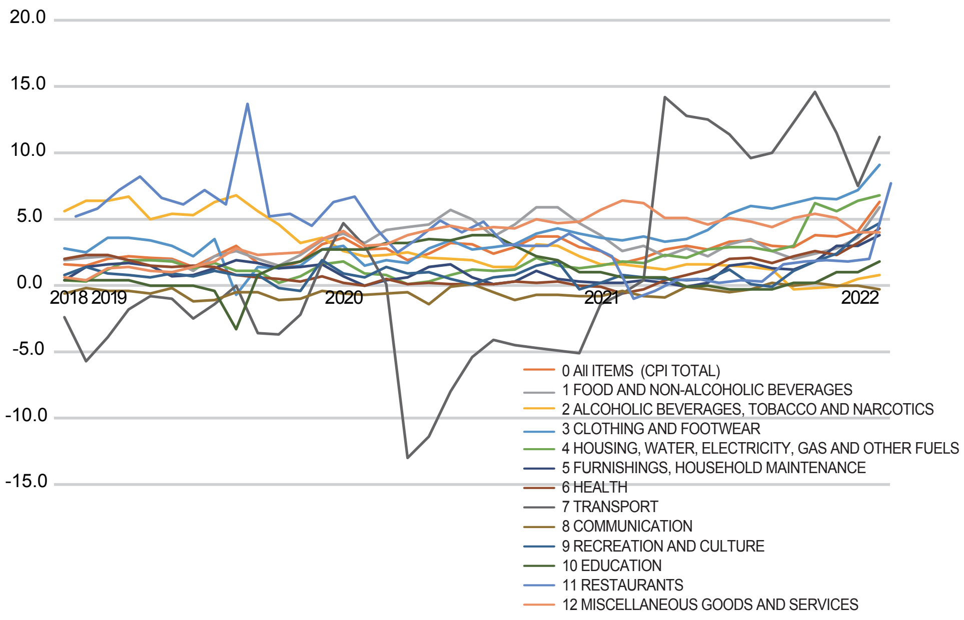
Source: COVID-19 Daily notification; Ministry of Health, Cambodia.

Figure 5 Core inflation for Cambodia



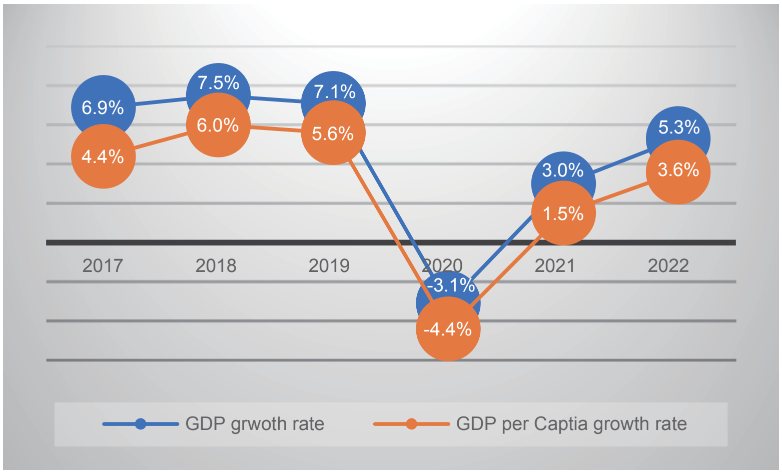
Source: Ministry of Planning, CPI Data, Cambodia.

Figure 6 Inflation by items



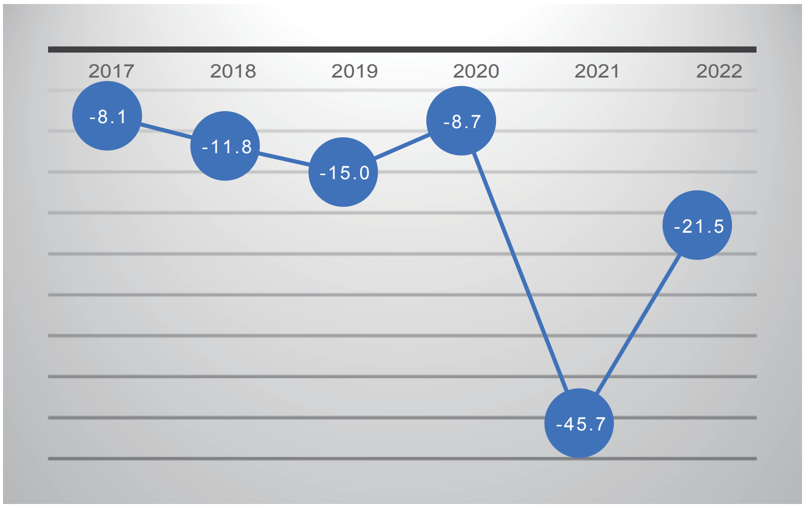
Source: Ministry of Planning, CPI Data, Cambodia.

Figure 7 GDP growth rate in Cambodia



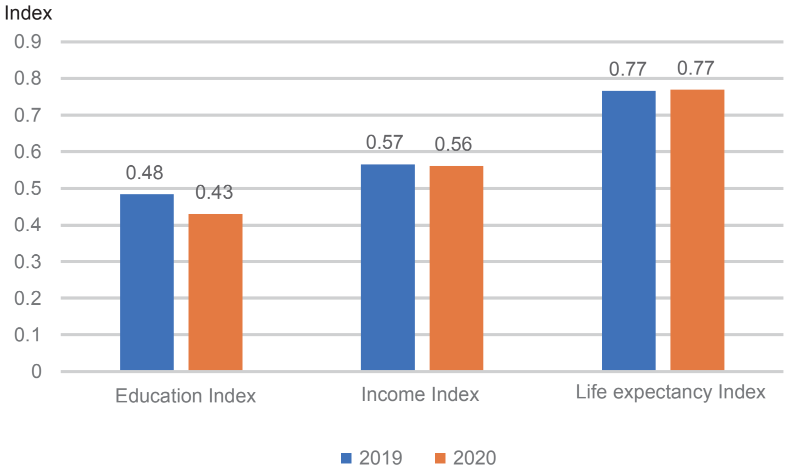
Source: Asian Development Bank. ADO 2022.

Figure 8 Current Account (% of GDP)



Source: Asian Development Bank. ADO 2022.

Figure 9 Human development indexes in Cambodia

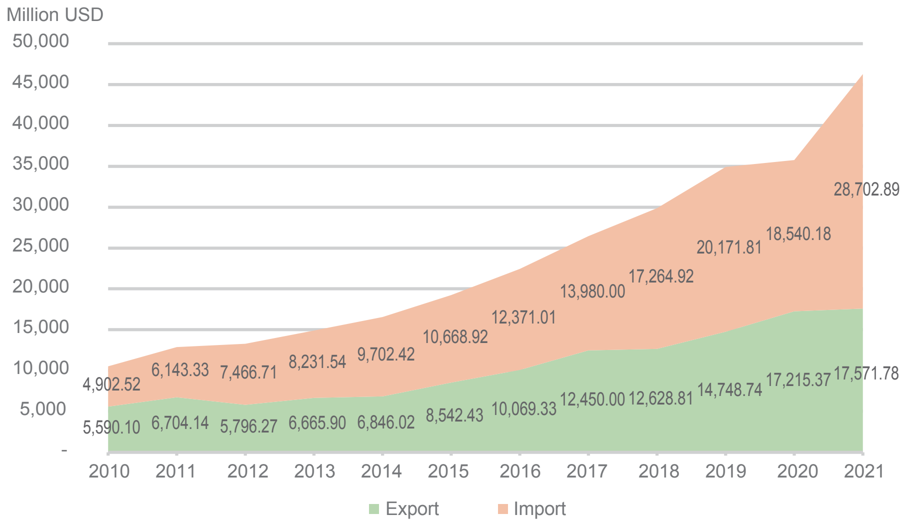


Source: United Nations Development Programme, HDI indexes.

Figure 10 International tourists and tourism revenue

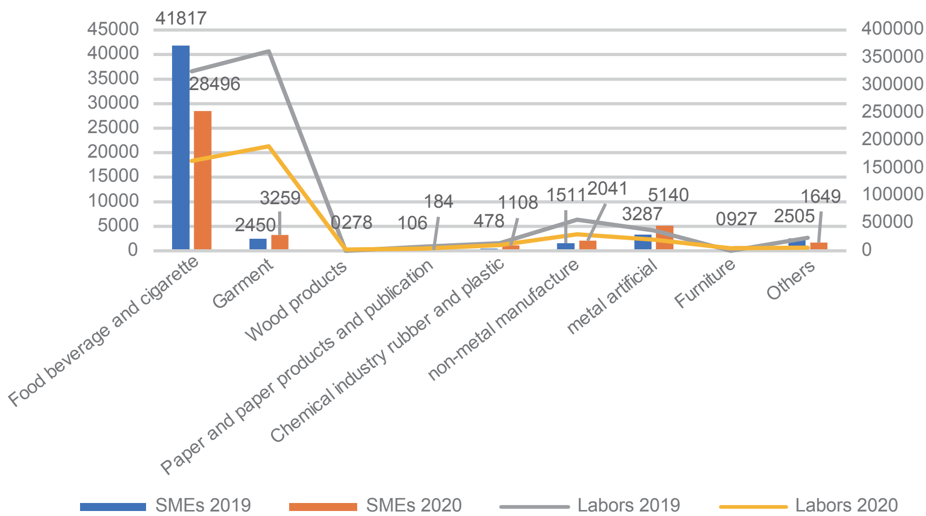
Source: Ministry of Tourism, Cambodia.

Figure 11 Cambodia trade



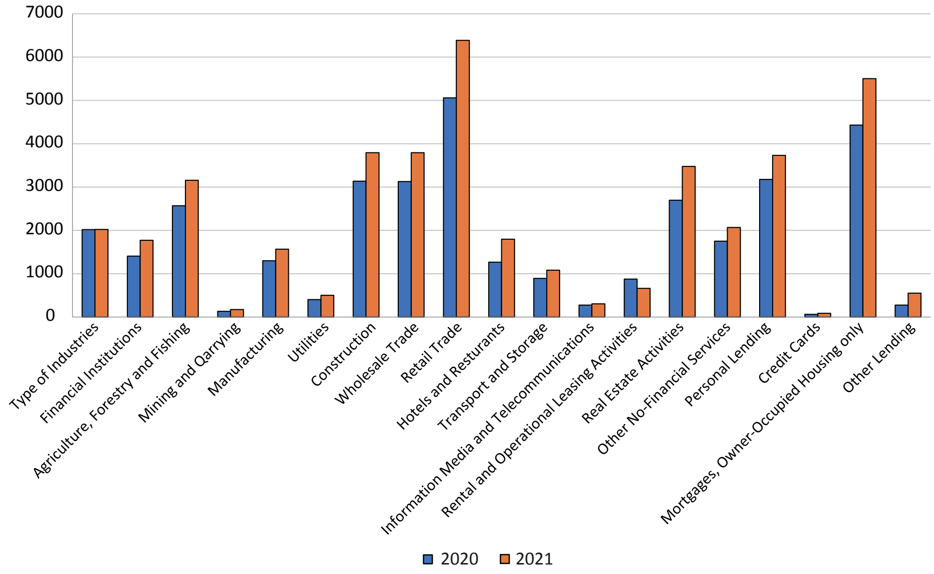
Source: Ministry of Commerce, Cambodia.

Figure 12 Cambodia SMEs and Labors



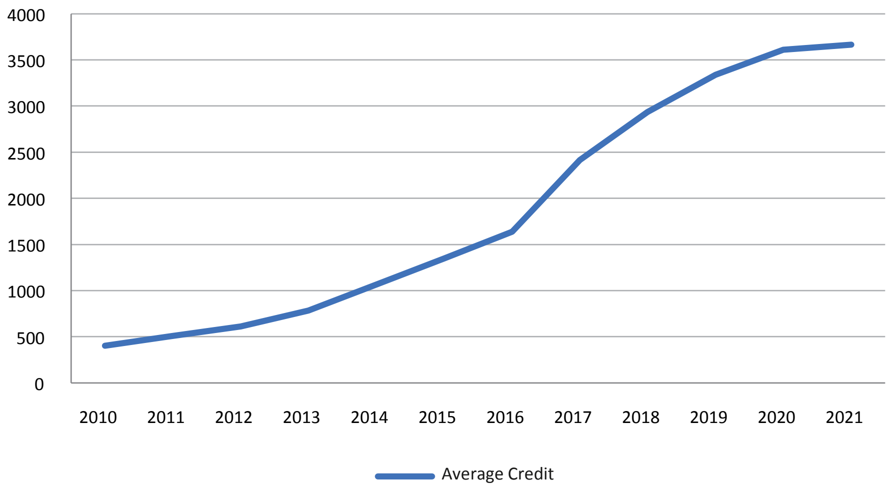
Source: Ministry of Labor and Vocational Training, Annual Report 2020, Cambodia.

Figure 13 Credit by industries in Cambodia



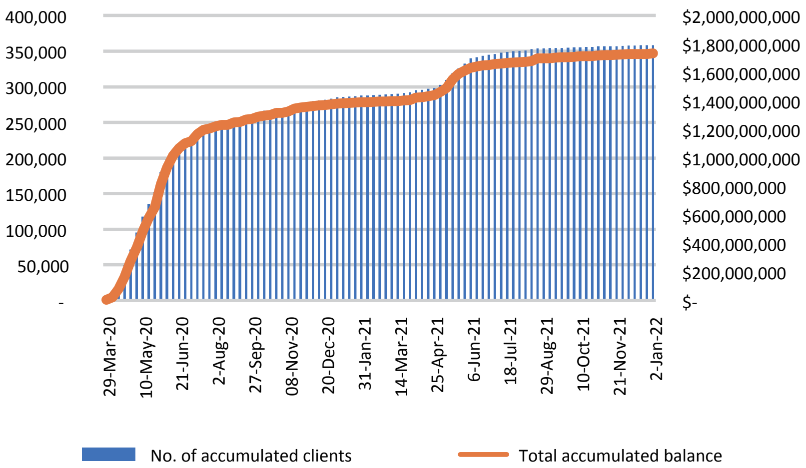
Source: National Bank of Cambodia.

Figure 14 Average household microfinance loan size



Source: Cambodia Microfinance Association.

Figure 15 Loan restructuring in Cambodia



Source: National Bank of Cambodia.

Appendix 2. Selected Tables

Table 1 Percentage of vaccination by group age

Age	Percentage	Target population
18 and over	102.7	10,000,000
12 to under 18	100.2	1,827,348
6 to under 12	107.8	1,897,382
5 years old	125.4	305,317
3 to under 5	52.1	610,730

Source: Or Vandine, Telegram Channel on COVID-19 in Cambodia.

Table 2 Exports of the garment sectors (US$ million)

Items	2019	2020	2021
Textile	285.35	381.81	476.45
Garment	8,266.35	7,420.28	8,017.86
Footwear	1,264.62	1,116.73	1,392.22
Travel goods and bags	1,078.89	964.7	1,494.76
Total	1,0895.21	9,883.52	11,381.29
Growth rate		-9.29%	15.15%

Source: Ministry of Commerce, Trade statistic report (2019-2021).

Table 3 Consumer Price Index, Percent rate of change over 12 months, Phnom Penh

COICOP main categories and important product groups		Weight	Dec-19	Dec-20	Dec-21
0	ALL ITEMS (CPI total)	100	3.1	2.9	3.7
01	FOOD AND NON-ALCOHOLIC BEVERAGES	44.775	3.4	4.7	2.8
01.1.1.1	RICE	6.162	3.8	2.1	0.7
01.1.2	MEAT	9.681	0.4	8.5	2.6
01.1.2.1	PORK (FRESH)	5.618	-1.4	13.3	2.9
01.1.3	FISH AND SEAFOOD	9.31	6.9	7.2	3.2
01.1.6	FRUITS	4.736	4.3	3.5	3.6
01.1.7	VEGETABLES	4.814	3.2	2.8	5.5
02	ALCOHOLIC BEVERAGES, TOBACCO AND NARCOTICS	1.625	3.6	2.2	-0.1
03	CLOTHING AND FOOTWEAR	3.036	2.7	3.9	6.5
04	HOUSING, WATER, ELECTRICITY, GAS AND OTHER FUELS	17.084	1.6	1.3	5.6
04.3	MAINTENANCE AND REPAIR OF THE DWELLING	4.098	1.7	2.6	3.4
04.5	ELECTRICITY, GAS AND OTHER FUELS	9.625	1.9	1	8.3
05	FURNISHINGS, HOUSEHOLD EQUIPMENT AND ROUTINE HOUSEHOLD MAINTENANCE	2.743	1.6	0.3	3
06	HEALTH	5.141	0.7	0	2.3
07	TRANSPORT	12.228	1.7	-5.1	11.5
07.1	PURCHASE OF VEHICLES	5.892	0.9	0.1	1.1
07.2	OPERATION OF PERSONAL TRANSPORT EQUIPMENT	5.524	3.2	-13.2	30.2
07.2.2.2	GASOLINE	4.969	3.2	-16.7	37.5
08	COMMUNICATION	1.136	-0.4	-0.8	0
09	RECREATION AND CULTURE	2.912	1.9	-0.3	2.4
10	EDUCATION	1.174	2.7	1	1
11	RESTAURANTS AND HOTELS	5.861	6.3	3	1.8
12	MISCELLANEOUS GOODS AND SERVICES	2.285	3.5	4.8	5.1

Source: National Institute of Statistics, CPI Table in www.nis.gov.kh
Note: COICOP = Classification of Individual Consumption According to Purpose.

Table 4 GDP and GDP per capita 2015–2022p

At current prices	2015/r	2016/r	2017/r	2018/r	2019/p	2020/p	2021/p	2022/p
GDP in billion Riels	73,423	81,242	89,831	99,544	110,014	105,892	110,506	121,030
Growth Rate in Percent (%)	8.9%	10.6%	10.6%	10.8%	10.5%	-3.7%	4.4%	9.5%
Per Capita GDP in '000 Riels	4,903	5,360	5,786	6,323	6,894	6,548	6,747	7,219
Growth Rate in Percent (%)	7.6%	9.3%	7.9%	9.3%	9.0%	-5.0%	3.0%	7.0%
GDP in US$ million	18,242	20,159	22,191	24,488	27,030	25,967	26,986	29,412
Growth Rate in Percent (%)	9.0%	10.5%	10.1%	10.3%	10.4%	-3.9%	3.9%	9.0%
Per Capita GDP in US$	1,218	1,330	1,429	1,555	1,694	1,606	1,648	1,754
Growth Rate in Percent (%)	7.7%	9.2%	7.5%	8.8%	8.9%	-5.2%	2.6%	6.5%
Household Final Consumption Expenditure (HFCE)	59,281	64,597	70,390	76,702	83,580	91,075	99,242	108,869
Per Capita HFCE in '000 Riels	3,958	4,262	4,533	4,872	5,237	5,632	6,059	6,494
Monthly Per Capita HFCE in Riels	329,865	355,128	377,789	405,984	436,454	469,350	504,925	533,453
At constant 200 prices	**2015/r**	**2016/r**	**2017/r**	**2018/r**	**2019/p**	**2020/p**	**2021/p**	**2022/p**
GDP in billion Riels	73,423	81,242	89,831	99,544	110,014	105,892	110,506	59,428
Growth Rate in Percent (%)	8.9%	10.6%	10.6%	10.8%	10.5%	-3.7%	4.4%	5.2%
Per Capita GDP in '000 Riels	4,903	5,360	5,786	6,323	6,894	6,548	6,747	3,545
Growth Rate in Percent (%)	7.6%	9.3%	7.9%	9.3%	9.0%	-5.0%	3.0%	2.8%
GDP in US$ million	18,242	20,159	22,191	24,488	27,030	25,967	26,986	14,442
Growth Rate in Percent (%)	9.0%	10.5%	10.1%	10.3%	10.4%	-3.9%	3.9%	4.7%
Per Capita GDP in US$	1,218	1,330	1,429	1,555	1,694	1,606	1,648	861
Growth Rate in Percent (%)	7.7%	9.2%	7.5%	8.8%	8.9%	-5.2%	2.6%	2.3%
Household Final Consumption Expenditure (HFCE)	59,281	64,597	70,390	76,702	83,580	91,075	99,242	55,551
Per Capita HFCE in '000 Riels	3,958	4,262	4,533	4,872	5,237	5,632	6,059	3,313
Monthly Per Capita HFCE in Riels	329,865	355,128	377,789	405,984	436,454	469,350	504,925	279,957

Source: National Institute of Statistics, Data set.
Note: r=revised estimates; p=preliminary estimates.

Table 5 GDP by production and GDP by expenditures

GDP by Economic Activity	2016	2017/p	2018/p	2019/p	2020/p	2021/p
Agriculture, Fisheries & Forestry	1.7%	2.6%	3.3%	4.5%	4.8%	3.9%
Crops	0.1%	1.5%	2.3%	2.6%	4.9%	1.9%
Livestock & Poultry	2.4%	2.3%	3.3%	6.7%	5.1%	3.5%
Fisheries	4.9%	5.1%	5.2%	6.8%	5.0%	7.4%
Forestry & Logging	3.1%	5.3%	5.4%	8.9%	3.8%	9.4%
Industry	6.5%	5.5%	3.9%	5.3%	-1.4%	2.4%
Mining	5.9%	3.0%	4.0%	4.2%	3.2%	7.3%
Manufacturing	3.2%	5.1%	2.6%	3.1%	-1.5%	3.3%
Food, Beverages & Tobacco	2.6%	5.1%	6.2%	3.9%	1.9%	2.8%
Textile, Ready to Wear Apparel & Footwear	3.1%	5.5%	1.9%	3.3%	-6.1%	3.6%
Wood, Paper & Publishing	2.1%	3.5%	3.4%	3.4%	1.2%	4.3%
Rubber Manufacturing	5.7%	4.1%	4.6%	4.2%	-5.0%	3.9%
Other Manufacturing	3.6%	2.0%	4.1%	1.2%	3.8%	1.9%
Non-Metallic Manufacturing	3.4%	3.7%	4.1%	0.4%	1.6%	4.3%
Basic Metal and Metal Products	2.8%	2.6%	5.0%	1.8%	3.9%	6.4%
Other manufacturing	3.7%	1.0%	3.9%	1.3%	4.2%	-0.4%
Electricity, Gas & Water	2.7%	3.3%	3.4%	2.0%	-1.0%	-0.5%
Construction	6.8%	2.4%	2.8%	3.4%	-3.0%	3.4%
Services	3.8%	2.9%	3.2%	2.4%	-3.2%	-0.6%
Trade	4.2%	4.0%	4.3%	0.5%	-2.7%	-3.1%
Hotel & Restaurants	4.3%	1.6%	2.0%	5.5%	-9.8%	-5.1%
Transport & Communications	4.8%	0.8%	0.8%	0.5%	-2.3%	12.5%
Finance	3.7%	4.0%	4.1%	2.2%	5.8%	3.3%
Public Administration	2.0%	1.9%	1.7%	1.4%	2.9%	0.3%
Real Estate & Business	5.5%	5.7%	5.9%	3.5%	-5.2%	-15.4%
Other services	0.5%	1.8%	2.3%	3.5%	-4.0%	-2.0%

GDP by Economic Activity	2016	2017/p	2018/p	2019/p	2020/p	2021/p
Taxes on Products less Subsidies	2.8%	3.7%	3.8%	0.8%	-2.2%	0.0%
Less: Subsidies	0.9%	3.5%	3.1%	0.4%	-2.0%	-5.0%
Less: FISIM	4.1%	2.0%	1.8%	1.3%	-3.2%	2.9%
GROSS DOMESTIC PRODUCT (GDP)	3.5%	3.3%	3.1%	3.2%	-0.7%	1.3%
GDP by Economic Expenditure	**2016**	**2017/p**	**2018/p**	**2019/p**	**2020/p**	**2021/p**
Final Consumption Expenditure	2.6%	2%	0%	2%	0%	-2%
Household Final Consumption Expenditure	2.8%	2%	0%	2%	0%	1%
Private Non-Profit Organizations Serving Households	-0.3%	2%	-2%	1%	10%	20%
Government Consumption Expenditure	1.1%	2%	-1%	1%	-5%	-17%
Gross Fixed Capital Formation	1.7%	5%	-1%	0%	2%	5%
Livestock	-5.4%	2%	-7%	5%	5%	5%
Durable Equipment	0.8%	4%	1%	4%	8%	10%
Construction	1.9%	5%	-3%	-2%	0%	3%
Change in Inventories	3.1%	3%	-6%	8%	-6%	-2%
Livestock & Poultry	2.8%	3%	-7%	8%	1%	8%
Industry	3.0%	3%	-6%	8%	-9%	-7%
Exports of Goods and Services	1.1%	4%	-1%	-3%	8%	-3%
Merchandise, f.o.b.	1.9%	5%	-3%	-4%	4%	-1%
Services	-0.9%	2%	4%	1%	40%	28%
Less: Imports of Goods and Services	1.1%	4%	-6%	-2%	6%	-8%
Merchandise, f.o.b.	1.0%	4%	-7%	-2%	5%	-8%
Services	2.9%	4%	0%	2%	17%	12%
Balance on External Goods and Services						
Statistical Discrepancy						
Gross Domestic Expenditures	3.5%	3.4%	3.1%	3.2%	-0.7%	1.3%

Source: National Institute of Statistics.
Note: r = revised estimates; p = preliminary estimates.

Table 6 Capital expenditure (US$ million)

Capital Expenditure	Total amount		Growth rate		% of GDP	
	2020	2021	2020	2021	2020	2021
National level budget	2,984.14	3,201.89	29%	7.3%	11.2%	11.3%
Public investment domestic financing	1,445.12	1,569.38	67.5%	8.6%	5.4%	5.6%
Public investment foreign financing	1,273.38	1,341.59	3.2%	5.4%	4.8%	4.74%

Source: Ministry of Economy and Finance, presentation on Government Budget 2022 at Hotel Sofitel Phoketra in Phnom Penh on 18 February 2022.

Table 7 COVID-19 intervention expenditure (US$ million)

Description	2020	2021	2022p
A. Health and social intervention expenses	**494**	**1,141**	**739**
1- COVID-19 prevention and treatment	29	747	300
Ministry of Health	29	747	300
2- Skill training program and work suspense support	58	22	59
Ministry of Labor and Vocational Training	53	22	59
3- Intervention program for keep living standard for the poor	306	282	280
Ministry of Social Affairs Veterans and Youth Rehabilitation	300	275	280
Ministry of Commerce (Green Trade)		7	
4- Cash-for-work program	100	90	100
B. Economic intervention expenses (SMEs)	**330**	**150**	**250**
5- Economic rehabilitation and promoting growth	30	150	250
Total Amount	**824**	**1,291**	**989**

Source: Ministry of Economy and Finance, presentation on Government Budget 2022 at Hotel Sofitel Phoketra in Phnom Penh on 18 February 2022.
Note: p = preliminary estimates.

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2022 KIPF-AMRO Joint Research

The Impact of COVID-19 on Regional Economies and Policy Responses

Chapter

5

China

Chapter 5

China[84]

China was the first country to take the brunt of the COVID-19 pandemic, but it was also the first to start to recover from recession. Its zero-COVID strategy has enabled China to keep its economy and production running at the cost of restricting domestic and cross-border mobility. It has focused on reducing taxes, spending more to support households and investment, and mobilizing state resources to help mitigate the negative impacts. The policies are complimentary with laxer monetary policies, and relaxed cross-border capital flows for external debt. While the outcome is satisfactory, there are still major challenges. In the future, China should give more flexibility to its special bond quota, focus more on new infrastructure investment, actively seek a new income model for local governments to offset weaker land sales, reform the pension system to reduce implicit pension debt, and create a competitively neutral environment for firms to be able to prepare for a rainy day.

1. COVID-19 development

1. **Ever since China identified its first COVID-19 case in Wuhan on 31 December 2019, the government has imposed a series of measures known as the "zero-COVID approach" to stamp out the disease and prevent transmissions.** While some measures may vary between provinces and are hard to quantify, the measurement of mobility is the best indicator for analyzing and summarizing the evolution of anti-pandemic policies. Based on the number of new confirmed cases and mobility, COVID-19 development can be divided into three stages, broadly in line with China's National Health Commission.

2. **The first stage lasted for about three months from mid-January to March 2020.** An average of 800 new cases daily in the first wave, with mobility falling by 26 percent in Q1 of 2020 and 66 percent at the trough in February 2020 (Figures 1 and 2). The official classification of a confirmed case does not include patients without symptoms. China took every possible measure to contain the outbreak in Hubei and later extended it to other provinces. As a result, local and intra-city transportation was shut down, with

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mobility declining 88 percent in Hubei. Soft constraints were put in place at checkpoints between cities to advise residents not to travel. In the end, the lockdown period in Wuhan ended after 76 days.

3. **The second stage spanned from April 2020 to July 2021, a period of relaxing mobility restrictions but strengthening measures against imported cases.** The number of daily new cases was tamed at around 20, while a health coding system and vaccinations were rolled out nationwide.

4. **Nonetheless, measures could be tightened with a targeted approach on identifiable new cases or clusters.** In mid-2021, imported cases from overseas flights led to outbreaks of the Delta variant in Guangzhou and Nanjing, in which the latter's cluster spread to at least 29 cities in 13 provinces, halting intra-city mass transport systems. Residents wishing to leave these cities needed to present negative COVID-19 test results with additional requirements on reporting to local governments upon arrival and a 7- to 14-day quarantine period. The outbreaks were brought under control mostly within 28 to 42 days. In the worst month, Guangzhou and Nanjing only faced a 1 and 14 percent fall in mobility, respectively. Mobility restrictions were minor among low-risk regions for anyone with a green health code and a negative COVID-19 test result.

5. **The third stage started with the new dynamic zero-COVID policy in August 2021, adhering to the strategy of preventing imported cases and internal transmission from rebounding.** However, the real challenge only arrived in 2022. Under the wave created by the Omicron variant, confirmed cases surged to 5,000 daily. The two places with the most confirmed cases, Shanghai and Jilin, went into lockdown, with residents prevented from leaving home and required to submit to universal testing. The measures were costly, with mobility falling 92 and 72 percent, respectively, in the two cities in early April 2022.

6. **From a pandemic policy perspective, China has taken a proactive approach to universal testing, lockdowns and quarantine.** Any confirmed case can trigger lockdowns in the neighborhood where the infected patient lives and the surrounding areas that the patient may have visited before. However, there is no clear standard for closing city boundaries. The rapid escalation of quarantines is probably the cornerstone for cutting off virus transmissions since the start of the pandemic. While quarantine policies may vary between cities, residents must isolate themselves for 7 to 14 days, together with multiple rounds of COVID-19 tests in order to travel from medium- to high-risk areas.

7. **In addition, a health code is used to control the mobility of residents and incorporate COVID-19 test results into public health governance.** A red code means home quarantine, and a yellow code indicates restrictions on mass transport and access to public places. As a proxy, residents could use a negative COVID-19 test result within seven days to travel across provinces during the Chinese Lunar New Year in 2021. However, only a negative COVID-19 test result within 24 hours could satisfy the requirement for the same period in 2022. This indicates that China has buttressed its ability to monitor and restrict cross-province travel through the health coding system.

8. **As for external border control, the quarantine policy has remained stringent.** A 14-day centralized quarantine at a government-designated place, followed by home monitoring ranging from 7 to 14 days depending on the local governments, remains in place. The results are clear. In 2021, passenger flights between China and the rest of the world plunged to a mere 2 percent of the pre-pandemic level, meaning that there were only 2.07 million travelers in 2021.

9. **China has also actively promoted vaccinations.** All vaccines in China are locally made and were rolled out for key groups in December 2020, followed by universal vaccinations from May 2021. As of March 2022, 1.24 billion people had received two doses of vaccines, covering 88 percent of the population (Figure 3).

2. The economic impact of the pandemic

10. **The sudden shock from the COVID-19 pandemic has negatively impacted China, but three key mechanisms of the country's economy have caused a formidable global spillover.** First, due to its enormous size, its different economic structure means that any impact is felt profoundly across the globe. Hence, the statement "when China sneezes, the world catches a cold" is more accurate now than ever. The China COVID-19 success story at the initial stage may be unique, but it is worth studying the reasons for this success and the longer-term implications.

11. **To begin with, China is an Asian and global powerhouse with a sizeable economy. Its large domestic market lowers the costs of lockdowns compared with the rest of the world, at least at the initial stage of the COVID-19 pandemic.** Before the pandemic, China had already made significant progress in growth as it expanded from accounting for a mere 3.6 percent in global GDP in 2000 to a massive 17.4 percent in 2020. China also contributed 14.8 percent of exports and 11.7 percent of imports to global trade in goods in 2020. This rapid economic development makes China an important player in international trade and provides a buffer from its growing domestic demand, mitigating the vulnerability when facing external shocks and the costs of lockdowns. For many inland provinces, the costs of having prolonged external mobility restrictions are lower than in other markets with stronger international connections and a greater reliance on tourism. Domestic sales could offset falling foreign demand amid the zero-COVID approach, even for the externally-facing coastal provinces.

12. **Its higher reliance on manufacturing has helped China offset the drag on services regarding the economic structure.** China still plays a critical role in global supply chains despite the turbulence from strategic competition with the United States. Although China is increasingly a services-oriented economy, manufacturing still accounted for 25 percent of its GDP in 2020, one of the highest levels in Asia. Even though mobility restrictions are painful, there are innovative ways for a closed-loop system to keep the workforce isolated and production flowing as normally as possible. China's role in industrial production has helped counteract the drag from the services sector, an even

bigger victim of mobility restrictions.

13. **Another significant difference between China and the rest of the world is the political reality that makes implementing lockdowns easier than in most other countries.** Starting from the top echelon of the central government down to local authorities, administrators were quick to introduce and execute effective COVID-19 policies. However, the critical success factor lies in community management. For historical reasons, China has developed a grid management mechanism in residential areas, meaning that lockdowns and resource allocation are rendered relatively straightforward. Street Offices are part of the government administrative agencies, and these had hired grid masters and workers to collaborate with resident committees even before the start of the COVID-19 pandemic. This meant that it was easier for China to introduce lockdowns, given the existing mechanism in place.

14. **With the quickest and strictest lockdown measures globally, China halted economic activities and restricted mobility as a trade-off to protect public health.** As a result, economic growth during the COVID-19 outbreak and its aftermath strongly reflected government policies, making it worthwhile to analyze the demand and supply shocks during the three-stage COVID-19 development section.

15. **Due to the initial COVID-19 outbreak, China experienced its biggest economic shock in decades in Q1 of 2020.** The Chinese economy contracted by 6.8 percent, unheard of even during the global financial crisis (Figure 4). Domestic demand collapsed, but the degree of impact varied. On the one hand, industrial sectors attempted a soft landing in production with an 8.4 percent decline, while on the other hand fixed-asset investment and retail sales declined by 16.1 and 19 percent, respectively (Figure 5). Exports also decreased by 13.6 percent with disrupted production (Figure 6).

16. **The good news was that economic momentum in China rebounded quickly under a "first-in, first-out" scenario from Q2 of 2020, as the country moved to the next stage of the pandemic.** With mobility restrictions gradually loosened, the economy picked up strongly with an annual growth rate of 2.2 percent, avoiding a full-year recession and becoming a rare major economy with growth. By the end of 2020, industrial production reverted to positive territory at 2.8 percent. Moreover, with the strong rebound from property investment, fixed-asset investment even rebounded to a growth rate of 2.9 percent. The only exception was retail sales, with a yearly contraction of 3.9 percent.

17. **A desynchronized world plagued with skyrocketing COVID-19 cases has made China a favorable production base globally, boosting its export performance.** Exports from China rebounded in H2 of 2020, achieving an annual growth rate of 3.6 percent. Thanks to the relatively minor disruption in supply chains, China received export orders diverted from the rest of the world, especially in electronics and health-care products.

18. **In 2021, the Chinese economy further rebounded by 8.1 percent, improving on most indicators.** Industrial production, fixed-asset investment and retail sales grew by 9.6, 4.9, and 12.5 percent, respectively. Foreign trade was also more active with a growth rate of

29.9 percent. However, amid the positive sentiment from a cyclical rebound, regulators have pushed for tighter oversight of real estate, and anti-trust and data sovereignty, creating downward pressure on specific sectors.

19. **The gap between producer and consumer prices has widened with the ongoing supply chain disruptions.** The Producer Price Index grew by 8.8 percent in 2021, favoring upstream sectors, such as coal and metals (Figure 7). This trend was in sharp contrast to the Consumer Price Index (CPI), which grew by only 0.9 percent in the same period. This meant that downstream firms absorbed higher raw material prices and failed to pass these on to consumers, causing a deterioration in corporate profits.

20. **When the third stage erupted with the Omicron outbreak in February 2022, China's market faced new uncertainties and the possible derailing of its growth trajectory with renewed lockdowns.** The Omicron variant, with its far higher risk of transmissibility, could increase the cost of lockdowns if the zero-COVID approach remains the only goal. Starting in Shanghai, it looked like déjà vu as China entered lockdown mode once again. As of March 2022, mobility in China fell by 11 percent versus the pre-pandemic level, with 20 provinces seeing declines. The situation was better than in February 2020, which saw a fall of 66 percent across 29 provinces, but there will be more headwinds in economic growth under the current policy.

21. **As the rest of the world reopens, China risks falling behind.** The recovery will be more balanced in a reopening, but uncertainties arising from on-and-off lockdowns may continue to dampen consumer and business optimism. The key question remains one of assessing the costs and benefits of epidemic policies and how sustainable they are economically, which can change over time. With much more contagious virus variants but far lower fatality ratios, the economic cost of the zero-COVID policy is clearly rising and the risks may be outpacing the benefits. It has become increasingly challenging to continue the routine testing of residents and using a closed-loop system in factories, which carry high risks of hurting consumer sentiment and disrupting production endlessly.

3. Policy measures in response to COVID-19

22. **A major characteristic of China is that most measures are "above-the-line," meaning higher government expenditure with consequences on the overall fiscal balance and debt.** To counter the drag from the pandemic, the Chinese government rolled out a series of policies to support the economy. Most measures were introduced in March 2020, and these began to fade in 2021 as the pandemic started to weaken gradually. The trend aligns with the magnitude of economic shock that China has experienced since the start of the pandemic.

23. **While the fiscal deficit showed a moderate increase in spending after the pandemic, a further budget consolidation revealed a wider gap between government revenues**

and expenditure. China's headline fiscal deficit only includes general budgeting, which may not reflect the full picture. Indeed, China's total on-balance-sheet budgetary activities include general budgeting, government funds, social security funds and state-owned enterprise (SOE) funds. And the fiscal deficit could widen with off-balance-sheet activities through local government financing vehicles. Considering the headline fiscal deficit, this only increased from 4.9 percent of GDP in 2019 to 6.2 percent in 2020, with a slight decline to 3.8 percent in 2021. However, the augmented fiscal deficit[85] widened from 10.5 percent of GDP in 2019 to 12.3 percent in 2020 and 12.1 percent in 2021 (Figure 8). This shows that government support remained strong even after the COVID-19 initial shock in Q1 of 2020.

24. **The approach taken by the Chinese government falls into three main categories.** For government revenue, faster implementation of tax and fee reduction policies is the core support for businesses. The government also expanded its fiscal expenditure through household support and investment. Given the uniquely high dominance that SOEs enjoy in China, the government can mobilize state resources more easily than in other countries.

25. **Comparing household and business support, China favors using revenue measures for corporations and expenditure for residents.** Even though there is a tax allowance in personal income tax (PIT), the degree of tax and fee reduction is more extensive for corporations (Figure 11). In contrast, the direct subsidies for households are bigger than the amount received by corporations.

26. **Reducing taxes and fees is a major approach for the Chinese government to support its corporations.** According to the State Taxation Administration of China, tax revenue after deducting export tax rebates declined by 2.6 percent to RMB 13.7 trillion, despite a positive economic growth rate in 2020 (Figure 9). The reduction showed the challenging economic environment for corporate profits and a stronger push from the Chinese government to lower taxpayers' burden. The government has since rolled out 28 policies in seven batches, including emergency measures targeting the adverse effects of pandemic control, the most severely affected industries and support in resuming industrial production. The magnitude of tax and fee reduction policies increased by 6.4 percent from RMB 2.35 trillion in 2019 to RMB 2.5 trillion in 2020, almost one-fifth of the general fiscal revenue (Figure 11).

27. **Domestically, China cut value-added tax (VAT) to reduce the corporate tax burden and support economic growth with a targeted approach.** First and foremost, immediate VAT credit was given to firms that were strategically important for medical supplies. Second, VAT on upcoming income was waived for sectors heavily impacted by the pandemic and mobility restrictions, including medical services, catering and hospitality, public transportation and other personal services. Third, the VAT rate was

85 Augmented fiscal balance includes general budgeting, other three on-balance sheet items (government funds, social security funds and state-owned enterprise funds, and another off-balance sheet item of local government financing vehicles.

lowered for small-scale taxpayers with annual taxable income equal or lower than RMB 500,000. The VAT was fully exempted for firms in the Hubei province and was reduced from 3 to 1 percent for other provinces. Most of the measures were extended until the end of 2021.

28. **The authorities also suspended social security contributions, as the central government pushed for a stronger redistribution drive to ease the pressure on corporations.** RMB 1.7 trillion was cut from social security contributions, forming 68 percent of the tax and fee reduction policy in 2020. The Chinese government lowered the contribution for three social security schemes, including basic pensions, unemployment and work injury insurance, while small and medium enterprises (SMEs) and self-employed individuals were made exempt from paying three social insurance units. Moreover, the levies were halved for large firms. For the basic medical insurance system, provinces could reduce half of the contribution depending on the substantiality of funds for a maximum of six months.

29. **While the lower contribution may impact pension payouts, the central government tackled the problem through redistribution between provinces.** In 2020, the redistribution rate by the central government reached 4 percent, climbing further from 3.5 percent in 2019. The ratio will increase even more amid growing divergence in fiscal health between provinces.

30. **Externally, China raised export tax rebates for a variety of products.** The export tax rebate rate increased to 13 percent for 1,084 products and 9 percent for 380 products. If the goods were re-transported back to China within a year due to the force majeure from the pandemic, import-related taxes would be made exempt, and export duties would be refunded if applicable. Most products, therefore, had an export tax rebate rate similar to the VAT rate, meaning the tax rate for most exported goods.

31. **Small and low-profit enterprises were allowed to defer their tax obligations.** The initial period was a three-month delay, which was extended to the first declaration period of 2021. As long as firms suffered losses from disrupted production and business activities, they could apply for a deferral of their tax payments. This also applied to corporations without enough cash to pay taxes after deducting wages and social insurance premiums.

32. **Beyond centralized measures, local governments also implemented more policies based on individual circumstances and with varied strengths.** However, the room for government support also depended on fiscal health. It has been a structural problem that most provinces in China face fiscal deficits, making bond issuance and redistribution from the central government their main lifeline. Lagging land sales and the contraction in the real estate sector have only made the situation more challenging.

33. **Many cities waived or reduced property and land taxes to reduce the burden on individuals and corporations.** Shenzhen was the most aggressive among first-tier cities in waiving the above taxes by three months. At the same time, Shanghai and Guangzhou allowed individuals and corporations to apply to lower their related taxes.

34. **In 2021, the government reduced the scale of lowering taxes and fees, and switched the focus to supporting the manufacturing sector in a longer time horizon.** Compared with 2020, the size of the policy was reduced to RMB 1.1 trillion. The fundamental change was a more targeted approach to support tax relief, including reductions and exemptions for manufacturing enterprises and coal power and heating firms, research and development (R&D) expenses, and a one-time corporate income tax (CIT) reduction for purchasing equipment. SMEs continued to be an important focus, with tax cuts and tax delays. In addition, the redistribution rate by the central government on pension payouts climbed further to 4.5 percent, showing the strong injection towards local governments.

35. **Beyond the larger expenditure on epidemic control and health care, China channeled fiscal stimulus mainly towards supporting households and investment.** While the personal income tax allowance was beneficial to individuals, the key support comes from fiscal expenditure, such as unemployment benefits, vocational skills enhancement, poverty alleviation, subsidies for people in need, and incentives for cross-provincial employment (Figure 10). However, the most important support came from the central government's transfer of pension payments, which was considerably larger than the above measures combined.

36. **Regarding investment, bond issuance was a key method for the Chinese government to increase its expenditure and hand out economic stimulus.** The measures can be viewed from two angles. Anti-epidemic special treasury bonds act as a contingent program for health-care-related expenses, while the ongoing issuance of special local government bonds has boosted infrastructure investment.

37. **During the Third Session of the 13th National People's Congress in May 2020, the central government announced the special anti-epidemic bond issuance plan of RMB 1 trillion.** The money was used to support SMEs, build infrastructure for the public health system, and finance other anti-epidemic spending.

38. **The Chinese government also used its usual measures by issuing special local government bonds focusing on infrastructure investment.** The bond issuance quota increased from RMB 2.15 trillion in 2019 to RMB 3.75 trillion in 2020, signaling strong policy support through investment by local governments (Figure 13). In July 2020, the Ministry of Finance allowed the local governments to expand the usage of the funding. Beyond traditional roads and bridges, local governments were encouraged to invest in energy, agriculture, forestry and water conservancy, environmental protection, people's livelihood services, cold-chain logistics facilities, and industrial parks. In particular, cold-chain logistics is an integral part of the government initiative in narrowing the gap between the urban and rural areas.

39. **Aside from investment, the proceeds of local government special bonds could also supplement banks' capital.** In July 2021, the State Council empowered local governments to allocate parts of the raised fund to support small-and-medium banks with close relationships with SMEs. Higher-risk provinces such as Henan, Liaoning and Shanxi, had allocated more funding to support banks. After local governments pocket

the proceeds, they can enter into convertible equity agreements or indirect equity capital injections to support banks. Local governments can inject capital into the banks through a state-owned platform while purchasing additional tier-1 (AT1) bonds, which can convert into core tier 1 capital if needed. The bonds usually come with conditions on a forced conversion when the core tier-1 capital ratio reaches 5.125 percent or other conditions that make the banks' businesses and liquidity unsustainable upon regulators' approval.

40. **Beyond immediate investment and capital injections from local governments, more subsidies were given to affected sectors.** Based on the data from listed firms in China and overseas markets, Chinese firms received RMB 323 billion worth of government subsidies in 2020, an increase of 12 percent from RMB 288 billion in 2019. Even though the figure may underestimate China's subsidies, the trends are still worth analyzing. About 85 percent of listed firms were granted fiscal support, more than the help offered to loss-making companies. Besides, the industrial and information technology sectors are the main recipients of subsidies. Beyond these two, software and services, technology hardware, automobiles, transportation, and semiconductors are the sub-sectors with a high reliance on subsidies.

41. **The fiscal stimulus for households and investment was mainly carried over into 2021.** To buffer the ongoing impact of the pandemic, the Chinese government maintained its support for poverty alleviation and health care, with lower benchmarks and broader coverage to receive the related subsidies. The special government bond quota for infrastructure investment was unchanged, but there was no issuance of the special anti-epidemic bond.

42. **With the ballooning public debt, the overall credit risk will be higher but should be manageable as long as economic growth rebounds.** The majority of debt in China is concentrated in the corporate sector, which means there is room for government debt to expand and maneuver compared with advanced economies, such as the United States, the EU, and Japan. As a proxy of credit risk, the ratio of RMB bonds with repayment pressure for SOEs increased to 0.36 percent in 2020 but fell to 0.18 percent in 2021. The higher saving rate also means that China has plenty of resources to mobilize through its banking and insurance sector, even though there are growing challenges from an ageing population. Therefore, the credit risk of Chinese government debt remains low, but pressures may emerge if the deleveraging process is too aggressive.

43. **Compared with other counties, a unique characteristic for China in fiscal measures against the COVID-19 pandemic is the ability to mobilize SOEs and resources.** Growth of fixed-asset investment for private firms collapsed from 4.7 percent in 2019 to 1 percent in 2020, while SOEs declined merely from 6.8 to 5.3 percent. The divergence showed the long-standing role of SOEs as the stabilizers of the economy (Figure 14).

44. **In the financial sector, the government's involvement in rebalancing resources was also vital in lowering the costs for corporations.** Even though only six commercial banks were classified as state-owned commercial banks, most banks in China had an interlaced

relationship with local governments as shareholders. Financial institutions form part of the fiscal support in giving up their profit margins, known as interest concessions.

45. **Banks were encouraged to lower fees and commission charges.** Unlike interest income, the People's Bank of China (PBoC), the central bank, could help adjust the reserve requirement ratio (RRR) and the policy rate, if necessary, while the burden of reducing non-interest income depends entirely on banks. For example, banks reduced account service charges, RMB transfer fees, remittance fees, and bank card transaction fees.

46. **The fiscal stimulus can only function with adequate monetary support, such as interest rate cuts and liquidity injections.** With a more accommodative monetary policy stance, aggregate financing growth to the real economy or the total social financing,[86] accelerated from 10.3 percent in 2019 to 13.3 percent in 2020.

47. **A lower policy rate is vital to reduce funding costs for both corporates and the government.** The PBoC cut its benchmark one-year medium-term lending facility (MLF) rate by 10 basis points in February 2020 and 20 basis points in April 2020, bringing it from 3.25 to 2.95 percent (Figure 15). Consequently, the one-year loan prime rate (LPR)—the benchmark for banks' lending to corporates—fell by the same margin of 30 basis points from 4.15 to 3.85 percent. For the five-year LPR, the reference for real estate and mortgages fell by only 20 basis points from 4.8 to 4.65 percent. Overall, it translated into a lower loan rate from 5.44 percent in December 2019 to 5.03 percent in December 2020, a decline of 40 basis points. Banks gave up their net interest margins to support the economy, implying a reduction in profitability. The authorities also relaxed the property sector's funding conditions by a fine margin, showing its different treatment compared with other sectors.

48. **With the reserve requirement ratio cuts, China's central bank has injected liquidity to boost credit growth.** Following the COVID-19 outbreak, the PBoC made three cuts in reserve requirements but with a targeted approach (Figure 16). In March 2020, a targeted RRR cut of 50 to 100 basis points was implemented based on the performance in inclusive finance. If the above criteria were met, joint-stock commercial banks could have an additional targeted RRR cut of 100 basis points. In April and May 2020, city and rural commercial banks received two RRR cuts with 50 basis points each. The PBoC also decided to cut the interest rate on excess reserves of financial institutions from 0.72 to 0.35 percent, encouraging banks to lend to the real economy.

49. **The extra liquidity was not only necessary to support corporates through credit growth but was also behind the ballooning fiscal spending.** Growth of total local government bond issuance surged from 14.3 percent in 2019 to 22.1 percent in 2020,

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86 Total social financing is a broad measure of credit in the Chinese economy, including two types of loans (RMB and other currencies), three shadow banking items (entrusted loans, trust loans and undiscounted bankers' acceptances), net financing of corporate bonds, government bonds, equity financing on the domestic stock market by non-financial enterprises, asset-backed securities of depository financial institutions and loans written off.

due to the demand for fiscal stimulus. In China's bond market, commercial banks are the biggest buyers, holding 55 percent of the total, and the ratio is as high as 85 percent for local government bonds as of 2020. This shows the importance for the central bank to channel liquidity to support fiscal stimulus and the economy.

50. **In 2021, the monetary stance was still accommodative but less so than before.** Total social financing decelerated from 13.3 percent in 2020 to 10.3 percent, but with faster local government bond issuance growth than other loans. There was no cut in banks' funding costs, such as the MLF rate. Nonetheless, banks lowered their one-year LPR rate by 5 basis points from 3.85 to 3.8 percent in December 2021, showing that banks needed to further support corporations by compressing their profit margins. The five-year LPR rate was left unchanged, indicating a tighter policy towards the property sector.

51. **Beyond fiscal and monetary policies, China also used its control over capital flows and external debt to stimulate the economy when necessary.** The essence is fine-tuning through administrative measures and regulations, such as the macro-prudential adjustment framework. To control forex risks, Chinese corporates and financial institutions face a borrowing limit in cross-border financing risk-weighted assets.[87] The relaxation mainly focused on altering the macro-prudential adjustment parameters. In March 2020, China raised the macro-prudential adjustment parameter for cross-border financing from 1 to 1.25, increasing the ability for firms to borrow externally. The measure was helpful for firms to take advantage of the lax liquidity and low interest rates globally without too much domestic easing.

52. **Since December 2020, China has started rolling back the relaxed measure.** To control external debt, the central bank lowered the macro-prudential adjustment parameter for cross-border financing to 1, first for financial institutions, followed by corporations. The reversal implies that it was hard for firms to accumulate foreign debt.

53. **Beyond reducing the room for foreign debt, China also raised the limit for its entities to lend to overseas markets, especially the RMB.** To begin with, Chinese firms need to abide by the regulations that the weighted overseas loan balance[88] needs to stay within the limit. Regarding the ceiling, China increased the macro-prudential adjustment coefficient for overseas lending by domestic companies[89] from 0.3 to 0.5, meaning that firms have a higher limit for lending to foreign markets or their offshore subsidiaries. However, China has also raised its currency conversion factor for foreign currency overseas loan balance from 0 to 0.5, which affects the calculation of the loan balance. It means that firms will face relatively lower regulatory costs in lending overseas in the RMB

87 Calculated by the multiple of net asset or capital, cross-border financing leverage ratio and macro-prudential adjustment parameter. The ceiling of corporates is calculated from net asset and cross-border financing leverage ratio of 0.8, while financial institutions face the limit from capital and cross-border financing leverage ratio of 1.

88 The exchange rate adjusted outstanding overseas loan is calculated from local currency overseas loan balance plus foreign currency overseas loan balance multiplied by the currency conversion factor.

89 The upper limit of the balance of overseas loans of domestic enterprises is calculated from the multiple of the owner's equity and macro-prudential adjustment coefficient.

than in foreign currencies. The consequences are that firms are encouraged to bring their capital out of China, which can somewhat ease the appreciation pressure of the RMB. Nonetheless, the authorities do not want full capital outflows in foreign currencies and intend to promote RMB internationalization, which is more of a long-term goal.

4. Assessment of policy responses and future challenges

54. **Overall, the fiscal response by China was highly supportive of the economy, and achieved a delicate balance between leverage and growth.** It was unavoidable that the economy would enter a contraction during the strict lockdowns. The Chinese government implemented a laxer monetary policy to ease liquidity stress for corporates and raise funds for anti-epidemic spending. While the effectiveness of fiscal and monetary policy often goes hand-in-hand, it is crucial for China, given its model of a bank-based credit channeling system, to inject liquidity into the financial system quickly. China's banks' assets amounted to 307 percent of GDP in 2021, higher than any country with a similar financial system. Once the number of confirmed positive cases fell, local governments speeded up bond issuance and supported the economy with infrastructure investment. Property investment also rebounded quickly, driven by faster mortgage loan growth and inelastic demand from residents.

55. **China increased its leverage in 2020 to keep economic growth afloat.** According to the Bank for International Settlements, China's total credit to the private non-financial sector increased from 206 percent of GDP in 2019 to 222 percent in 2020, followed by a decline to 217 percent as of Q3 of 2021. There was an increase in leverage in all sectors, especially corporates and government. Corporate debt grew from 150 percent of GDP in 2019 to 161 percent in 2020, while government debt expanded from 58 percent in 2019 to 68 percent in 2020. Households also expanded their leverage from 56 percent of GDP to 62 percent for the same period.

56. **However, the Chinese government was serious about deleveraging and containing financial risks, leading to a different path in 2021.** With a less accommodative liquidity condition, corporate debt declined to 156 percent of GDP as of Q3 of 2021. In contrast, the government and household sectors' debt levels were relatively low, keeping their leverage ratios unchanged and reflecting a more conservative approach to containing debt risks of firms and the gradual shift of debt burden towards the government and household sectors.

57. **The approach was supportive, but no measures are perfect, and the recovery has not come without challenges.** Economic growth has not fully normalized due to uneven recovery across the size of firms and sectors. The Chinese economy is not yet out of the woods in the aftermath of the COVID-19 pandemic, even with the fiscal and monetary stimulus.

58. **As large firms generally weather the storms better, the divergence between the**

size of enterprises has become apparent. The lagging Purchase Managers' Index (PMI) largely reflected the poorer sentiment of small firms, which was below the expansionary zone of 50 most of the time since 2020 (Figure 17). The sectoral distribution was also crucial in explaining the trend, as a bigger proportion of large firms operating in the fields of energy and raw materials benefited from the surge in prices. Even if the PBoC had preferential policies to support SMEs, loan growth eventually fell short of expectations in H2 of 2021. Firms without liquidity stress may be more resistant to borrowing and investing amid uncertainty.

59. **There was also an uneven recovery in consumption, with more volatile sentiment compared with other sectors.** On a positive note, the lack of outbound tourism trapped spending in the local market, supporting consumption. However, disposable income for Chinese households only grew by 6.3 percent in 2021 on a two-year average basis, still lower than the pre-pandemic level of 8.8 percent. Consumer sentiment was also still conservative. According to the quarterly survey conducted by the PBoC, 51.8 percent of the respondents planned to keep more savings, with 24.7 percent wanting to consume more as of 2021 (Figure 18). The result was still relatively pessimistic compared with the pre-pandemic levels of 45.7 and 28 percent, respectively, of those planning to save and those planning to spend more. Although there could be a shift in consumption patterns, tourism spending during National Day Holidays only reached 60 percent of the pre-pandemic level, showing that consumer confidence was still affected by uncertainties.

60. **The COVID-19 pandemic will not be the only crisis that China faces, and it is important to think and prepare for a rainy day.** There are challenges that China can resolve to ensure timely and effective implementation of fiscal policies should there be another economic shock.

61. **First, a more flexible allocation of the local government special bond quota with expanded usage will be key for the future effectiveness of government stimulus.** Past experience shows that the financing and implementation of local government projects were generally better in the years with an early allocation of special government quotas in November 2018 and December 2019. In contrast, the quota was only allocated in March 2021, resulting in a lack of bond issuance in the first two months, hence the lagging investment boost. Given the timing of the COVID-19 outbreak, there was probably no choice. Nonetheless, an earlier allocation is beneficial in planning for any stimulus to reach its target groups more easily.

62. **Second, the fiscal stimulus should cater to both traditional and new infrastructure.** As China no longer treats GDP growth as the sole policy target, the direction has switched towards seeking sustainable growth. On the one hand, traditional infrastructure, such as roads and bridges, is still vital for growth in China, and the demand for transportation and logistics will continue to grow. On the other hand, local governments' special bonds must keep up with the changes. As a result, new infrastructure should become a more important focus, such as 5G transmission, data centers, and industrial parks for high-tech industries. This would require a new assessment method as its related cash flows can differ from traditional infrastructure. In particular, economic impacts may only be seen

in the longer term compared with the immediate demand for building materials and metals. Nevertheless, it can help narrow the divergence of fiscal policy benefits between large and small firms, especially as the latter mainly operate in the manufacturing and the related services sector.

63. **Third, the financial health of local governments could become a cause for concern amid the strengthened risk control on the real estate sector.** Fiscal expenditure will only grow with an ageing population, and the evaporation of income from land sales will pose more headwinds. This trend raises concerns not only regarding the ability of local governments to meet debt obligations beyond their bonds but also on the related local government financial vehicles and local SOEs. The problem is there is no Plan B as an alternative to real estate, both for growth and fiscal revenue. It seems essential to either relax the regulations or local governments will need to find a new and sustainable model to keep a healthy fiscal position to repay their creditors.

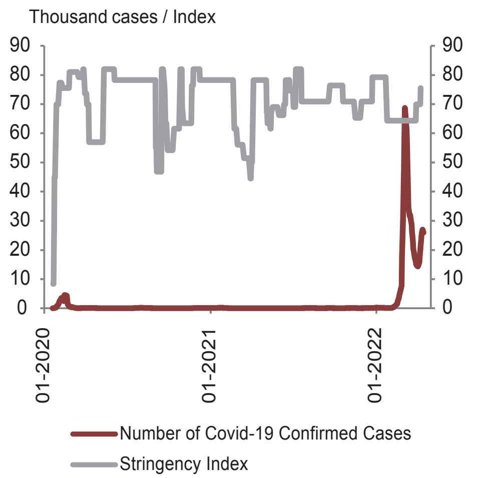
64. **An ageing population also means that China will face higher implicit pension debt, a concept describing that both workers and pensioners also have claims on the government, as do bondholders.** In China, the current pension system is heavily reliant on the government. Within the three-pillar classification, the first pillar in China includes the "Basic Pension Insurance for Urban Employees" and "Basic Pension Insurance for Urban and Rural Residents" led by the government. The second pillar includes annuities developed independently by enterprises, but its size and coverage are not comparable to the government. Meanwhile, the third pillar, namely personal pensions, is largely underdeveloped.

65. **China will need to reform its pension system to reduce pressure on the government.** In April 2022, China's State Council unveiled the outlines of a voluntary private pension system and participants will be able to contribute as much as RMB 12,000 annually. However, quicker reform is now needed through providing more incentives given that the regulatory crackdown, bond issuances, and COVID-19-related spending have all added pressure on the government.

66. **Lastly, ensuring a competitively neutral environment for firms in China can be an indirect solution to the slow rebound of consumption in any potential crisis and the divergence between large and small firms.** Given the large population size, it seems unrealistic for the Chinese government to hand out cash universally, especially with a large amount per person and the concern on fiscal sustainability. In short, competitive neutrality means creating a level-playing field among SOEs and private firms, of which the scope can also include foreign enterprises. Moreover, allowing more room for the private sector to grow will mean more job opportunities and better transmission of fiscal policy through local government investment. This is because private firms can participate and play a greater role and bring capital into the projects created by local governments, which is especially important in new infrastructure projects.

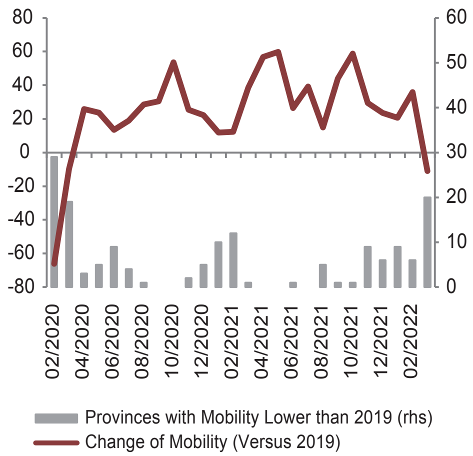
Appendix 1. Selected Figures

Figure 1 Number of COVID-19 cases and stringency index



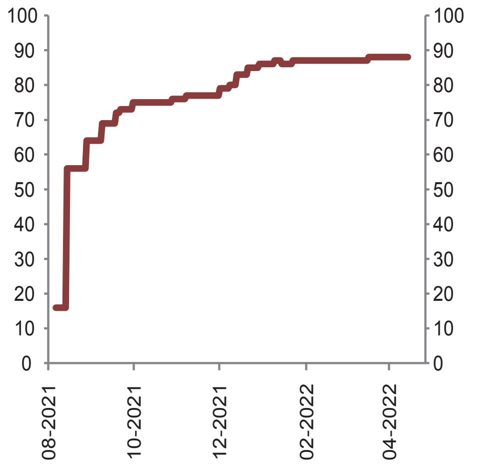
Source: Johns Hopkins University; Blavatnik School of Government; Bloomberg.

Figure 2 Mobility index



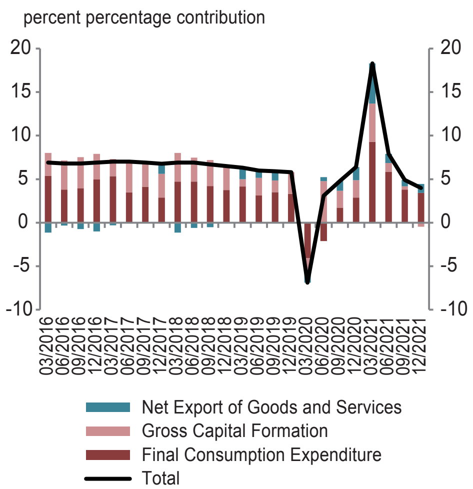
Source: AutoNavi; CEIC.

Figure 3 Vaccination rate



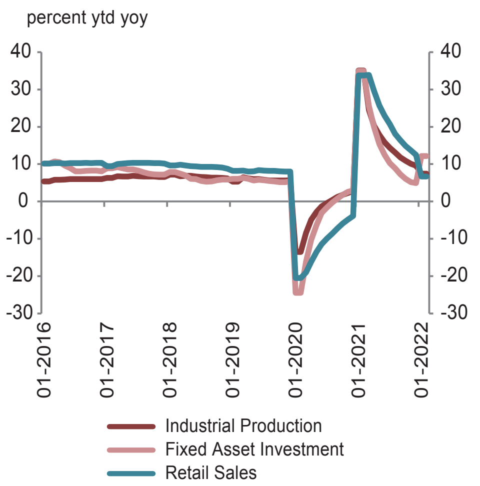
Source: Johns Hopkins University; Bloomberg.

Figure 4 GDP growth by component



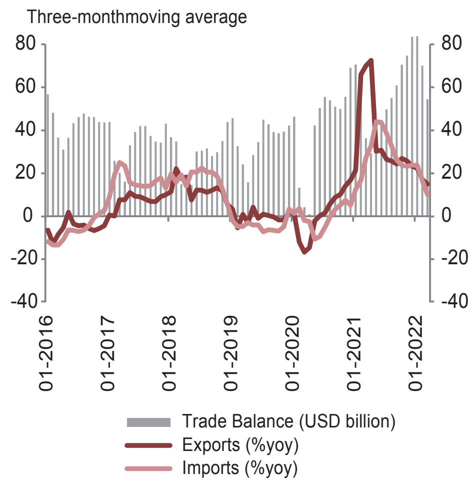
Source: National Bureau of Statistics of China; CEIC.

Figure 5 Industrial production, fixed asset investment and retail sales



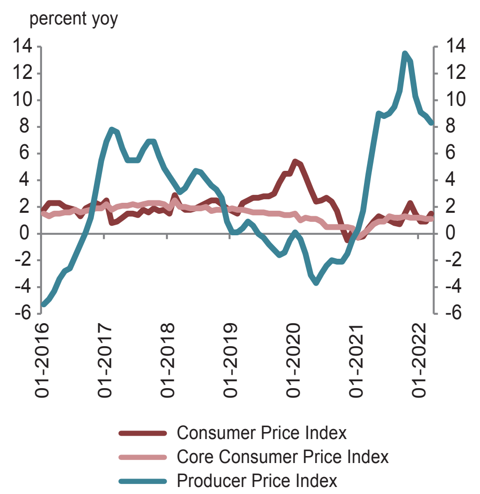
Source: National Bureau of Statistics of China; CEIC.

Figure 6 Foreign trade



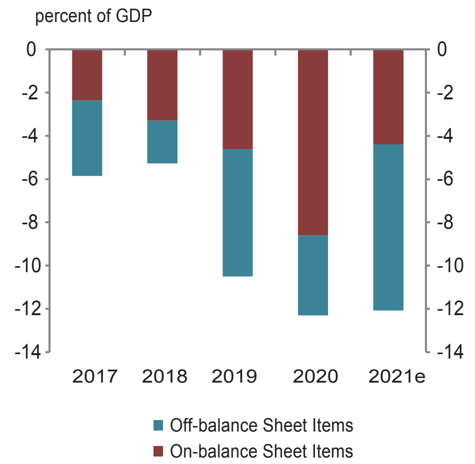
Source: General Administration of Customs of China; CEIC.

Figure 7 Consumer and producer price indexes



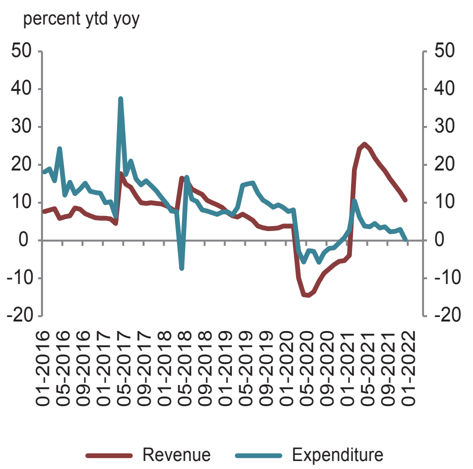
Source: National Bureau of Statistics of China; CEIC.

Figure 8 Augmented fiscal balance



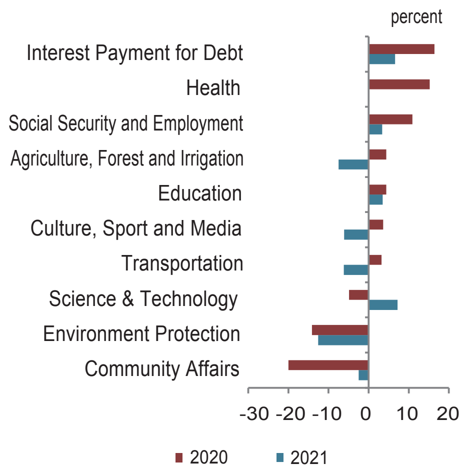
Source: China's Ministry of Finance; National Bureau of Statistics of China; CEIC; WIND.

Figure 9 General government revenue and expenditure



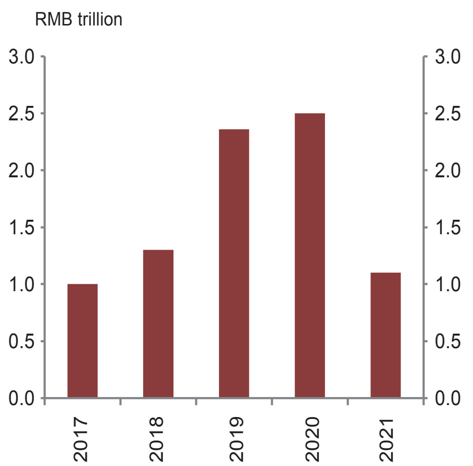
Source: Ministry of Finance of China; WIND.

Figure 10 General government expenditure by type



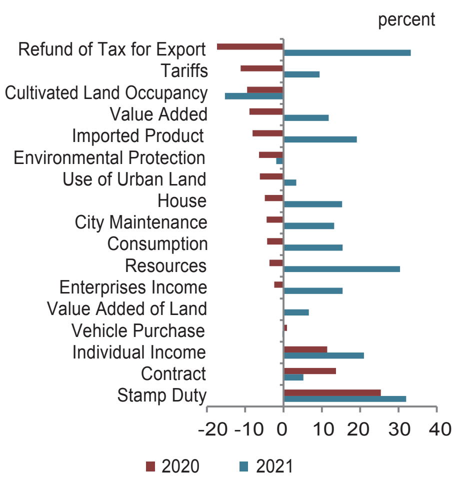
Source: Ministry of Finance of China; CEIC.

Figure 11 Amount of taxes and fees reduction



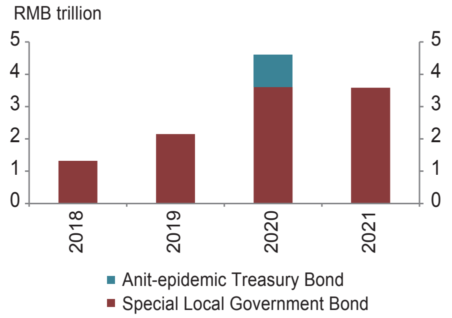
Source: State Taxation Administration of China; WIND.

Figure 12 General government revenue by type



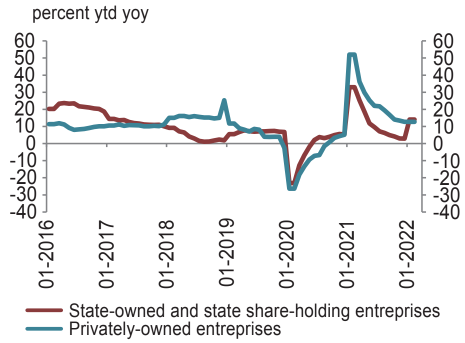
Source: Ministry of Finance of China; CEIC.

Figure 13 Issuance of special bonds



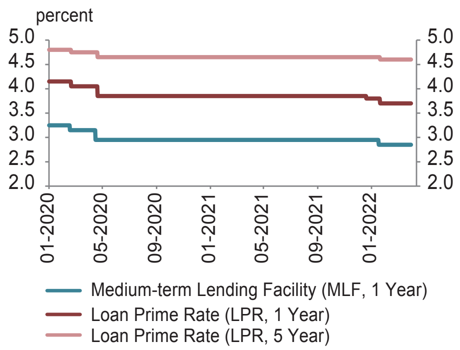
Source: Ministry of Finance of China; WIND.

Figure 14 Fixed asset investment by the types of enterprise



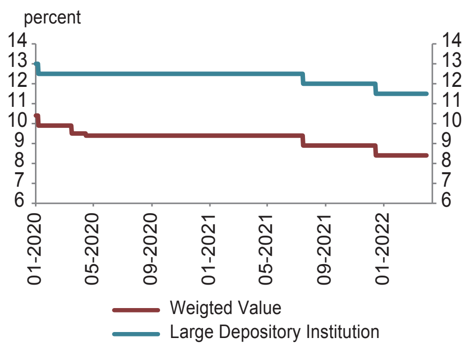
Source: Ministry of Finance of China; CEIC.

Figure 15 Key policy rates



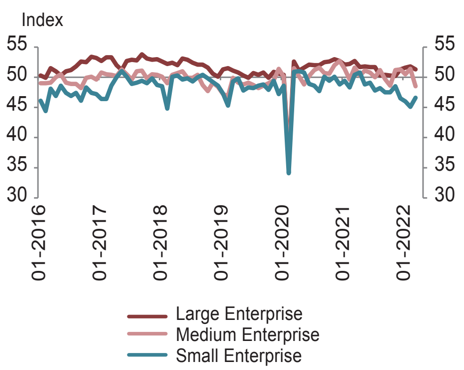
Source: People's Bank of China; CEIC.

Figure 16 Reserve requirement ratios



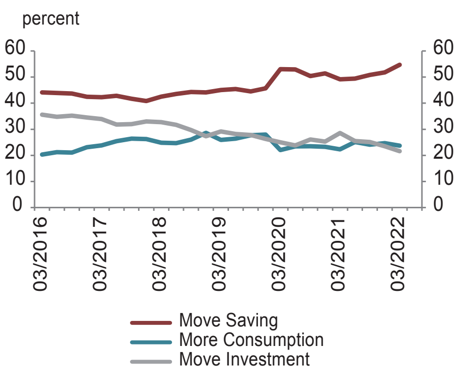
Source: People's Bank of China; CEIC.

Figure 17 Purchasing managers' index by the types of enterprise



Source: National Bureau of Statistics of China; CEIC.

Figure 18 Survey on consumer sentiment



Source: People's Bank of China; WIND.

Appendix 2. Selected Tables

Table 1 Selected economic indicators

	2017	2018	2019	2020	Estimate 2021
Real sector and prices	(Annual percentage change)				
Real GDP	6.9	6.7	6.0	2.2	8.1
Agriculture	4.0	3.5	3.1	3.1	7.1
Industry	5.9	5.8	4.9	2.5	8.2
Services	8.3	8.0	7.2	1.9	8.2
GDP deflator	4.3	3.3	0.5	-3.1	4.4
CPI inflation (average)	1.6	2.1	2.9	2.5	0.9
CPI inflation (end of period)	1.8	1.9	4.5	0.2	1.5
External sector	(US$ million, unless otherwise specified)				
Current account balance	188,676	24,131	102,910	248,836	317,301
(Percent of GDP)	1.5	0.2	0.7	1.7	2.1
Trade balance	438,024	368,200	429,620	537,455	689,375
Exports	2,280,358	2,501,334	2,498,570	2,597,571	3,368,232
Imports	1,842,334	2,133,135	2,068,950	2,060,115	2,678,857
Services, net	-258,932	-292,168	-261,149	-152,530	-99,916
Primary income, net	-16,478	-61,365	-39,184	-118,192	-162,031
Secondary income, net	-11,856	-2,410	10,250	8,455	16,524
Financial account balance	18,021	153,795	26,598	-89,997	-149,992
Foreign Direct Investment	27,791	92,338	50,260	99,375	205,942
Other Investment	81,746	80,344	-42,952	-160,522	-167,708
Overall balance	206,606	177,358	129,181	158,763	167,400
Gross international reserves	3,139,949	3,072,710	3,107,924	3,216,520	3,250,170
(Months of imports)	20.5	17.3	18.0	18.7	14.6
External debt	1,757,958	1,982,800	2,070,811	2,400,807	2,746,600
(Percent of GDP)	14.3	14.3	14.5	16.3	15.5
Fiscal sector	(In percent of GDP)				
Revenue and grants	35.5	37.1	36.7	35.3	35.0

	2017	2018	2019	2020	Estimate 2021
Tax revenue	17.4	17.0	16.0	15.2	15.1
Nontax revenue	18.1	20.1	20.7	20.1	19.9
Of which: Grants	11.3	13.9	13.6	14.5	13.7
Expenditure	37.8	40.4	41.3	43.9	39.4
Interest payments	0.8	0.8	0.9	1.0	0.9
Overall fiscal balance	-2.4	-3.3	-4.6	-8.6	-4.4
Primary balance	-1.6	-2.5	-3.8	-7.6	-3.5
Public debt	48.3	51.6	53.7	57.4	67.3
Monetary and financial sector	(In annual percentage change, end-period)				
Domestic Credit	14.1	10.9	10.7	13.3	10.3
Credit to private sector	10.5	12.6	12.5	13.6	9.9
Broad money	9.0	8.1	8.7	10.1	9.0
Reserve money	4.5	-2.1	1.7	4.2	2.1
Memorandum items					
Nominal GDP (RMB billion)	83,204	91,928	98,652	101,357	114,367
Nominal GDP (US$ million)	12,315	13,903	14,283	14,690	17,732
GDP per capita (US$)	8,820	9,911	10,146	10,435	12,555
Exchange rate (RMB/US$, average)	6.75	6.61	6.90	6.90	6.45
Exchange rate (RMB/US$, end of period)	6.53	6.86	6.98	6.52	6.38

Source: National Authorities; Bank of International Settlements; Bloomberg; CEIC; WIND

Note: Other investment includes portfolio investment, financial derivatives, and others in the balance of payment. On-balance-sheet figures used for the fiscal sector. Public debt as of Q3 2021. Domestic credit measured by total social financing. Credit to private sector measured by the claims by banks on non-financial sector.

Table 2 Fiscal deficit

	2017	2018	2019	2020	Estimate 2021
Fiscal Balance	(Percent of GDP)				
On-balance sheet balance (A = B + C+ D + E)	-1.8	-3.3	-4.6	-8.6	-4.4
General government (B)	-3.1	-3.2	-2.5	-2.6	-2.3
Government managed funds (C)	0.1	-0.6	-0.7	-2.4	-1.4
State Capital Operations (D)	0.1	0.1	0.2	0.2	0.2
Social Insurance Funds (E)	1.2	1.3	0.9	-0.2	0.6
Local government financial vehicles (F)	-3.5	-2.0	-5.9	-3.7	-7.7
Augmented fiscal balance (A + F)	-5.3	-5.3	-10.5	-12.3	-12.1

Source: National Authorities; Bloomberg; CEIC; WIND.

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2022 KIPF-AMRO Joint Research

The Impact of COVID-19 on Regional Economies and Policy Responses

Chapter

6

Indonesia

Chapter 6

Indonesia[90]

The COVID-19 pandemic has caused significant damage to the Indonesian economy. GDP contracted for the first time since the onset of the 1998 Asian financial crisis on the back of disrupted economic activities propagated by stringent mobility restriction measures domestically and globally. Business and factory closures in tandem with plummeting demand triggered a financial market rout, reflecting on capital outflows both in the stock market and the bond market. In response to such a disastrous health and economic crisis, the Government of Indonesia undertook several emergency measures, focusing on three critical areas: (i) tackling the pandemic; (ii) providing lifeline support to poor and near-poor families; and (iii) protecting businesses from mass bankruptcies. As a consequence, the government has had to confront unprecedented fiscal pressures. In the past five decades, the fiscal deficit has widened to a historical record, leading to a sizeable public debt increase.

1. COVID-19 development

1. **No country could isolate itself from the COVID-19 pandemic, including Indonesia.** Indonesia's first COVID-19 case was confirmed on 2 March 2020, with the first death recorded on 11 March 2020. By 9 April 2020, the pandemic had spread to all 34 provinces. Albeit not as severe as its peers with a comparable population, up to Q1 of 2022, Indonesia went through three different major infection waves: the Alpha wave (January to February 2021); the Delta wave (July to August 2021), and the Omicron wave (February to March 2022). While the Alpha wave led to daily cases just below 15,000 at its peak, the Delta wave sparked far higher daily cases of around 55,000 in July to August 2021, with daily deaths peaking at above 2,000. Even though far more transmissible than the Delta wave, the Omicron wave showed a milder impact, with fewer hospitalizations and a much lower death rate.

2. **In response to such a devastating health crisis, the government pursued various health-related interventions to contain the COVID-19 virus.** Learning from global best practice and WHO guidance, the government immediately undertook stricter social

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mobility restrictions followed by the closure of non-essential businesses. In mid-January 2021, the government modified the measures, allowing for a different level of social restrictions depending on the development of the COVID-19 pandemic across regions. With relatively relaxed rules and the emergence of a new variant of the virus (Alpha), the daily cases increased rapidly to a new high of around 14,000 cases before leveling off again. A more rapid wave then started to emerge in mid-June 2021, triggered by the Delta variant, which was much more contagious and led to more fatalities than the previous Alpha variant. As the Delta variant still triggered severe symptoms, while the vaccination rollout was still at an early stage, the hospital bed occupancy rate (BOR) surged, overcrowding health facilities across regions. As a consequence, the fatality rate increased significantly. At the peak level in July, the daily deaths reached over 2,000.

3. **Entering Q4 of 2021, the daily cases declined rapidly, at the same time as efforts were made to speed up the vaccination rollout.** By early October 2021, the daily cases had been lowered to below 2,000 cases. Social restrictions in many regions were adjusted to a lower level to allow economic activities to restart. Vaccinations were also accelerated to nearly 2 million a day on average. Learning from the Delta wave, people became more conscious of participating in the vaccination rollout and voluntarily followed the health protocol and the "new normal" way of life. These two combined had played an essential role in sustaining the declining trend of the daily cases and the death rate. By the end of 2021, the seven-day moving average of the daily cases was kept below 200, sparking pent-up demand.

4. **Indonesia was better prepared for the emergence of the Omicron wave in early 2022.** Having learned from the Delta wave, the government was far better prepared for the emergence of a new wave of infections. An expansion of emergency facilities had been undertaken, while also ensuring an adequate supply of oxygen to hospitals. More importantly, vaccinations were accelerated. Awareness among Indonesian people of the importance of adhering to the health protocol also improved. These improvements were all seen during the Omicron wave. Even though daily cases of the Omicron wave recorded a new high over the past two years, reaching nearly 65,000 cases, the BOR remained relatively low, as did the death rate. The less severe symptoms generated by Omicron infection were another factor explaining the less powerful impact of the Omicron wave on the economy.

2. The economic impact of the pandemic

5. **Before the COVID-19 outbreak, the Indonesian economy had been in generally good shape and on a solid footing.** Gradual and consistent economic reforms had made the Indonesian economy better protected from shocks. Even during the period heightening the United States-China trade war in 2019, most macroeconomic indicators were relatively solid: robust economic growth, low and stable inflation, distinctly improved current account deficit, and stronger fiscal position with the continued declining fiscal deficit and, in turn, a lower government debt ratio (Crystallin and Abdurohman, 2021).

The real sector was also progressing well, with the unemployment rate and poverty consistently falling. However, the devastating and unprecedented COVID-19 health shock, upended this solid footing.

6. **The imposition of stringent social restrictions slowed the economy significantly.** The imposition of mobility restrictions forced people to stay at home, do their regular work from home, and study from home. Except for groceries and pharmacies, most business activities were closed to contain the spread of the COVID-19 virus. The Google Mobility Index[91] captured muted economic activities during the pandemic, plunging to 36 percent below the pre-pandemic level in April 2020. The Consumer Confidence Index[92] shrank significantly to 77.8 in March 2020. The social restrictions and business closures generated a downward spiral effect on the economy.

7. **The COVID-19 pandemic started to weigh on the economy in Q1 of 2020.** Even though it still managed to grow at 3.0 percent in Q3 of 2020, economic growth slowed significantly from its average growth rate of around 5.0 percent. Private consumption dropped to 2.6 percent, much lower than 5.3 percent in Q1 of 2019. Investment activities also slowed down from 5.0 percent in Q1 of 2019 to 1.7 percent in Q1 of 2020. Almost all sectors experienced a slowdown on the production side, particularly in the high-contact services sector, such as trade, accommodation, and transportation (Figure 6).

8. **The full-blown impact of the COVID-19 pandemic was seen in Q2 of 2020.** The economy contracted at 5.3 percent in Q2 of 2020, a record low in the past two decades (Figure 5). Real consumption fell sharply by 5.7 percent as social mobility was restricted, mainly dragged down by fashion and tourism-related consumption. Investment contracted even more, with weaker demand and supply chain disruption. Exports and imports also declined, with the border closure policy in trading partner countries. The manufacturing sector experienced a significant setback, with a 6.2 percent decline in production. The high-contact services sector segments, such as transportation, accommodation, and trade, were hit the hardest, dropping at 30.8, 22, and 7.6 percent, respectively (Figure 2).

9. **The manufacturing sector had to deal with a double whammy.** This started first with the diminished supply of raw materials and capital goods from major trading partners, and with logistics scarcity complicating the challenges. Indonesia's imports of raw materials and capital goods contracted by 15.0 and 16.8 percent, respectively, in H1 of 2020. Sectors that were sensitive to physical interaction were the most severely hit. As malls, supermarkets, and traditional shopping centers were empty, the demand shock also dragged down fashion-related industries. As one of the high value-added sectors, the automotive sector experienced a significant downturn. Retail car sales dropped

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91 Google Mobility Index by Google reports mobility trends over time to places such as retail and recreation, groceries and pharmacies, parks, transit stations, workplaces, and residential. Baseline used to track the trend is the median value during 3 January to 6 February 2020.

92 Consumer Confidence Index is a survey conducted by Bank Indonesia to describe people confidence on economic condition. It covers people perception on their income, timing for purchasing durable goods, employment availability, commodity prices, food supply, interest rates, and saving condition. 100 indicates balanced confidence.

by 81.8 percent (y/y) in May 2020. Production capacity greatly diminished, leaving the unemployment rate soaring as layoffs mushrooming in many sectors.

10. **The impact of the pandemic was, nonetheless, heterogeneous across sectors, depending on each sector's reliance on social contact and mobility.** The stringent social restrictions imposed by the government to contain the spread of the COVID-19 virus dramatically affected those services involving direct contact between buyers and sellers, activities that gathered people in public places, traveling, and non-essential sectors involving physical interaction between employees. Meanwhile, business activities that could be undertaken remotely and those related to medical and pharmaceutical industries benefited from the pandemic.

11. **Weaker economic activities led to higher unemployment and poverty rates. As economic activities contracted significantly, layoffs increased, resulting in rising unemployment.** The unemployment rate surged to 7.1 percent in August 2020, well above its initial level in August 2019 of 5.2 percent. Deteriorating labor market conditions were also seen in an elevated share of informal workers, reflecting lower and more insecure incomes. Meanwhile, the COVID-19 pandemic caused the poverty rate to increase from 9.2 percent in September 2019 to 10.2 percent in September 2020.

12. **In the financial sector, investor confidence was disrupted due to sudden capital flight.** The Indonesia Stock Market plummeted, while the Indonesian rupiah (IDR) saw its largest depreciation since the Asian financial crisis in 1998, weakening from IDR 14,318/US$ to IDR 16,575/US$. A slowdown in economic activities increased the level of non-performing loans (NPL) or loans at risk. The Financial Services Authority eased credit restructuring for debtors affected by the pandemic. It also granted a more lenient approach for determining asset quality for SMEs with POJK No.11/2020 to lower the NPL surge. Companies' revenues and profitability dropped, and many employees had to be furloughed or put on temporary leave to reduce labor and overhead costs.

13. **One year after the COVID-19 outbreak, the economy started to show signs of recovery.** After four quarters of contraction, the economy rebounded strongly, posted a 7.1 percent growth rate in Q2 of 2021. While acknowledging that the strong rebound was partly due to the low base effect, all the main contributors to the overall economy had been trending upwards since the trough in Q2 of 2020. This trend continued towards the end of 2021. Over the whole of 2021, the Indonesian economy posted positive growth of 3.7 percent. Indonesia is among the few countries whose output level in 2021 exceeded the pre-pandemic level (2019), at 1.6 percent higher. Exports and investment were above their pre-pandemic levels, while private consumption remained slightly below its pre-pandemic level. Trade and manufacturing sector output exceeded the pre-pandemic level on the production side. Agriculture was badly affected by the pandemic, while the mining sector benefited from rising commodity prices.

14. **Robust economic recovery was followed by lower unemployment and poverty rates.** More vigorous economic activities in 2021 created 2.6 million jobs. As a result, the unemployment rate declined from 7.1 percent in August 2020 to 6.5 percent in 2021.

With more people returning to the labor market, the poverty rate also declined and returned to a single-digit level, from 10.1 percent in 2020 to 9.7 percent in 2021.

15. **The recovery path of the COVID-19 crisis seems to have been remarkably short, but this depends to a large degree on COVID-19 development.** Compared with the Asian financial crisis of 1997/98, the recovery path from the COVID-19 crisis seems to be much quicker. While the Asian financial crisis needed around 20 quarters for the Indonesian economy to return to its pre-crisis level, the COVID-19 crisis only needs six quarters to level up its pre-pandemic level. The output of the main components, such as manufacturing, trade, and construction sectors, has already exceeded their pre-pandemic levels. However, the recovery path shows an oscillating pattern, depending on the COVID-19 situation. Effective measures to contain the pandemic are critically important, including accelerating the vaccination rollout.

16. **Reflecting on the recent escalating external headwinds, the financial sector remains relatively strong.** Faster-than-expected normalization of the US Federal Reserve's monetary policy has led to a much tighter global financial market. Triggered by persistent high inflationary pressures, the US Federal Reserve has accelerated its tapering policy, followed by the rate hike announced in mid-March 2022. It has also signaled a more hawkish monetary policy ahead. Several emerging economies have undertaken similar moves by raising their policy rates significantly. In addition, the Russia-Ukraine conflict has added another uncertainty to global financial markets. Nevertheless, Indonesia's financial sector has remained relatively stable, with a continued rally in the stock market to record a new high. The rupiah exchange rate has remained relatively stable. Rising commodity prices should benefit Indonesia and commodity prices could partly explain the factors behind Indonesia's stable financial market.

17. **Indonesia's banking sector has also proved to be relatively strong.** The credit restructuring program has helped domestic banks effectively withstand the economic turmoil due to the COVID-19 pandemic, while also boosting the liquidity of firms. As economic activities have strengthened, restructured credit has declined significantly. The credit guarantee scheme also fostered the recent trend towards rising credit growth, sustaining further economic recovery. Ample liquidity supported by solid deposit growth helped to ensure adequate support in demand for bank loans by businesses. At this juncture, the government plans to unwind fiscal policy support to avoid a crowding-out effect, which could hinder private sector recovery.

3. Policy measures in response to COVID-19

18. **Fiscal policy aims to address multi-dimensional challenges due to the COVID-19 pandemic.** Given the overarching impact of the COVID-19 pandemic, it was crucial to address all issues simultaneously. While health issues were the first priority, it was also critical to address socioeconomic risks by addressing demand and supply issues. Apart from the cost of cushioning the impact of the COVID-19 pandemic, first, the government

had to escalate its spending to address the health crisis, in particular, to upgrade health facilities and ensure adequate medical supplies, medicine, and vaccines. Parallel to the health measures, providing support to the poor, especially those working in the most affected sectors, together with protecting businesses, was equally important in preventing permanent damage to the economy. Thus, fiscal policy played a critically important role in addressing the COVID-19 crisis.

19. **An unprecedented fiscal policy was needed to respond to the COVID-19 crisis and the follow-up challenges.** The government took a bold and decisive step by issuing a Government Decree in Lieu of Law, giving greater flexibility to the government to take any possible measures necessary in an emergency. This was agreed by parliament subsequently and then fully regulated in law as Law No. 2/2020. Its main features include allowing the government to temporarily widen the fiscal deficit above 3 percent of GDP until 2022 and, among others, allowing Bank Indonesia, the central bank, to purchase government bonds in the primary market.

20. **The government initiated the COVID-19 Handling and National Economic Recovery Program (PC-PEN) and widened its budget deficit to tackle the COVID-19 pandemic and undertake countercyclical measures for the economy**. The PC-PEN is a comprehensive program directed to intervene in three key aspects: (i) providing support for health measures; (ii) cushioning the impacts of the COVID-19 pandemic for poor and vulnerable families; and (iii) supporting businesses to avoid widespread bankruptcies and, in turn, massive layoffs.

21. **In the health sector, the government presented a set of policies.** The government was fully aware that economic recovery would be impossible to sustain if the health sector issues were left unaddressed. Therefore, health intervention was seen as vital and was the primary focus. The interventions included providing expenses for COVID-19 treatment (all borne by the government), medical supplies, the expansion of health-care facilities, additional financial incentives for health workers and, most importantly, the vaccination rollout program.

22. **As the primary countercyclical tool, the government budget played a critical role through both demand and supply.** On the demand side, providing support to poor and near-poor families through various social assistance programs was also aimed at maintaining their purchasing power to boost aggregate demand. The social assistance programs included those already in place, together with new programs, allowing the government to expand the volume and the number of beneficiaries.[93] The government also introduced several new support schemes such as electricity tariff discounts, internet subsidies, wage subsidies, and the breakthrough program, Kartu PraKerja.[94] The government also attempted to stimulate new and quick employment opportunities

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93 Regular social protection programs including cash transfer program (PKH) and food card program

94 Kartu PraKerja was initially developed as a training facilitation program for Indonesian citizens that are looking for a job. Since it was launched during the COVID-19 pandemic, the government decided to add cash transfer benefits to all members, since most of them are fresh graduates or those who had experienced a job loss.

through public construction projects such as cash-for-work programs spread across regions, administered by central and local governments.

23. **As for the support for businesses, the government grouped them into three categories.** First, the government offered a series of tax incentives to help companies avoid liquidity pressures as revenues plummeted due to the pandemic, including the reduction in the corporate income tax, corporate income tax debt relief, income tax exemptions on imported goods, in-advance VAT returns, relaxation on MSME taxation, and exemptions on minimum electricity payments. Second, a credit crunch was inevitable amid the heightened risks due to the COVID-19 pandemic. The government and the financial sector authorities provide financing support, including fund placement in banks to be channeled to MSMEs with a significantly low interest rate, cash transfers to more than 12.8 million MSMEs that could not access bank loans, interest subsidies to more than 15.9 million businesses, and a credit guarantee scheme. Third, the government also provided boosters for domestic demand to encourage production activities in the automotive industries. Car sales increased sharply to an almost pre-pandemic average level, helping the domestic auto-parts industry.

24. **However, these pressing measures increased government spending.** The 2020 State Budget was mainly adjusted to incorporate the PC-PEN program of IDR 575.85 trillion (82.8 percent of the budget), equivalent to 3.7 percent of GDP. The 2020 PC-PEN was categorized into six clusters: (i) health: 10.9 percent of the total PC-PEN budget; (ii) social protection: 37.6 percent; (iii) support for MSMEs: 19.5 percent; (iv) line ministries and regional government programs: 11.3 percent; (v) support for corporations: 10.5 percent; and (vi) business incentives: 10.1 percent. Even though the package was implemented via revenue, expenditure, and "below-the-line" measures, the most significant chunk was delivered through the expenditure channel, amounting to around IDR 387.6 trillion or 2.4 percent of GDP. The 2020 PC-PEN program yielded significant government expenditure growth of 12.4 percent, or 2.2 percent more than the pre-pandemic budget.

25. **In 2021, the PC-PEN was immediately adjusted to tackle the rapid spread of the Delta variant.** The government's agility was the main factor behind the budget being easily modified. The PC-PEN budget was increased from IDR 699.43 to IDR 744.77 trillion. Soaring hospital bills were the leading cause of the budget revision. The previous year's social protection programs were also continued, supporting the recovery of poor households. Fortunately, with the strong collaboration of all parties, the Delta variant saw a relatively rapid decline. The PC-PEN spending in 2021 was recorded at IDR 658.6 trillion, or 88.4 percent of the allocated amount.

26. **The fiscal expansion was taken amid tumbling revenue as economic activities weakened.** Total government revenue dropped from 12.3 percent of GDP in the previous year to 10.7 percent of GDP (Table 5), corresponding to external shocks (i.e., sharp economic slowdown and falling commodity prices) and fiscal measures undertaken by the government (i.e., tax relief). Lower corporate profit, falling consumption, contracting imports, and rising unemployment will lead to, respectively, a fall in revenues from corporate and personal income taxes, consumption-based taxes, and international trade

taxes. Total tax revenue hit a record low in two decades at 8.3 percent of GDP, shrinking by 19.6 percent compared with 2019. This revenue shrinkage was mainly driven by a sizeable fall in income taxes. Falling commodity prices were also primarily reflected in the decline of the non-tax revenue, contributed primarily to natural-resources revenue, namely royalties. Non-tax revenue experienced a contraction of 15.9 percent in the same period.

27. **The substantial budget for the COVID-19 relief package has widened the government's fiscal deficit to its highest level in the past five decades, at 6.1 percent GDP in 2020 and 4.6 percent GDP in 2021.** This forced the government to improvise and to become more creative in securing the financing. Budget reallocation was one crucial step, showing the government's serious effort in adapting to the pressures. The capital flight that occurred during the pandemic limited the government's avenues for financing and manage the stability of the government bond market. Foreign ownership declined from 38.6 percent in 2019 to 25.2 percent in 2020, and trended down to 19.1 percent in 2021.

28. **The government initiated the synergy and collaboration with Bank Indonesia to secure low-cost but prudent financing schemes, following Law No. 2/2020.** Facing high uncertainties in the early phase of the pandemic, Bank Indonesia focused more on safeguarding the stability of the financial system. However, with a strong and robust financial sector, owing to post-global financial crisis reforms, along with subdued inflationary pressures, unconventional measures to support the government's efforts in tackling the COVID-19 crisis were undertaken. The government and Bank Indonesia instituted a joint decree[95] to collectively mitigate the impact of the pandemic and accelerate economic recovery through the so-called "burden-sharing scheme." This burden-sharing scheme was aimed at providing low-cost financing sources to contain the COVID-19 pandemic and support economic recovery programs. The system was developed such that the government and Bank Indonesia could still honor the market mechanism to maintain fiscal, as well as monetary, policy credibility and independence. Under this scheme, Bank Indonesia still had the flexibility and sovereignty on whether or not to hold the bond to its maturity. Aside from bond issuance, the government also withdrew multilateral and bilateral loans targeted to address COVID-19 interventions. Consequently, government debt increased sharply from 25.9 percent of GDP in 2019 to 39.4 percent in 2020.[96]

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95 Joint decree (SKB) I dated 16 April 2020, BI is allowed to purchase government bond in the primary market through auctions, additional auctions or Green Shoe Option (GSO), or Private Placement. SKB II dated 7 July 2020, the government and BI agreed on a burden-sharing scheme, including a BI contribution to bear the interest payments on several targeted scheme. SKB III dated 23 August 2021, the government and BI agreed to improve the financing scheme and to carry the scheme forward until the end of 2022.

96 In Indonesia rupiah terms. The significant increase was partly caused by the depreciation of IDR that pushed the foreign currency denominated bond or loan converted value to IDR.

4. Assessment of policy responses and future challenges

29. **This massive increase in government spending seems to have paid off, with the economy advancing further and paving the way to a recovery.** The PC-PEN program played a significant role in guiding the economy throughout this difficult period. Efforts to mitigate the more profound impacts of the pandemic were well-delivered. Social protection program expansion was able to cushion households' purchasing power, especially those in the bottom 20 percent. The net impact of government transfers to this group is estimated to have been adequate in compensating for the economic losses and even increasing their purchasing ability. Consequently, the 2020 PC-PEN is estimated to have saved more than 5 million people from falling into poverty. The Indonesian economy also managed to reroute on its recovery track. The economic trajectory was significantly improved from a contraction of 2.1 percent in 2020 to positive growth of 3.1 in 2021, marking Indonesia as one of the countries with a rapid recovery from the pandemic. Job openings have been convincingly strengthened as the unemployment rate declined from 7.1 percent in 2020 to 6.5 percent in 2021.

30. **The economic recovery continued in 2021, even though the post-holiday period and the Delta variant wave held back progress.** Once again, Indonesia experienced increasing cases in January 2021, forcing the government to re-impose tighter social restrictions. The pace of the recovery was slightly altered in the first two months of 2021. Then, the second COVID-19 wave peaked in Q3 of 2021, triggered by the Delta variant's more virulent and deadlier contagion. This phase was marked as the most severe period of Indonesia's pandemic journey. Nevertheless, the Indonesian economy was still able to grow in Q3 of 2021 by 3.5 percent (y/y), slower than 7.1 percent in Q2 of 2021. It is worth noting here that the economy managed to record quarter-to-quarter positive growth. The trend intensified in Q4, pushing the overall 2021 growth rate to 3.7 percent in 2021, compared with a contraction of 2.1 percent in 2020. With this achievement, Indonesia's output level could surpass the pre-pandemic level, making it one of the few countries to achieve a rapid recovery from the pandemic. It also created jobs convincingly, with the unemployment rate decreasing from 7.1 percent in 2020 to 6.5 percent in 2021.

31. **The government's capacity to respond and the private sector's ability to adapt to the fluctuations of the pandemic were key in nudging the Indonesian economy back onto a growth trajectory.** Besides social protection programs, parts of the PC-PEN program that were intended to spur the recovery on the supply side were also effective in bolstering economic recovery. Capitalizing on stable middle-income purchasing power and the tendency to accumulate wealth in banks and other financial market instruments during the pandemic, the government introduced tax incentives to stimulate demand. One of incentives was the borne-by-the-government car sales VAT. This policy turned around the automotive sector, both on the production and the trading sides. Retail car sales and production increased by 49.3 and 62.6 percent, respectively, in 2021. As a result, the automotive industry grew by 17.8 percent in real terms, in stark contrast to the 2020 contraction of 19.9 percent.

32. **Securing fiscal consolidation in 2023 will be critical in mitigating the mounting budgetary pressures as the Indonesian economy recovers.** As the private sector has started to regain its traction, the government is aiming to gradually wind down its policy support. Reducing the fiscal deficit also means avoiding the crowding-out effect in the financing market to allow the private sector to continue to expand. As mandated by Law No. 2/2020, the fiscal deficit rule of a maximum 3.0 percent of GDP will need to be re-enforced, while the burden-sharing scheme with Bank Indonesia needed to be closed. The rapid increase in government debt to an alarming level of around 40 percent of GDP underscores the urgency of fiscal consolidation to preserve prudent fiscal management. Moreover, since interest payments have grown significantly, lowering debt affordability is critical to creating more fiscal space to support development needs and facilitate further structural reforms going forward.

33. **The lower 2022 budget deficit aims to transition the economy towards fiscal consolidation in 2023.** The 2022 fiscal package is directed at accelerating economic recovery further, while at the same time providing adequate space to anticipate further shocks from the COVID-19 pandemic. The 2022 budget deficit target is set at 4.85 percent of GDP. The government has allocated IDR 1,944.5 trillion for 2022 expenditure, 2.6 percent lower than the 2021 audited spending. Several reforms in public finance management (PFM) will be carried out in the 2022 budget to strengthen government spending, including reforms to energy subsidies, social protection programs, and intergovernmental fiscal transfers.

34. **The PC-PEN has been continued into 2022 in order to ensure the last mile of pandemic relief.** As the economic recovery progresses and the pandemic is thought to be transitioning into an endemic, the PC-PEN policy direction needs to become more targeted. Its size is gradually being reduced to pave the way for a smooth and safe fiscal consolidation in 2023. As the recovery strengthens and the pandemic transitions into an endemic, the PC-PEN main focus is to shift towards more selected and targeted schemes. In 2022, it mainly bolsters production and employment recovery, while maintaining COVID-19-related treatment and social protection programs. Essential tax incentives are provided for selected sectors that are still experiencing hardship, such as accommodation and transportation services, while demand-side stimulus, investment, and labor-intensive programs are extended. Meanwhile, the vaccination program has been continued in order to achieve its coverage target of 70 percent of the population in 2022. Allocation for treatment and incentives for health care is also reserved to anticipate the risk of new COVID-19 variants. The government's commitment to bolstering inclusive recovery is also reflected by maintaining the entire program and preserving extra allocation when needed. Social assistance and cash-for-work programs have been extended to accelerate an inclusive economic recovery. Unemployment insurance is also newly developed to be an automatic stabilizer tool.

35. **Government revenue in 2022 is expected to parallel the substantial tax collection in 2021.** In 2021, the Directorate General of Taxes exceeded its initial target expectation by gaining 103.9 percent of its initial target, growing 19.2 percent compared with the previous year. Substantial economic recovery and commodity price hikes contributed

to increasing revenue collection, including taxation in 2021. As economic recovery continues in tandem with higher commodity prices, government revenue collection is expected to continue in 2022. In addition, the implementation of tax reform, which includes the VAT tariff hike, the introduction of the carbon tax, and the voluntary declaration program, will help to broaden the tax base and improve tax performance even further this year. The tax ratio is projected to strengthen from 9.1 percent in 2021 to above 10 percent in 2022.

36. **The general direction of financing policies is to capitalize on domestic resources, while also promoting the market optimism based on Indonesia's economic potential.** As the recovery has continued, banks' ownership of government bonds—banks' holding during the pandemic increased noticeably from 20.1 percent in 2019 to 35 percent on average in 2020–22—is expected to decrease, channeling the excess funds into the real sector. This year will also be the last year of Bank Indonesia's participation in the primary market and the burden-sharing scheme. While Bank Indonesia's policy normalization confronts the uncertainties of global markets, raising budget funding from other domestic resources is a high priority. Here, the government is trying to develop creative and innovative financing by deepening the domestic market. On the other hand, the significant improvement in tax collection could help to reduce the financing needs from the financial market. Therefore, the financing strategy transition from extraordinary measures, including Bank Indonesia's burden-sharing scheme, towards a normal market orientation should be smooth and well-organized.

37. **Indonesia keeps learning from every economic cycle.** The COVID-19 pandemic has taught a very important lesson in moving forward. This event has created excellent momentum for the economy to transform further. The structural reform agenda is critical to carrying through on the dream to become a high-income country by 2045. But first, inclusive and comprehensive economic recovery has to be ensured, building a solid foundation on which the economy can progress further.

Appendix 1. Selected Figures

Figure 1 Indonesia COVID-19: Daily Cases

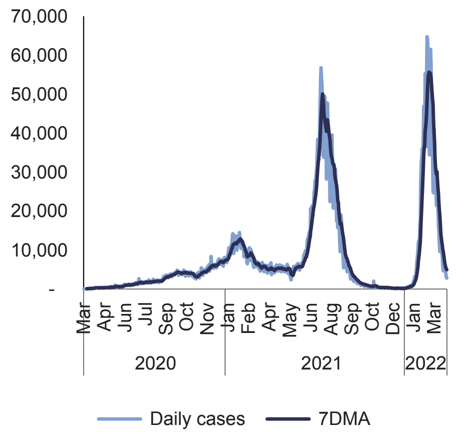


Figure 2 Indonesia COVID-19: Death Rate

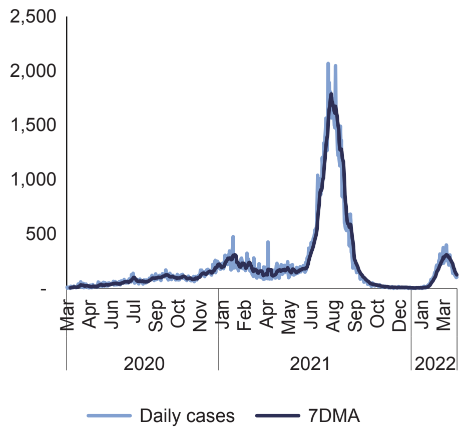


Figure 3 Indonesia COVID-19: Daily Doses Vaccination

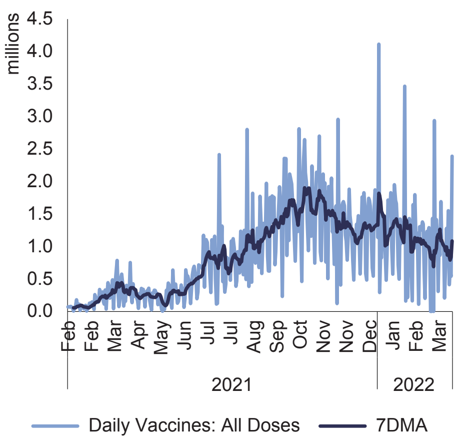


Figure 4 Google Mobility Index

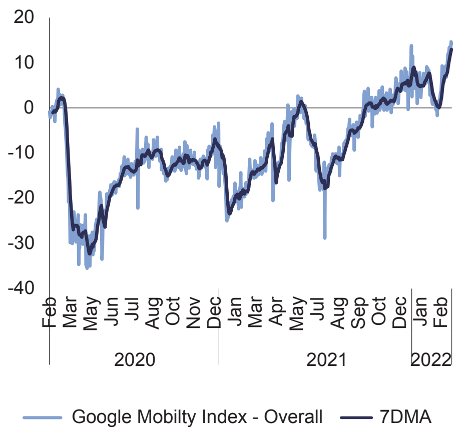


Figure 5 GDP Growth: Demand Side

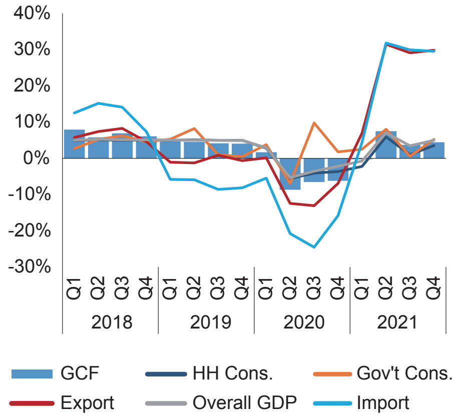


Figure 6 GDP Growth: Production Side

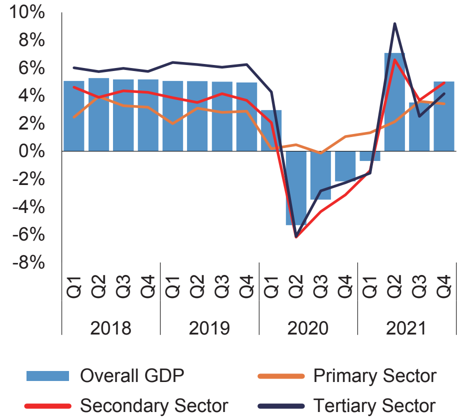


Figure 7 Inflation Rate

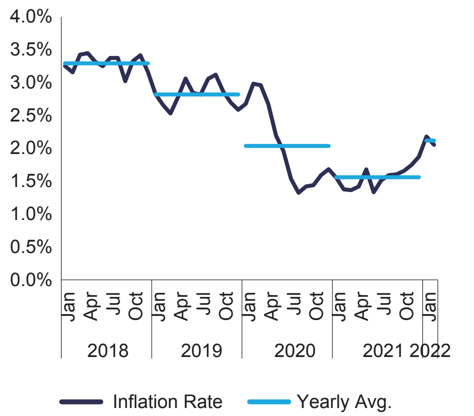


Figure 8 Trade Balance

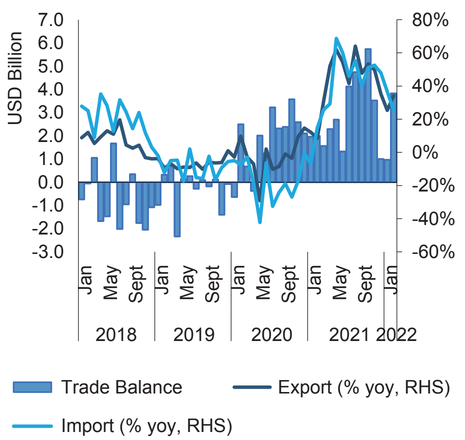


Figure 9 Balance of Payment (% of GDP)

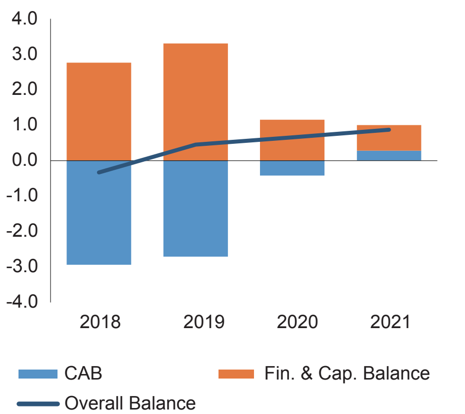


Figure 10 Foreign Exchange (US$/IDR)

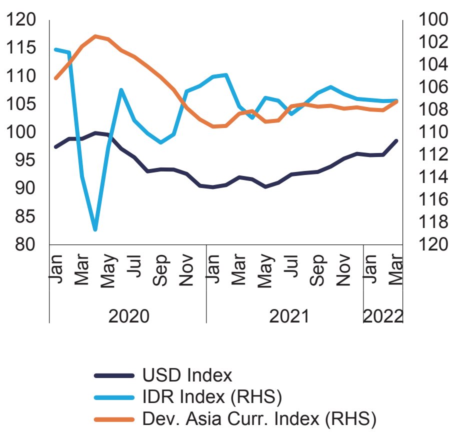


Figure 11 Fiscal Deficit and Government Debt (% of GDP)

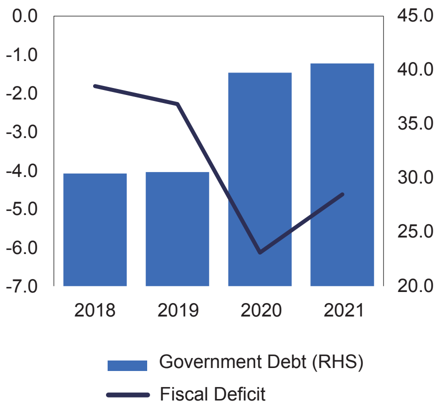


Figure 12 Central Government Expenditure (% of GDP)

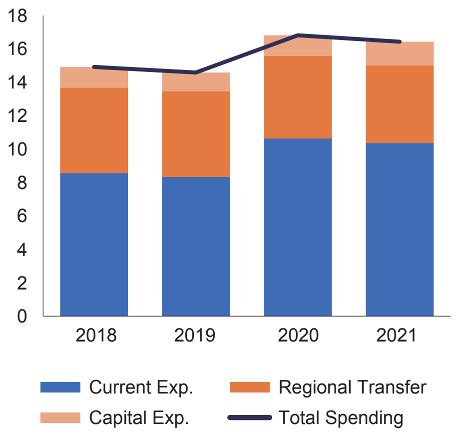


Figure 13 Tax Ratio (% of GDP)

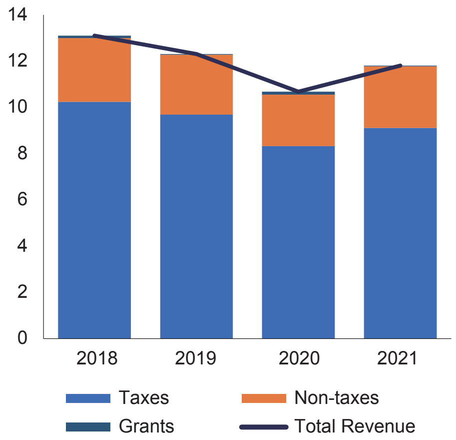
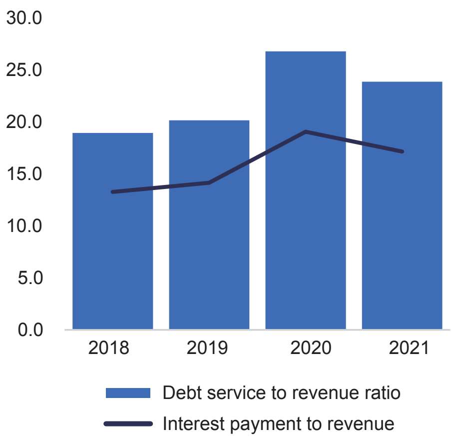


Figure 14 Interest Ratio (% of revenue)



Appendix 2. Selected Tables

Table 1 Fiscal position, 2018–2021

(IDR trillion)	2018	2019	2020	2021
Revenue	1,943.7	1,948.0	1,647.8	2,003.1
Domestic revenue	1,928.1	1,942.5	1,629.0	1,998.5
Tax	1,518.8	1,533.5	1,285.1	1,546.5
Domestic tax	1,472.9	1,492.5	1,248.4	1,473.0
Taxes on international trade	45.9	41.1	36.7	73.5
Non-Tax	409.3	409.0	343.8	452.0
Grants	15.6	5.5	18.8	4.6
Expenses	2,213.1	2,309.3	2,594.2	2,786.8
Central government	1,455.3	1,496.3	1,833.0	2,001.1
Compensation of employees	346.9	376.1	380.5	387.6
Use of goods and services	347.5	334.4	422.3	526.6
Consumption of fixed capital	184.1	177.8	190.9	241.5
Interest payment	258.0	275.5	314.1	343.5
Subsidies	216.9	201.8	196.2	243.1
Grants	1.5	6.5	6.3	4.3
Social benefits	84.3	112.5	202.5	173.6
Other expense	16.2	11.7	120.0	80.8
Regional transfer	757.8	813.0	761.2	785.7
Primary balance	-85.3	-183.4	-755.5	-542.2
Overall balance	-269.4	-361.3	-946.4	-783.7
Financing	305.7	402.1	1,193.3	868.6
Debt financing	372.0	437.5	1,229.6	867.4
Government bonds	358.4	446.3	1,177.2	877.5
Loan	13.6	-8.7	52.5	-10.1
Investment	-61.1	-44.4	-104.7	36.1
Another financing/investment	-5.2	8.9	68.4	102.9
Financing surplus/deficit	36.2	53.4	245.6	84.90

Note: 2021 figure is temporary and unaudited.

Table 2 2020 fiscal policy package

Program (in IDR trillion)*	Sub-Program	Objectives
1. Health measures 2020: 62.7 *Budget: 99.5*	(1) incentives for health officials, (2) death benefits for medical workers, (3) COVID-19 mitigation and prevention, (4) subsidy for BPJS premium, (5) COVID-19 task force expenses, and (6) tax incentives on medical supplies and medicines.	To control the spread of the disease and strengthen the health care system in dealing with the pandemic.
2. Supports for Micro and Small Medium Enterprises (MSMEs) 2020: 112.3 *Budget: 116.3*	(1) interest rate subsidy, (2) working capital guarantee, (3) return guarantee, (4) investment financing for cooperatives, (5) fund placement for credit restructuring, and (6) final income tax break facility.	To soften the impact of the COVID-19 pandemic by reducing the financial stress faced by MSMEs, which is hoped to prepare them to jump-start their businesses when the pandemic is under control.
3. Social safety net 2020: 216.6 *Budget: 230.2*	(1) Family Hope Program/cash transfer (PKH), (2) food card (Kartu Sembako), (3) staple food package assistance for JABODETABEK (Greater Jakarta) area, (4) Cash transfer for Non-JABODETABEK area, (5) Pre-work card program (Kartu Prakerja), (6) direct cash transfer from village fund (BLT-Dana Desa), (7) electricity bill discount, and (8) reserved fund for food security.	To expand and complement the existing social assistance programs in cushioning the impact of the COVID-19 pandemic on poor and vulnerable families.
4. Tax relief and incentives 2020: 58.4 *Budget: 120.6*	(1) income tax relief for employees in selected sectors, (2) income tax exemption for import of goods, (3) reductions of income tax installments, (4) accelerated refund for value-added tax, (5) income tax reduction for corporates, and (6) other incentives.	To reduce the tax burden of corporations to ease their cash flow problem during the pandemic and/or to encourage demand.
5. Support for sectoral & regional government 2020: 65.2 *Budget: 67.9*	(1) labor-intensive programs in the Ministry of Public Works and Public Housing, Ministry of Agriculture, and Ministry of Marine Affairs and Fisheries, (2) extension of housing credits, (3) tourism sector supports, (4) regional economic recovery program, (5) additional specific fund for housing and agriculture, (6) regional financing facility, and (7) reserve fund for other regional activities.	To keep labor-intensive public works moving to create jobs while at the same time developing basic infrastructure in the region.
6. Corporate financing 2020: 60.7 *Budget: 60.7*	(1) capital injection to state-owned enterprises (SOEs), (2) bailout investment for working capital, and (3) credit restructuring for labor-intensive corporations.	To assist SOEs to keep running their businesses and workers from layoffs and allow them to contribute to softening the impact of the crisis.

* 2020 figures are based on the audit report.
Source: Ministry of Finance.

Table 3 2021 fiscal policy package

Program (in IDR trillion)*	Sub-Program	Objectives
1. Health measures 2021: 198.5 *Pre-delta variant budget: 193.9* *Post-delta variant budget: 215.0*	(1) incentives and death benefits for health workers, (2) COVID-19 treatment, tracing, tracking, (4) emergency healthcare facilities, (5) vaccination program, (6) tax incentives on medical supplies and medicines, and (7) government health insurance premium subsidy for low-income households	To control the spread of the disease, provide free vaccines, and strengthen the health care system in dealing with the pandemic.
2. Supports for Micro and Small Medium Enterprises (MSMEs) and Corporations 2021: 116.2 *Pre-delta variant budget: 177.8* *Post-delta variant budget: 162.4*	(1) interest rate subsidy, (2) working capital guarantee, (3) MSMEs non-repayable financing, (4) investment financing for corporations and SOEs, and (5) fund placement to provide low-cost MSME loan	To jump-start businesses and to support cashflow during the Delta variant period
3. Social safety net 2021: 171.0 *Pre-delta variant budget: 153.9* *Post-delta variant budget: 186.6*	(1) Family Hope Program/cash transfer (PKH), (2) food card (Kartu Sembako), (3) staple food package assistance for JABODETABEK (Greater Jakarta) area, (4) Cash transfer for Non-JABODETABEK area, (5) Kartu Prakerja program, (6) direct cash transfer from village fund (BLT-Dana Desa), (7) electricity bill discount, (8) internet subsidy for schooling, (9) wage subsidy, and (10) extra support for households in extreme poverty	• To expand and complement the existing social assistance programs in cushioning the impact of the COVID-19 pandemic on poor and vulnerable families • To alleviate extreme poverty
4. Tax relief and incentives 2021: 67.7 *Pre-delta variant budget: 62.8* *Post-delta variant budget: 62.8*	(1) income tax relief for employees in selected sectors, (2) income tax exemption for imported goods, (3) reductions of income tax installments, (4) accelerated refund for value-added tax, (5) income tax reduction for corporates, (7) borne-by-the government sales tax for home and car purchases, and (8) other incentives.	• To reduce the tax burden of corporations to ease their cash flow problem during the pandemic • To encourage demand and consumption recovery
5. Priority programs 2021: 105.4 *Pre-delta variant budget: 117.0* *Post-delta variant budget: 117.9*	(1) labor-intensive programs in the line ministries and regional government, (2) tourism sector supports, (4) extending food security programs, (5) development of industrial areas, (6) ICT infrastructure development, and (7) loan for the regional government through PT. SMI	• To encourage labor-intensive activities • To support economic recovery in the region • To prepare the enabler for a more robust economic recovery

* 2021 figures are temporary and unaudited realization.
Source: Ministry of Finance.

Table 4 2022 fiscal policy package

Program (in IDR trillion)*	Sub-Program	Objectives
1. Health measures 2022: 122.5	(1) COVID-19 handling, including incentives for health officials, testing and tracing, incentives for healthcare, medical supply, (2) vaccination program, (3) others, including tax incentives for medical supply, earmarked regional transfer for COVID-19 handling, reserves	To control the stability of pandemic conditions and mitigate potential risks of any emergence of new variants.
2. Social safety net 2022: 154.8	(1) regular primary programs (cash transfer, food card, Kartu Prakerja), (2) internet subsidy, (3) unemployment insurance, and (4) programs to alleviate extreme poverty	To maintain the purchasing power recovery and to anticipate other dynamics.
3. Economic recovery program 2022: 178.3	(1) labor-intensive programs in the line ministries, (2) support for the tourism sector, (3) food security development, (4) infrastructure projects, (5) industrial area development, (6) support for MSMEs, (7) tax incentives, and (8) others priority programs	To stimulate economic recovery, especially from the production side, bolster employment.

Source: Ministry of Finance.

Table 5 Selected macroeconomic indicators

	2018	2019	2020	2021
Real Sector				
National Income and Prices				
(annual growth, % YoY, otherwise stated)				
Real GDP	5.2	5.0	-2.1	3.7
Nominal GDP	9.2	6.7	-2.5	9.9
GDP deflator	3.8	1.6	-0.4	6.0
Consumer price inflation (period average)	3.2	3.0	2.0	1.6
External Sector				
Trade Balance *(US$ billion)*				
Exports, fob	180.7	168.5	163.4	232.8
Imports, cif	181.0	164.9	135.1	189.0
Balance of Payment *(% of GDP)*				
Current account balance	-2.9	-2.7	-0.4	0.3
Financial and capital account balance	2.8	3.3	1.2	0.7
Overall balance *(US$ billion, otherwise stated)*	-0.3	0.5	0.7	0.9

	2018	2019	2020	2021
Gross international reserves	120.7	129.2	135.9	144.9
In months of imports of goods & services	6.6	7.6	10.2	8.0
The short-term debt of remaining maturity	2.3	2.5	2.6	2.8
General government sector *(% of GDP)*				
Total Revenue	13.1	12.3	10.7	11.8
Taxes	10.2	9.7	8.3	9.1
Non-taxes	2.8	2.6	2.2	2.7
Grants	0.1	0.0	0.1	0.0
Total Spending	14.9	14.6	16.8	16.4
Central government spending	9.8	9.5	11.9	11.8
Transfer to regional government	5.1	5.1	4.9	4.6
Primary Balance	-0.6	-1.2	-4.9	-3.2
Overall Balance	-1.8	-2.3	-6.1	-4.6
Government Debt *(% of GDP, otherwise stated)*				
Public Debt (IDR trillion)	4,466.2	4,786.6	6,079.2	6,911.3
LCY Govt Debt (IDR trillion)	2,608.8	2,971.5	4,038.2	4,836.1
FCY Govt Debt (IDR trillion)	1,857.4	1,815.1	2,041.0	2,075.2
Debt to GDP ratio	30.4	30.6	39.8	40.6
Debt service to revenue ratio	18.9	20.2	26.8	23.9
Interest payment to revenue	13.3	14.1	19.1	17.1
Monetary sector				
Broad money (annual growth, % y/y)	6.3	6.5	12.5	13.9
Loan to deposit ratio	93.7	96.2	96.3	97.5
Domestic credit (annual growth, % y/y)	11.2	5.4	3.7	9.6
Of which: Private sector	12.5	5.5	-1.7	5.4
Memorandum items				
Exchange rate (IDR/US$) - period avg	14,236.9	14,151.5	14,581.7	14,309.8
Nominal GDP (US$ billion)	1,042.3	1,118.8	1,058.7	1,186.0
Nominal GDP (IDR trillion)	14,838.8	15,832.7	15,438.0	16,970.8
GDP Per Capita (US$, current)	3,906.6	4,151.2	3,890.3	4,317.5
GNI Per Capita (US$, current)	3,791.1	4,025.9	3,784.1	4,201.1

Note: FCY = foreign currency; LCY = local currency

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2022 KIPF-AMRO Joint Research

The Impact of COVID-19 on Regional Economies and Policy Responses

Chapter

7

Korea

Chapter 7

Korea[97]

Korea experienced a total of five outbreaks of the pandemic since the first case of COVID-19 occurred in the country on 20 January 2020 through to the end of 2021. In order to stop the spread of the COVID-19 virus, a quarantine system was established and responded based on the 3T strategy, Test, Trace, and Treat. In addition, efforts were made to reduce COVID-19 transmission through social-distancing measures, and vaccines were supplied to fight with the COVID-19 virus from February 2021. In Q1 of 2020, when the first case was confirmed, the services sector growth rate decreased, but the impact on aggregate output was constrained. The output growth rate fell below zero and turned considerably negative in Q2 of 2020 as the manufacturing sector and private consumption decreased sharply. To mitigate the economic downturn, the Korea actively used easing monetary policy and financial policies to support small businesses and SMEs. The fiscal authorities also responded to the COVID-19 pandemic through an active fiscal policy. From 2020 to 2021, a total of KRW 114.8 trillion in supplementary budget funding was organized six times. Due to the expansionary fiscal policy, the current account deficit increased to 4.4 percent of GDP in 2021, while the government debt increased to 47.3 percent of GDP in 2021. As the Omicron variant, which spread rapidly in early 2022, has been on the decline since May, the Korea is now attempting to return to normal daily life, both socially and economically. In this situation, it is also necessary for the fiscal authorities to recover their exhausted fiscal space. To this end, efforts are needed to reduce the speed and level of public debt growth by setting the total expenditure growth rate lower than the total revenue growth rate over the next three to five years.

1. COVID-19 development

1. **Following the first COVID-19 case detected in early 2020, the Korea has experienced five COVID-19 outbreaks.** Two COVID-19 waves or outbreaks occurred in 2020, and the third and fourth waves occurred in 2021. Currently, the Korea is in the midst of its fifth wave, in mid-2022, which has turned out to be the most severe wave. This fifth COVID-19 wave occurred after the Gradual Recovery to a New Normal was implemented (Figure 1).

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2. **The start of the first outbreak and COVID-19 wave occurred on 18 February 2020.** As of 25 March 2020, 55.6 percent (5,080) of the total 9,137 cumulative confirmed cases were related to the religious group. Through a revision of the Infectious Disease Prevention and Management Act, the Korean government strengthened the penalty for a suspected infected person refusing to be diagnosed. The Seoul Metropolitan Government also banned all large gatherings during February 2020 to prevent the spread of the virus.

3. **The second COVID-19 wave was caused by a mass infection of the virus at the Sarang Jeil Church in Seoul, causing an outbreak in the metropolitan area.** The Seoul Metropolitan Government issued a restrictive administrative order affecting 7,560 religious facilities in downtown Seoul for two weeks from 15 to 30 August 2020. As of midnight on 24 August, it became mandatory to wear a face mask.

4. **The third COVID-19 wave began with a surge in the number of new confirmed cases from fewer than 100 cases by the end of October 2020.** On 13 December, 1,030 new confirmed cases occurred, recording a four-digit number of confirmed cases for the first time, and on 25 December 1,241 confirmed cases were detected, the highest number ever in 2020. The reason for the surge in cases was that the quarantine measures had been eased too hastily, with social distancing falling back to stage 1, while the second wave of the pandemic was still not completely over. On 8 December 2020, the government raised social distancing to stage 2.5, and banned gatherings of five or more people from 23 December to 5 January 2021.

5. **The fourth wave occurred as the number of new confirmed cases surged due to the high mobility of the young generation and the spread of the Delta variant.** Since July 2021, the number of new confirmed cases increased to over 2,000. The government imposed strengthened quarantine measures, such as raising the degree of social distance to four levels across the metropolitan area and allowing only four people in private gatherings before 18:00 and only two people after 18:00.

6. **The fifth wave developed into the Korea's largest wave, with the number of confirmed cases exceeding 30,000 since 2 November 2021, due to the emergence of the Omicron variant with its high transmissibility but relatively low fatality rates.** On 22 January 2022, the number of positive cases increased to 7,005 cases and then 13,008 cases on 26 January, exceeding 10,000 for the first time. From 3 January 2022, the most powerful social-distancing restrictions were initiated, such as applying the six-month validity period of the quarantine pass, prohibiting private gatherings of more than five people, and restricting the hours of use at restaurants and cafes from 5:00 to 21:00.

7. **Prior to the outbreak of the Omicron variant, COVID-19 quarantine in the Korea was carried out in the 3T, 'Test, Trace, Treat' method.** 'Test' refers to the expansion of testing capabilities; the Korea tested up to 40,000 cases a day before the outbreak of the Omicron variant. 'Trace' is to quickly track the movement of the confirmed patient. In Trace, the Korea's IT and communication infrastructure was utilized to its fullest extent. 'Treat' means rapid quarantine treatment of confirmed COVID-19 patients. This was conducted through a dual method that treated mild patients in a residential treatment center, and patients

with moderate or severe symptoms with isolation in special treatment beds.

8. **At the beginning of 2022, the 3T strategy was virtually suspended as the Omicron variant spread significantly.** PCR testing were only available to the elderly and high-risk groups aged 60 or older, while patients with mild symptoms were tested through self-test kits and home treatment was conducted. COVID-19 treatment drugs were supplied to the elderly and home patients in the high-risk group. As the number of confirmed cases decreased from mid-March 2022, the social-distancing measures were greatly eased after mid-April. The COVID-19 virus was lowered to a second-class infectious disease at the end of April 2022.

9. **The social-distancing stage—the core of the quarantine policy—was adjusted several times depending on the COVID-19 situation.** The initial social-distancing policy began with the establishment of regulatory measures for multi-person facilities. Subsequently, it was adjusted to a three-stage plan that included social distancing in daily life. In June 2020, a unified social-distancing system was introduced and organized, first in 2.5 stages, and later into four stages. In November 2020, when the third pandemic wave was underway, the social-distancing stage was expanded to five stages. In July 2021, when the fourth pandemic wave began, the social-distancing stage was simplified to four stages once again.

10. **In the Korea, after starting the rollout of COVID-19 vaccinations on 26 February 2021, 86 percent of the first vaccination, 83 percent of the second vaccination, and 36 percent of the booster shots were achieved by the end of 2021.** In the early days of the vaccination rollout, there was a shortage of vaccines around the world, which disrupted the government's vaccination plan. However, with the support of high-quality administrative power using e-government, a well-designed public health system, and a well-equipped medical system, the vaccination rate exceeded 80 percent, recording the highest vaccination rate in the world (Figure 2).

2. The economic impact of the pandemic

11. **The real GDP growth rate fell the most in Q2 of 2020, but recovered to a positive growth rate from Q3 of 2020 and continued into 2021.** Output growth began to fall to -1.27 percent in Q1 of 2020 and fell to -3.2 percent in Q2 of 2020. From Q3 of 2020, the growth rate recovered to an average of 1 percent in 2021 (Figure 3).

12. **Looking at the sectoral growth rate, the decline in the services sector was the largest, at 2.5 percent in Q1 of 2020, the early stage of the COVID-19 pandemic, and the decline in the growth rate of the manufacturing sector was 9.4 percent in Q2 of 2020.** As a result of a sharp drop in people's mobility in the early days of the COVID-19 pandemic, the services sector growth rate fell, but it recovered in Q2 of 2020 and maintained a positive rate until Q4 of 2021. The manufacturing sector fell sharply in Q2 of 2020, driving a significant drop in real GDP growth. The decline in the growth rate in

the construction sector has been recovering since reaching -4.5 percent in Q3 of 2020. Although their shares of real GDP are low, the agriculture and mining sectors also fell significantly to -8.6 and -4.8 percent, respectively, in Q2 of 2020.

13. **The aggregate consumption growth rate fell the most in Q1 of 2020, showing -4.56 percent, but the growth rate rebounded from Q2 of 2020.** Aggregate consumption shrank significantly due to the pandemic, but recovered in Q2 of 2020, when aggregate output fell the most. As the third pandemic wave occurred in Q4 of 2020, aggregate consumption became a negative 1.07 percent. Aggregate consumption maintained an average growth rate of 1.66 percent in 2021 (Figure 3).

14. **The real investment growth rate followed a similar trend to the real GDP growth rate.** The real investment growth rate was -0.87 percent in Q2 of 2020. However, the growth rate recovered from Q3 of 2020, and the growth rate rose to 2.47 percent in Q1 of 2021. In Q3 of 2021, between the fourth and fifth pandemic waves, the real investment rate contracted by -2.24 percent and registered the largest negative growth (Figure 3).

15. **The economic recession caused by the COVID-19 pandemic was different from the conventional recession due to supply-side shock.** The recession caused by the supply-side shock resulted in a sharp decrease in aggregate investment and output, and then a decrease in aggregate consumption over time. Because of the consumption smoothing motive, the decrease in aggregate consumption was less than the decrease in the aggregate investment or output. However, the COVID-19 recession contrary to the conventional recession, aggregate consumption plunged first, and then total investment and output decreased.

16. **The COVID-19 recession was different from the 2008/09 global financial crisis.** At the time of the global financial crisis, aggregate output, investment, and consumption fell at the same time in Q1of 2009. Aggregate investment dropped the most, while aggregate consumption fell the least. The global financial crisis illustrated the recession pattern as a result of a supply-side shock. On the other hand, in the COVID-19 recession, aggregate consumption fell sharply first, and then aggregate output fell, while investment increased slightly (Figure 4).

17. **As the movement of people decreased rapidly due to the pandemic, aggregate consumption decreased first.** Aggregate consumption shrank first as social-distancing measures and quarantine were used as major health policies. The decrease in aggregate output not only occurred later than the decrease in aggregate consumption, but also dropped relatively less than consumption. Even in Q4 of 2020, aggregate consumption declined, but aggregate output and investment did not.

18. **The dynamics of aggregate consumption and investment relative to GDP were also different from past recessions.** In Q1 of 2020, aggregate consumption relative to GDP decreased sharply, while aggregate investment relative to GDP increased. In addition, in Q4 of 2020 and Q1 of 2021, the consumption to GDP ratio collapsed sharply, whereas the investment to GDP ratio surged. These patterns of the COVID-19 recession imply that it is

necessary for the government to come up with a stabilization policy that could well be quite different from policies used in previous recessions.

19. **By dividing aggregate consumption into private and public consumption, we can judge that fiscal policy did not play a proper stabilization role.** Private consumption rapidly decreased in Q1 of 2020, the early days of the pandemic, but public consumption showed a gradual trend. In Q4 of 2020, when private consumption grew negatively, public consumption also fell. Meanwhile, public consumption rose in Q2 of 2021, while private consumption recovered. We can presume that the countercyclical fiscal policy did not work properly, given that public consumption moved more in sync with private consumption (Figure 6).

20. **The labor market variables, employment and unemployment rates, were less volatile than macroeconomic variables during the COVID-19 crisis.** The employment rate in Q1 and Q2 of 2020 was 60 percent, down 1.5 percent from just before the pandemic, but it was similar to the same quarters in 2019. The unemployment rate rose to 4.2 and 4.4 percent at the time, but it did not rise significantly compared with the same quarter in 2019. The employment rate was 58.6 percent in Q1 of 2021, down 1 percent from Q1 of 2019, the pre-pandemic year. Labor market variables were slightly worse than in the pre-pandemic period, but the decline was less than that of aggregate consumption or output (Figure 7).

21. **The Consumer Price Index (CPI) inflation rate has sharply risen since 2021, whereas the GDP deflator growth rate has risen since Q2 of 2020.** The CPI inflation rate was low in 2020, but rose sharply to 1.4 and 2.4 percent in Q1 and Q2 of 2021, respectively, and rose to 3.6 percent in Q4 of 2021.

3. Policy measures in response to COVID-19

22. **As part of the monetary policy response to the COVID-19 pandemic, the Bank of Korea (BOK), the central bank, lowered its base rate from 1.25 percent pre-pandemic to 0.5 percent in May 2020.** In August 2021, the base rate was raised to 0.75 percent and then continuously increased to recover 1.25 percent, the level of the pre-pandemic interest rate, in January 2022. Recently, the base rate has risen to 1.75 percent by raising 0.25 of a percentage point twice in April and May 2022 to cope with inflationary pressures. In addition to lowering the base rate, the BOK also signed a US$60 billion currency swap agreement with the Federal Reserve Board in the United States, expanded the supply of liquidity, and expanded securities and institutions subject to open market operations.

23. **As exports and domestic demand declined due to the pandemic, and financial market instability increased, the Financial Services Commission implemented financial policies in response.** The Commission focused on maintaining stability in the financial system by building a thick firewall and preventing issues in the real sector from spreading

to the financial sector. A new funding program was introduced for small business owners and SMEs directly or indirectly affected by the pandemic. From March 2020, KRW 175 trillion in financial countermeasures were prepared. These countermeasures focused on preventing the spread of anxiety by operating large-scale programs to the fullest extent possible by making use of available policy capacity.

24. **To respond to the COVID-19 outbreak, the Korean government implemented four supplementary budgets in 2020 and two more in 2021, overall amounting to KRW 66.8 trillion in 2020 and KRW 48 trillion in 2021.** The 2020 supplementary budget was twice as large as the supplementary budget introduced in 2008/09 in response to the global financial crisis. The supplementary budgets were mainly designed to support households and small business owners who were directly hit by the COVID-19 shock. Since the spread of the COVID-19 virus was expected to slow in late 2020, the economic stimulus package for economic recovery was an important item in the supplementary budget in 2020. However, as the spread of the COVID-19 virus continued and social-distancing measures were maintained into 2021, the supplementary budget in 2021 emphasized health measures such as purchasing COVID-19 vaccines.

25. **The first supplementary budget in 2020 was for a total KRW 11.7 trillion in March 2020.** Of the KRW 11.7 trillion total, KRW 8.5 trillion was added for new spending, while KRW 3.2 trillion was used to make a revenue adjustment. The budget consisted of four items: (i) setting up disease control efforts (KRW 2.3 trillion); (ii) supporting small merchants and SMEs (KRW 2.4 trillion); (iii) supporting consumption and employment (KRW 3.0 trillion); and (iv) supporting local economies hit by the COVID-19 outbreak (KRW 0.8 trillion).

26. **The second supplementary budget in 2020 was proposed to finance an emergency relief payment of KRW 7.6 trillion.** The budget was designed to support households in the bottom 70 percent income bracket, although this was later changed by Congress to support all households. The final amount passed by Congress for KRW 12.2 trillion was paid out to 21.71 million households. KRW 1.0 million was paid to households with more than four family members. The emergency relief payment was financed by issuing government debt (KRW 3.4 trillion) and restructuring government expenditure (KRW 8.8 trillion).

27. **The third supplementary budget worth KRW 35.3 trillion in 2020 was proposed to support employment and finance economic stimulus packages, as well as to make a further revenue adjustment.** Among the KRW 35.3 trillion total, KRW 11.4 trillion was for a revenue adjustment, while KRW 23.9 trillion was for new spending. The budget was composed of five items: (i) supporting marginal firms and financing for job retention programs (KRW 5.0 trillion); (ii) improving job security and expanding social safety nets (KRW 9.4 trillion); (iii) helping to revive the economy (KRW 11.3 trillion); (iv) the Korean New Deal [KRW 5.1 trillion, Digital New Deal (KRW 2.7 trillion) + Green New Deal (KRW 1.4 trillion) + Job Security (KRW 1.0 trillion)]; and (v) further developing the K-COVID-19 response model (KRW 2.5 trillion). The unique feature of this supplementary budget was the Korean New Deal, which was not directly targeting a response to the COVID-19 pandemic. The Korean New Deal plan was designed to cope with carbon neutrality and

boost the Korean economy in the longer term.

28. **The fourth supplementary budget worth KRW 7.8 trillion in 2020 was proposed to finance a package supporting small business, the unemployed, low-income families and parents burdened by childcare.** All of the KRW 7.8 trillion total was new spending, financed by government bonds (KRW 7.5 trillion) and bonds issued by the Korea SMEs and Startup Agency (KRW 0.3 trillion). The budget was composed of four items: (i) emergency support for small businesses and SMEs (KRW 3.8 trillion KRW); (ii) emergency employment support (KRW 1.4 trillion); (iii) emergency livelihood support for low-income households (KRW 0.4 trillion); (iv) emergency daycare support and others (KRW 2.2 trillion).

29. **The first supplementary budget in 2021, worth KRW 15 trillion in total, was drawn up to help Koreans suffering from the prolonged social-distancing regulations and to support the country's vaccination rollout.** An extra KRW 4.5 trillion of the original 2021 budget was utilized to help small businesses to carry on their operations and retain their employees. The budget was composed of three items: (i) a relief package for small business owners and workers (KRW 8.1 trillion); (ii) an employment package (KRW 2.8 trillion); and (iii) the vaccination rollout (KRW 4.1 trillion).

30. **The second supplementary budget in 2021, worth KRW 33 trillion, was drawn up to help those left behind by the economic recovery from the pandemic, as well as to ensure the proper control of the disease, including rapid vaccination rollouts and broad coverage.** KRW 3.0 trillion of that year's original budget was utilized for housing and other basic livelihood support. The budget was composed of four items: (i) COVID-19 relief packages (KRW 13.4 trillion); (ii) effective control of the disease (KRW 4.4 trillion); (iii) strong employment support and social safety nets (KRW 2.6 trillion); and (iv) measures to boost local economies (KRW 12.6 trillion).

31. **To cope with the COVID-19 pandemic, the Korean government passed a total of six supplementary budgets in 2020 and 2021 and, looking at the composition, household support accounted for 38.4 percent, business support for 22.0 percent, health measures for 11.3 percent, economic stimulus packages for 13.3 percent, and others for 13.5 percent.** Household support consisted of direct cash transfers and employment insurance-related support. Business support consisted of support for SMEs and self-employed people. The Korean New Deal project organized in the third supplementary budget in 2020 accounted for the largest share of support for economic stimulus (Table 2.) Surprisingly, the budget for responding to the COVID-19 pandemic was relatively small compared with the other items.

32. **Household support (22 percent) and economic stimulus (26.6 percent) accounted for the largest shares of the four supplementary budgets conducted in 2020.** Emergency relief payment support accounted for 50 percent of household support. Most of the economic stimulus consisted of the Korean New Deal. Meanwhile, health measures accounted for 4.8 percent, a very small share compared with other support. At that time, a large budget was set up for the Korean New Deal to help the economy to recover. However, it was unclear whether this budget set up was to respond to the economic

recession due to the pandemic, or whether it was a policy to enhance potential growth in the mid to longer term. As a result, there was considerable ambiguity over how to adjust the size of related spending in the post-pandemic period.

33. **In the supplementary budgets conducted twice in 2021, household support (32.7 percent), business support (22.5 percent), and health measures (17.7 percent) accounted for more than 70 percent.** Most of the business support consisted of support for the self-employed who had been adversely affected by the tightening of social-distancing measures. Unlike the 2020 supplementary budgets, there was almost no support for economic stimulus. As social distancing continued, economic damage to small business owners and the self-employed increased. As a result, the support for them grew more urgent, and a large share of the supplementary budget was allocated to business support.

34. **Financing methods for the six supplementary budgets from 2020 to 2021 were covered by the issuance of government bonds (47 percent), revenue growth (27 percent), and expenditure restructuring (16 percent).** In 2020, the issuance of government bonds (67 percent) and spending cuts (28 percent) were the main financing methods, whereas in 2021, as the revenue situation improved, the main sources of financing came from increases in revenue (63 percent) and the issuance of government bonds (20 percent) (Table 3). Tax revenue increases in 2021 were related to a recovery of the overall economic situation.

4. Assessment of policy responses and future challenges

35. **As the supplementary budget was implemented to respond to the COVID-19 pandemic, the fiscal deficit-to-GDP ratio increased sharply compared with 2019, to 3.7 percent in 2020 and then 4.4 percent in 2021.** The fiscal deficit excluding contributions to the Social Security Fund, which directly increases government debt, was 5.8 percent in 2020 and 6.2 percent in 2021, far exceeding the average of 1.5 percent up until 2019. The main driving force in this increase in the fiscal deficit was a large increase in fiscal expenditures in response to the pandemic. The decline in fiscal revenues due to the pandemic-induced recession was not significant, so it was not the major factor in the fiscal deficit.

36. **The government debt-to-GDP ratio also increased significantly, reaching 43.8 percent in 2020 and 47.3 percent in 2021.** Deficit debt, which is repaid with tax in the future, increased sharply to 26.5 percent in 2020, and to 29.9 percent in 2021. However, financial debt, which has corresponding assets, remained at 16 to 17 percent. The actual financial burden in the future, therefore, increased significantly due to the higher deficit debt.

37. **Looking at the growth rates of total expenditure and revenues, which determine the fiscal balance, total expenditure increased more sharply than the growth rate of revenues.** The total revenue growth rate decreased in 2020 due to the pandemic, but

increased sharply in 2021, resulting in excess revenues. The total expenditure growth rate was 14 percent in 2020 and 16 percent in 2021 under the COVID-19 supplementary budget. The high total expenditure growth rate resulted from the COVID-19 response, but it had already increased sharply in the pre-pandemic period due to the Moon Jae In government implementing an expansionary fiscal policy stance.

38. **Although the national debt increased as a result of the pandemic response, the increase was less severe than in other countries; however, the Korean government needs to restore fiscal soundness in the medium term due to challenging demographic changes on the horizon.** According to the『Population Projections for Korea 2020–2070』released by the National Statistics Office in December 2021, a decline in the total population started in 2021, eight years earlier than previous projections, and the lowest total fertility rate was further lowered from 0.86 in 2021 to just 0.7 in 2024. As marriage decreased during the pandemic, this is expected to continue to drive a decline in the fertility rate over the next few years. Such changes in the demographic structure risk damaging the economic growth rate of the country and increasing the welfare expenditure on the elderly, and ultimately in the medium to longer term could threaten the country's fiscal sustainability.

39. **Recognizing this situation, the fiscal authorities proposed the K-fiscal rule in October 2020, which mandates sound measures if the national debt exceeds 60 percent and the fiscal deficit of 3 percent; the plan will be applied from FY2025, and the limit will be reviewed every five years.** Unlike the fiscal rules implemented in other countries, the balance and the debt rules are not required to be satisfied independently. The unique feature of the K-fiscal rule is that the balance and debt rules are formulated to complement each other: the product of the balance and debt relative to each limit should not exceed the value of 1. Under this specification, the level of fiscal or debt can exceed its own limit, as long as the other variable is much lower than its limit.

40. **In considering the long-term fiscal burden, the Korean government's proposal for the K-fiscal rule is generally positive, but it also needs to come up with separate fiscal measures to restore fiscal space.** According to Han (2021),[98] if the fiscal deficit is maintained at 3 percent of GDP, whose level is the same as the mid-term plan established in 2021, the fiscal rules will be fulfilled by 2025, but will start to violate them from 2026 onwards. Moreover, the national debt will exceed 70 percent of GDP in 2030. Therefore, stronger fiscal soundness measures are required than those proposed in the K-Fiscal rule.

41. **The Korean government has introduced and operated a mid-term fiscal plan and top-down budget planning since 2004, in order to strategically allocate national resources and efficiently operate public finances in the mid-term period.** These two systems have so far played a critical role in maintaining and securing the Korea's fiscal soundness. In particular, the increase in national debt has been controlled by setting the growth rate of total expenditure lower than that of total revenues.

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98 Han (2021), "Fiscal Policy in the Post COVID-19 Periods," The Korean Economic Forum, vol. 14 no. 3, Korean Economic Association

42. **As the Moon Jae In administration placed an emphasis on an expansionary fiscal position, the method of establishing the mid-term plan has changed significantly.** Unlike the previous administration, where the fiscal stance was somewhat tight, the Moon Jae In administration set a total expenditure growth rate that exceeded the total revenue growth rate, as the fiscal stance was expansionary. As a result, the fiscal deficit and national debt were projected to continue to grow in the mid-term plan. Since such an expansionary fiscal policy continued from 2019, before the outbreak of the pandemic, the actual fiscal deficit and national debt increased significantly in 2018 and 2019. The extra expansion of fiscal expenditure due to the pandemic has eroded fiscal soundness still further.

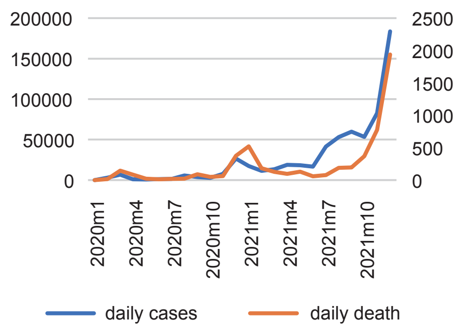
43. **To reduce the national debt that has increased recently, it is necessary to maintain the fiscal deficit at a level lower than 3 percent of the mid-term fiscal plan.** If the fiscal deficit is maintained at, or exceeds, 3 percent, then the government debt-to-GDP ratio may exceed 70 percent by 2030. Due to the recent unstable international situation and subsequent inflationary environment, international organizations are lowering their projections of global and countries' output growth rates. Under this situation, fiscal capacity is likely to be exhausted even faster than previously estimated, such that a stronger fiscal soundness policy is now required.

44. **As a specific recommendation to restore fiscal soundness, the total expenditure growth rate should be set lower than the total revenue growth rate in the new mid-term plan in 2022.** It is more critical to lower the total expenditure growth rate below the total revenue growth rate, in order to cut the fiscal deficit to below 3 percent. The interest rate on government bonds is expected to rise as the United States and Korean monetary authorities raise their policy rates further to fight the surge in inflation. When the bond interest rate increases, interest payments will automatically rise. Considering this situation, the primary balance, excluding interest payments, needs to be improved by a greater margin than 3 percent. Therefore, the total expenditure growth rate should be reduced far more than in the previous mid-term plan.

45. **Considering the recent economic situation and the demographic changes, especially after the pandemic, the Korea needs intensive spending reviews and spending cuts to secure fiscal space in the medium term, and to prepare for the longer-term fiscal consequences**. In the Korea, there is growing concern regarding the risk of stagflation, the combination of economic recession and inflation. The national debt is expected to increase sharply if stagflation becomes a reality. As the ageing of the Korean population is progressing at a faster pace than five years ago, ageing-related expenditures such as basic pensions are expected to increase faster. This situation will worsen the long-term fiscal outlook conducted by the Ministry of Economy and Finance in 2020 at a faster pace. Therefore, it is necessary to conduct a higher-level review of all potential spending cuts than has been conducted in the past to prepare for the future and the more rapid ageing of Korean society.

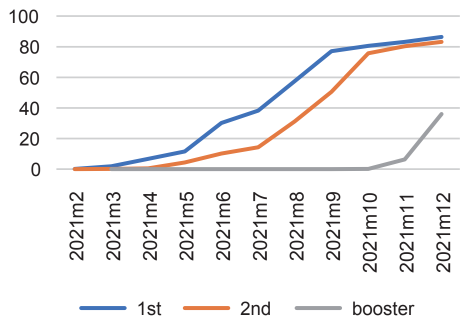
Appendix 1. Selected Figures

Figure 1 COVID-19 cases and deaths



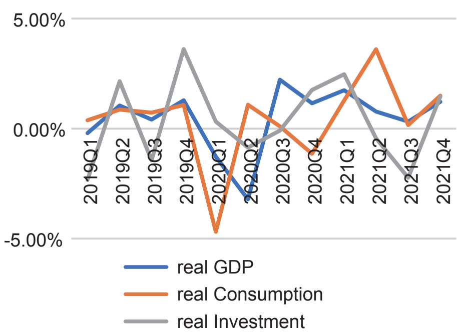
Source: Korea Disease Control and Prevention Agency

Figure 2 COVID-19 vaccination Status



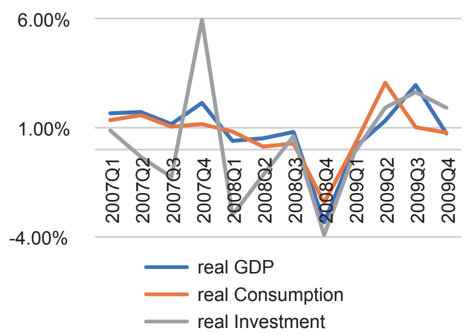
Source: Korea Disease Control and Prevention Agency

Figure 3 Macroeconomic variables



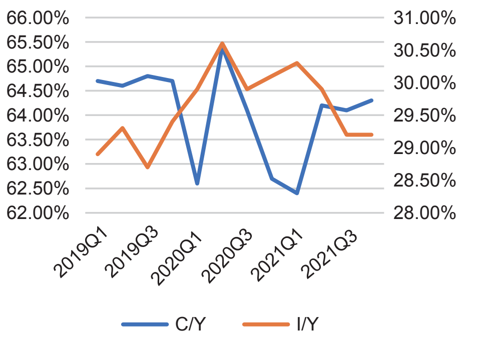
Source: Economic Statistics System, Bank of Korea.

Figure 4 Macroeconomic variables –GFC



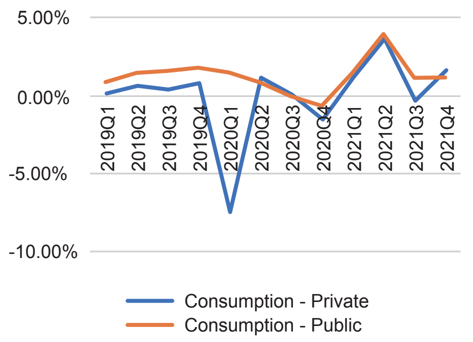
Source: Economic Statistics System, Bank of Korea.
Note: GFC = global financial crisis

Figure 5 Consumption and investment to GDP



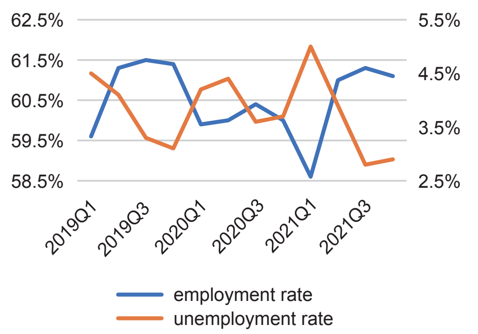
Source: Economic Statistics System, Bank of Korea.

Figure 6 Private vs. Public consumption growth



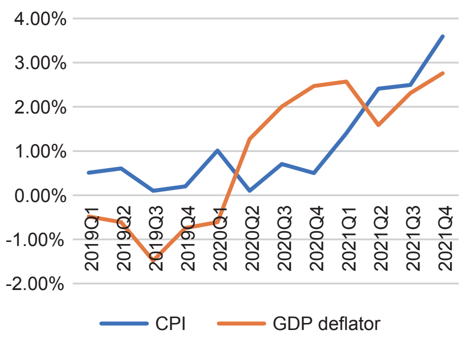
Source: Economic Statistics System, Bank of Korea.

Figure 7 Labor market variables



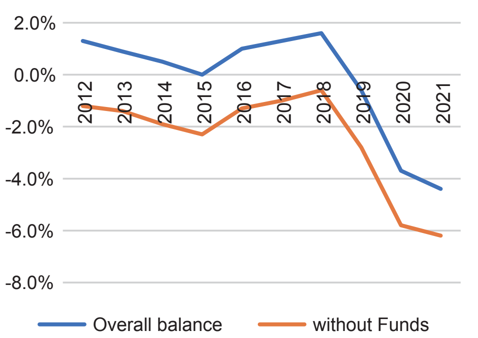
Source: Statistical Database, Statistics Korea.

Figure 8 Inflation rate



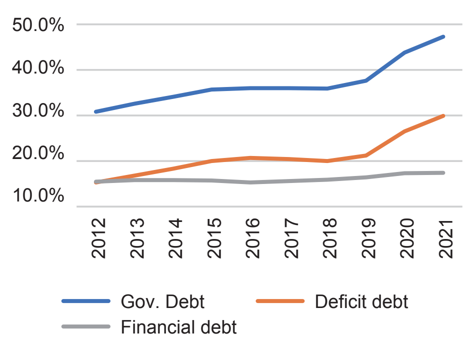
Source: Economic Statistics System, Bank of Korea.

Figure 9 Consolidated fscal balance to GDP



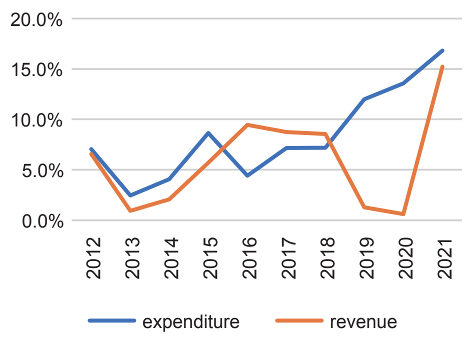
Source: Ministry of Economy and Finance.

Figure 10 Government debt to GDP



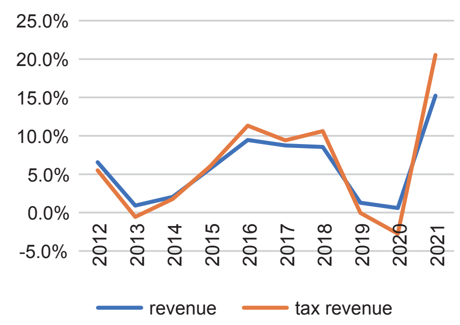
Source: Ministry of Economy and Finance.

Figure 11 Expenditure and Revenue (growth rate)



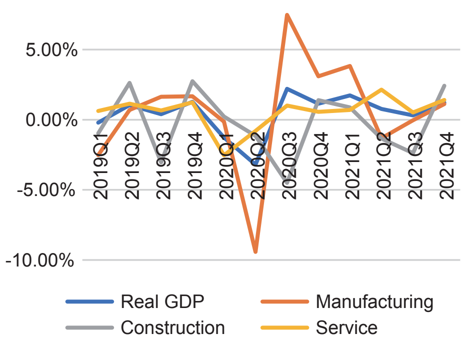
Source: Ministry of Economy and Finance.

Figure 12 Revenue and Tax (growth rate)



Source: Ministry of Economy and Finance.

Figure 13 Sectoral GDP (growth rate)



Source: Economic Statistics System, Bank of Korea.

Appendix 2. Selected Tables

Table 1 Selected Economic Indicators

	2017	2018	2019	2020	Estimate 2021
Real Sector and Prices	(Annual percentage change)				
Real GDP	3.2	2.9	2.2	-0.9	4.0
Agriculture	2.3	0.2	3.9	-4	2.7
Industry	3.7	3.3	1.1	-0.9	6.6
Services	2.6	3.8	3.4	-1.0	3.7
GDP deflator	2.2	0.5	-0.8	1.3	
CPI inflation (average)	1.9	1.5	0.4	0.5	2.5
CPI inflation (end of period)	1.4	1.3	0.7	0.6	3.7
External Sector	(US$ million, unless otherwise specified)				
Current account balance	75,231	77,467	59,676	75,276	
(Percent of GDP)					
Trade balance	113,593	110,087	79,812	81,945	
Exports	580,310	626,267	556,668	516,604	
Imports	466,717	516,180	476,856	434,659	
Services, net	-36,734	-29,369	-26,845	-16,190	
Primary income, net	5,337	4,902	12,856	12,050	
Secondary income, net	-6,965	-8,153	-6,147	-2,530	
Financial account balance	84,516	76,473	59,027	77,116	
Foreign Direct Investment	16,157	26,038	25,605	23,256	
Other Investment	72,256.1	34,442.3	25,723	32,253.2	
Overall balance	75,204	77,783	59,507	74,936.3	
Gross international reserves	4,357	17,496	1,466	17,392	
(Months of imports)					
External debt	412,020	441,153	470,736	544,917	
(Percent of GDP)					
Fiscal Sector	(Percent of GDP)				
Revenue and grants	21.8	22.9	22.9	23.0	24.0

	2017	2018	2019	2020	Estimate 2021
Tax revenue	14.5	15.5	15.2	14.8	15.8
Nontax revenue	4.1	4.1	4.1	4.3	4.8
Grants	3.3	3.4	3.6	3.9	3.5
Expenditure	19.8	20.5	22.7	25.3	23.9
Current non-interest expenditure	17.4	18.2	19.4	22.8	21.8
Interest payments	0.8	0.8	0.7	0.7	0.6
Capital expenditure	1.7	1.6	2.6	1.8	1.5
Overall fiscal balance	1.3	1.6	-0.6	-3.7	-1.1
Primary balance	0.5	0.9	-1.3	-4.4	-1.7
Public debt	36.0	35.9	37.6	43.8	
Monetary and financial sector	(Annual percentage change, end-period)				
Domestic credit	8.1	5.9	4.2	8.0	
Credit to private sector	7.9	5.6	4.0	8.4	
Broad money	5.1	6.7	7.9	9.8	
Reserve money	8.7	10.6	11.3	15.5	
Memorandum items					
Nominal GDP (KRW billion)	1,835,698	1,898,193	1,924,498	1,933,152	2,049,523.8
Nominal GDP (US$ hundred million)	16,233	17,252	16,510	16,382	1,790,884.3
GDP per capita (US$)	31,605	33,429	31,929	31,637	
Exchange rate (KRW/US$, average)	1,131	1,100	1,166	1,180	1,144.4
Exchange rate (KRW/US$, end of period)	1,071	1,118	1,158	1,088	1,185.5

Table 2 COVID-19 stimulus package and health measures

	Total	2020	2021
Household support	36.8 (38.4%)	21.1 (44.1%)	15.7 (32.7%)
Business support	22.0 (23%)	11.2 (23.4%)	10.8 (22.5%)
Health measures	10.8 (11.3%)	2.3 (4.8%)	8.5 (17.7%)
Economic stimulus	13.3 (13.9%)	12.7 (26.6%)	0.6 (1.3%)
Others	12.9 (13.5%)	0.5 (1.%)	12.4 (25.8%)
Total	95.8	47.8	48

Source: Ministry of Economy and Finance, authors' calculations.

Table 3 Financing methods

	Total	2020	2021
Spending cut	18.9 (16.2%)	18.9 (28.2%)	0.0 (0%)
Revenue increases	31.5 (26.9%)	0.0 (0%)	31.5 (63%)
Borrowing (include Bond)	54.9 (46.9%)	45.0 (67.2%)	9.9 (19.8%)
Reserve funds	11.4 (9.7%)	2.8 (4.2%)	8.6 (17.2%)
Others	0.3 (0.3%)	0.3 (0.4%)	0.0 (0%)
Total	117.0	67.0	50.0

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Chapter

8

Lao PDR

Chapter 8

Lao PDR[99]

The COVID-19 pandemic has had a devastating impact across the globe, including on small developing countries such as Lao PDR. To mitigate the damaging impact of the COVID-19 pandemic, the Government of Lao PDR implemented several policies, including fiscal and monetary responses. This chapter aims to discuss these government policy responses, focusing on fiscal policy measures. In addition, the chapter also discusses the strategy for economic recovery in Lao PDR going forward. The author conducted a survey[100] and collected data and information from literature and line ministries, finding that the Government of Lao PDR had responded quickly to bring the initial outbreak of COVID-19 under control. A nationwide lockdown, together with the closure of international and domestic border crossings, and travel restrictions were all put in place. However, these policy responses also carried heavy economic costs. As a result, Lao PDR suffered a severe slowdown in economic growth and an increase in the poverty rate. In addition, Lao PDR has encountered high debt levels, high inflation, and a devaluation of the domestic currency. It is critical to stabilize inflation and exchange rate volatility, and avoid a debt crisis. In the medium term, policies should emphasize maximizing the utilization of the Lao PDR-China railway system for boosting exports and improving the business climate, and encouraging greater foreign direct investment.

1. COVID-19 development

1. **The COVID-19 pandemic has had a devastating impact on economic development around the globe, not least among developing countries and Least Developed Countries.** In addition, the pandemic has also increased the already massive challenge of achieving the Sustainable Development Goals among developing countries (Wang and Huang, 2021). Furthermore, the level of impact of the COVID-19 pandemic on economies has been complex, with effects on both the supply and demand sides. The impact of

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100 The figures and tables are based on the findings from the expert survey, which is a part of the regional project examining the impact of COVID-19 on inclusive development and governance in Cambodia, Laos, Myanmar, and Vietnam. This project is funded by the International Development Research Centre, Canada, and coordinated by Cambodia Development Resource Institute (CDRI). Views expressed in this article are those of the authors, and they do not necessarily represent the views of either the CDRI or the funder.

the pandemic also differs from country to country, depending on individual country characteristics. Its impact depends on: (i) the quality of health facilities; (ii) the economic structures in place; (iii) public health measures; (iv) policy responses and other factors (Hale et al., 2021; Cheng et al., 2020).

2. **Lao PDR successfully controlled the pandemic by making use of various measures, including a nationwide lockdown. Lao PDR detected its first case in March 2020**. However, despite its initial success, subsequently, the Lao PDR economy and society were hit hard by the impacts of the COVID-19 pandemic, with economic growth declining significantly and the poverty rate increasing (World Bank, 2020; World Bank, 2022).

3. **During the pandemic, the Government of Lao PDR implemented a number of health measures.** These measures included the closure of schools, quarantines and lockdowns, external border restrictions, social-distancing measures, and internal border restrictions (Hale et al., 2021). According to the COVID-19 Government Response Event Dataset (Hale et al., 2021), Lao PDR took the quickest action in the shortest time after New Zealand and Latvia. Those government responses had a positive impact on controlling the pandemic, but they also negatively impacted the economy in the short and medium terms.

4. **There are several studies on the assessment of government responses to the COVID-19 pandemic across countries** (Ozili, 2020; Greer et al., 2020; Le et al., 2021; Alon et al., 2020; Van Nguyen and Nghiem, 2021; El Masri & Sabzalieva, 2020; Luo et al., 2020). However, there are few assessments of the government response in the case of Lao PDR. In addition, there are few studies on the pathway of economic recovery in the case of Lao PDR. Therefore, the main objective of this chapter is to discuss the policy responses and economic recovery in the case of Lao PDR. To achieve the aim of this chapter, the author collected data and information from literature and the Government of Lao PDR. The author also conducted a survey to collect data and perspectives on the government response and economic recovery pathway in Lao PDR. It is hoped that this chapter will prove of use to the Government of Lao PDR in formulating effective policies for economic recovery going forward.

5. **At first, Lao PDR was successful in controlling the pandemic.** Initially at least, Lao PDR was successful in controlling the COVID-19 pandemic, but nonetheless, by 23 May 2022, it had accumulated 209,823 cases and 754 deaths. The first wave of the COVID-19 pandemic occurred at the beginning of March 2020.[101] As of 3 June 2020, Lao PDR had conducted 7,249 tests, of which 19 were confirmed positive cases, with 16 requiring treatment. From 3 June onwards, Lao PDR detected zero COVID-19 cases until the beginning of April 2021. The successful control of the pandemic was due to various measures taken by the government, including a nationwide lockdown and other regulations.[102] The second wave of the pandemic occurred in April 2021 (during the Laotian New Year). This second wave had a high infection rate, causing more fatalities.

101 See the figures of total cases and death cases in Figure 1, 2, 3, and 4.

102 The nationwide lockdown and introduction of social distancing and domestic lockdown during 1-9 April 2020 (PM order No. 6, March 29, 2020); lockdown extended to 3 May 2020.

The government applied various measures during this period, including a partial lockdown and travel restrictions, among others. Given its highly transmissible nature, the Omicron variant rapidly spread across all countries of the globe. Lao PDR confirmed a total of 27 cases of the Omicron variant, including the first infection in the community, on 23 February 2022. The number of infection cases and the number of deaths increased in the third wave. The government did not impose lockdown measures or strict policies during this period.

6. **Increasing the vaccination rate is the key to controlling the infection rate.** Rising vaccination rates may enable a gradual withdrawal of restrictions. On 20 May 2021, completed vaccinations (percent of the population) were at 68.09 percent. The vaccination rate is slightly higher than in Indonesia and the Philippines, but still far behind Thailand, Vietnam, and Cambodia. However, the vaccination of children and vulnerable groups is concerning. In addition, the vaccination rates vary considerably across provinces. At the end of 2021, the government claimed to have vaccinated 80 percent of the population. High vaccination rates are crucial for the opening of international borders. Some measures, such as shortened quarantine times for some groups of visitors and home isolation, were recently relaxed, while several other measures remain in place, though compliance varies significantly (World Bank, 2022).

2. The economic impact of the pandemic

7. **The pandemic has had a major impact on the Lao economy.** In 2020 and 2021, economic growth is expected to be about 3 percent (World Bank, 2020; NIER, 2021). GDP growth is estimated to have rebounded to 2.5 percent in 2021, in line with the trends in most neighboring countries. However, GDP growth remained significantly below pre-pandemic levels. Industry and agriculture, supported by robust external demand, were the main growth drivers. In contrast, the services sector was severely affected by the prolonged lockdown and continued to struggle, especially hotels and restaurants, transportation, and other tourism-related services (World Bank, 2022).

8. **All sectors of the Lao economy have been hit, but to varying degrees.** Before the outbreak of the pandemic, hydropower, construction, and wholesale and retail industries all contributed considerably to GDP growth, but their contributions have been gradually eroded. At the same time, natural calamities and low productivity have impeded agricultural growth (Rasphone, 2020; World Bank, 2020). Export industries such as garments and industrial spare parts are projected to have negative growth as a result of decreasing global demand. Furthermore, due to the impact of the pandemic on tourism and related activities, the services sector is predicted to post a negative rate of -1.6 percent, down from roughly 9 percent in prior years. The hydropower and construction industries, on the other hand, are expected to grow at a rate of around 3.5 percent, more than offsetting the declines in other sectors, especially in the services sector (Rasphone, 2020).

9. **Since the start of the COVID-19 pandemic in early 2020, many micro and small businesses have lost revenue due to containment measures, resulting in layoffs and income losses across industries.** According to an LNCC (2020) survey, 70 percent of businesses laid off some employees, 40 percent had to lay off more than 50 percent of total staff, and 13 percent had to lay off more than 90 percent of staff. Unemployment has left many families on the edge of starvation and poverty. UNDP (UNDP, 2020) estimates that about 321,700 people lost jobs in Lao PDR due to the pandemic. These include 191,200 domestic layoffs and 130,532 migrant workers. In 2020, unemployment accounted for 23.4 percent of the total labor force of 2.16 million. Moreover, an increase in unemployment may force 361,000 individuals into poverty.

10. **The COVID-19 crisis has exacerbated long-standing macroeconomic weaknesses in the Lao economy.** The economy has struggled to manage huge fiscal budget deficits and current account deficits in recent years. Despite this, the government continues to restrict its expenditure by decreasing overall spending from 20.2 percent in 2019 to 17.8 percent in 2020. However, annual revenue performance is likely to remain very weak owing to the second COVID-19 wave since April 2021. The government's revenue decreased by 23 percent in H1 of 2020 compared with H1 of 2019. A reduction in total income generates a greater budget deficit for the government. Therefore, additional borrowing to cover the shortfall raises overall public debt. According to the World Bank (2021a), the budget deficit was 5.2 percent in 2017 and is anticipated to decline to 4.7 percent in 2021. At the same time, overall public debt increased from 58.2 percent in 2019 to 62.1 percent in 2020, and is expected to reach 66.4 percent in 2021 (World Bank, 2021b).

11. **The pandemic's macroeconomic impact, combined with continuing structural issues, has pushed the country into debt difficulty** (World Bank, 2022). Due to a high debt service burden, inadequate tax collection, limited financing choices, and low foreign currency reserves, Lao PDR is now starting to experience liquidity and solvency issues (Table 1). Debt service deferrals of about 3.6 percent of 2021 GDP provided short-term relief to fiscal and external imbalances in 2020–21, but pressures remain severe (World Bank, 2022). The success of bilateral debt negotiations with major creditors continues to influence debt sustainability and play a major role.

12. **The COVID-19 pandemic also brings serious economic and social risks to Lao PDR.** Experts point out the risks, such as household debt, sovereign debt, commodities shocks, and youth unemployment (Table 2). Therefore, policy makers need to find an optimal balance between policies, strategies, and measures to mitigate these risks.

3. Policy measures in response to COVID-19

13. **Lao PDR introduced a nationwide lockdown from the end of March to April 2020** (Government of Lao PDR (GOL), 2020b). This nationwide lockdown had a significant impact on the economy. To mitigate the negative impacts of the pandemic and the lockdown, the government's policy responses were based on the Prime Minister Agreement No. 31 on

policies and measures for mitigating the impact of the COVID-19 pandemic on the Lao PDR economy issued in April 2020 (GOL, 2020). This Prime Minister Agreement included the fiscal policy, monetary policy, and another measures.[103] These can be summarized as follows:

(1) Cash transfers

The government approved a budget of LAK 1.5 billion to disburse cash allowances for the poorest households and provide other subsidies for almost 6,000 low-income earners and informal sector workers who had lost income due to the pandemic.

(2) Low-interest loans from the SME Fund

The government allocated LAK 200 billion and US$20 million (World Bank) to the SME Development Fund. Subsequently, the SME Development Fund contacted commercial banks and microfinance institutions to loan to MSMEs at a low interest rate.

(3) Income tax exemption

On 2 May 2020, the government announced income tax exemptions for three months for both civil servants and employees in the private sector with incomes of less than LAK 5 million a month.

(4) Profit tax exemption

Profit tax exemptions for a period of three months were announced for microenterprises with annual income between LAK 50–400 million.

(5) Exemption of customs duties

Exemption of customs duties on imports of goods were announced.

(6) Deferring payment

Deferrals of tax collection from tourism-related businesses for three months.

(7) Reduction in public utility charges

The government also instructed utility companies, including the Électricité du Laos and the Public Water Company, as well as telecom operators, to cut their rates for three months.

(8) Unemployment allowance

Members of the social security scheme who had their work suspended from 1 May 2021 received an unemployment allowance until they resumed their work.

103 International Monetary Fund (IMF)'s summary on Lao PDR's Policy Responses to COVID-19 (IMF, 2020).

(9) Reduction in administrative expense

Cuts in administrative expenses by at least 30 percent of the annual budget were announced for ministries and central organizations and 10 percent for local authorities.

(10) Receiving donations

The government also received donations of about LAK 80 billion from the private sector and development partners to procure vaccines and medical equipment.

14. However, due to the fiscal constraints, several programs have still to be implemented. These programs include: (i) Cash-for-work program. This program can absorb those in the labor force who have lost their jobs from factories/enterprises and returned home from foreign countries by constructing small local physical infrastructure projects to enhance the agriculture and economic sectors. (ii) Subsidies to business. This financial support was targeted at the garment/textile, footwear, travel accessory, bag, and tourism industries (e.g., hotels, guesthouses, restaurants, and travel agents). (iii) Skills training programs. The allocation of wage subsidies for unemployment/immigration labor to join skills training programs.

15. Implementing a strong monetary policy was crucial during the COVID-19 pandemic (Harjes et al., 2020). The role of the Bank of Lao PDR was also vital during the pandemic. The Bank of Lao PDR (BoL) issued a Decision (No. 238/BoL) on Credit Policy to Mitigate the Impacts of the COVID-19 Pandemic (BoL, 2020). This decision aimed to improve liquidity in the banking system and the economy in response to the effects of the COVID-19 pandemic. The detailed policies are as follows:

(1) Reduction in reserve requirement

The BoL reduced the reserve requirement from 10 to 8 percent and to 5 percent on foreign exchange, and from 5 percent to 4 and 3 percent on local currency.

(2) Cutting the policy rate

The BoL also cut its policy rate from 4 to 3 percent for one-week loans, from 5 to 4 percent for one-to-two-week loans, and from 10 to 9 percent for two-week to one-year loans.

(3) Providing a low interest rate

The BoL made available LAK 200 billion for low-interest rate small and medium enterprise (SMEs) loans through commercial banks and prepared to allocate LAK 1,800 billion as low-interest bank loans for post-pandemic economic and business recovery. In February 2021, the government launched a US$40 million emergency finance support project, backed by the World Bank, enabling local banks and financial institutions to provide loans to SMEs.

(4) Reduction in interest rates and fees

The BoL issued BoL Decision No. 23 on the Credit Policy to mitigate the impacts of the pandemic (BoL, 2020). The BoL instructed commercial banks, financial institutions, leasing companies, and pawn shops to reduce their interest rates and fees for new loans.

(5) Debt construction

The BoL instructed commercial banks, financial institutions, leasing companies, and pawn shops to postpone debt payments and interest rates from May 2021 until July (BoL, 2020).

4. Assessment of policy responses and future challenges

16. **It was crucial that the Government of Lao PDR implemented effective policy responses to help households maintain their livelihoods, and support the private sector to maintain businesses during the pandemic.** In this section, we discuss the assessment of policy responses and future challenges. The government implemented several policies to cope with the pandemic. This section discusses the effectiveness of those policy response. The data were from the survey of key policy makers, private sectors, and academia in 2021[104] (Kyophilavong, 2021). During the pandemic, the government's support was crucial due to the economic slowdown. However, there was only a limited amount of fiscal space and Lao PDR has a large budget deficit, as well as significant external debt. More than half of the experts contacted in this assessment believe that the Lao PDR economy was in a precarious condition (Figure 5). The pandemic caused a significant economic slowdown in Lao PDR.

17. **The economy of Lao PDR is predicted to recover by 2024 (Figure 6), indicating that a return to the pre-pandemic level of economic growth will take around three years.** Nonetheless, about 40 percent of experts believed that the government should do more to help the economy (Figure 7). More than half of the experts said that Lao PDR's fiscal stimulus initiatives were too modest (Figure 8), illustrating that Lao PDR is dealing with a challenging scenario due to the post-pandemic economic slowdown. The survey of experts showed that the fiscal policy measures were ineffective in mitigating the negative impacts of the COVID-19 pandemic and the nationwide lockdown.

18. **Due to limited documentation and literature, it is difficult to assess the impact of the government's policies.** However, the interviews with the private sector and households reveal that providing low-interest loans from the SME Development Fund, deferring

104 For Lao officials and academics, the economic recovery from the COVID-19 pandemic is a serious concern. We completed an expert opinion survey on the COVID-19 recovery pathways in Laos. The responses' target audience includes high-ranking government officials, academics, international development specialists, NGOs, and others in Laos. We collected more than 80 experts.

payments, reducing administrative expenses, and receiving donations seemed to work well. Providing low-interest loans from the SME Development Fund allowed SMEs to access finance, and maintain their businesses during difficult economic conditions. In addition, deferring payments helped SMEs to carry on their businesses, mitigating the impact of the pandemic on business performance. Moreover, the government also reduced administrative expenses, and received donations from individuals and the private sector for the purchase of medical and health-care facilities to reduce COVID-19 infections.

19. **In addition, income tax exemption, profit tax exemption, and customs duties exemption had short-term impacts, but their duration was too short, and documents, applications, and processes for receiving these exemptions were complex and very difficult for SMEs to handle.** Meanwhile, the cash transfers program and the unemployment allowance program did not work well. This was because of the limitation of funding sources, and the limited target groups. In addition, the management of implementation encountered numerous challenges. During the pandemic, the government tried to reduce electricity tariffs, but the price of electricity did not decline in line with people's expectations. As a result, the policy caused significant public debate on the processes behind the electricity price-setting and their future reform.

20. **There were two main reasons behind the ineffectiveness of the fiscal policy measures.** The main reasons for the ineffectiveness of fiscal policy measures are: (i) Limited budgetary space. Lao PDR had significant budget deficits due to ineffective revenue collection, investment, and spending. In addition, Lao PDR has an elevated level of external and debt servicing payments that require significant revenue. (ii) Lack of saving for an emergency. Many resource-rich countries have sovereign wealth funds. These sovereign wealth funds are special-purpose investment vehicles intended to save for the future or provide stability against economic shocks. However, there are no sovereign wealth funds in Lao PDR.[105] Therefore, the government did not have sufficient funds at hand to cope with the health emergency and the negative economic impacts of the COVID-19 pandemic. Consequently, the government was forced to seek support from international organizations, bilateral support, and the private sector to mitigate the severe effects of the pandemic.[106]

21. **The policy priorities differed according to the timeframe, which depended on the number of COVID-19 cases, health measures and the condition of the economy.** The government acted fast to control the COVID-19 outbreak by imposing a nationwide lockdown and travel restrictions during the first COVID-19 wave. Lao PDR imposed the lockdown on 29 March 2020, the Prime Minister of Lao PDR issued Order No. 06/PM on the Reinforcement of Measures for the Containment, Prevention, and Full Response to the COVID-19 Pandemic. Lao PDR has remained a relatively reclusive country with a strict immigration policy, with very few foreigners permitted to enter since borders

105 Kyophilavong (2016) and Kyophilavong et al. (2013) suggested the establishment of sovereign wealth funds from the resources sector in Lao PDR.

106 For a discussion on the debt solution, see Barney and Souksakoun (2021).

were closed in late March 2020. Even those who could secure permission to enter were required to do a pre-departure COVID-19 PCR test and an on-arrival test, and were then required to spend 14 days in quarantine at a government-designated facility at their own expense. Even to leave the country, foreigners were required to apply for the necessary approval to their embassies several days in advance.

22. **However, during the second and third COVID-19 waves, the government focused more on economic recovery, removing all travel and border restrictions.** Thanks to the decrease in confirmed cases, the government has recently announced a reopening of all international borders and a reinstatement of the pre-COVID Visa-on-Arrival and e-Visa policies, effective from 9 May 2022. Lao PDR fully reopened to tourism on 9 May 2022. All foreign tourists can now visit Lao PDR, although some COVID-19 requirements remain in place. This is the final stage of a three-stage reopening plan. Fully vaccinated foreign visitors on pre-booked tours have been permitted to enter since 1 January 2022.

23. Lao PDR faces a number of challenges in the post-pandemic era, as follows:

(1) Stabilizing inflation and exchange rate

Inflation and fuel prices have risen significantly due to the impact of the COVID-19 pandemic, raising global fuel and food prices (Figure 9 and Figure 10). At the same time, the Bank of Lao PDR does not have sufficient reserves to intervene and lacks monetary and exchange rate tools (Kyophilavong, 2010). Inflation and exchange rate stability are challenging for Lao PDR policy makers to achieve continuous and sustainable economic growth. The government will need policy space to deploy flexible macroeconomic tools to accomplish these intermediate goals, including fiscal and monetary policy restrictions, exchange rate regime management, and strong regulation and supervision on the banking sector.

(2) Avoiding a debt crisis

Even before the COVID-19 pandemic, the World Bank and IMF (2019) identified Lao PDR as a country with a high risk of debt distress, in 2017.[107] The projection identified mismatches between short-term maturity of debt obligations and longer-term mobilization of state revenues (IMF, 2019). Much of the debt is denominated in foreign currency, which exceeds Lao PDR's foreign exchange reserves, putting the country's financial situation in danger (Barney and Souksakoun, 2021). The government should implement various restructuring measures, including privatizing state assets and renegotiating debt with China. Lao PDR must also renegotiate or restructure its sovereign debt, and provide proposed policies focusing on energy sector reform. The government should participate in the multilateral and bilateral COVID-19 support programs and the IMF through its Rapid Credit Facility, G20 Debt Service Suspension Initiative, Chiang Mai Initiative Multi-lateralization, and access the ADB COVID-19 Active Response and

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107 Applied the Low-Income Country Debt Sustainability Framework (International Monetary Fund. 2020a, March 12).

Expenditure Support (Barney and Souksakoun, 2021). Moreover, direct negotiations with China as the most significant bilateral creditor (including a China-Lao PDR currency swap arrangement) are crucial.

(3) Maximizing the use of the Lao PDR-China railway link

The Lao PDR-China train line was completed and launched on 3 December 2021. The Lao PDR-China Railway connects Lao PDR to the entire network of the Belt and Road Initiative at a lower cost and less time, which has the potential to improve the comparative advantage of the Lao PDR.[108] Moreover, the Lao PDR-China railway provides more opportunities to access regional and global value chains, making the country more attractive to investors (World Bank, 2020). The Lao PDR-China railway also brings excellent opportunities for Lao goods and products to be exported to China and also promotes greater foreign direct investment (FDI). However, due to the Chinese border lockdown and other restrictions, the use of Lao PDR-China railway has still to reach its full potential. In addition, there were some complaints from the business sector that the costs of sending freight by rail are still too high.

(4) Increasing the support of the private sector

An effective government response during the COVID-19 pandemic is crucial to mitigate the negative impacts on economies. The experts consulted in this assessment stated that policy responses should focus on low-interest loans for SMEs, income tax exemptions, reducing electricity tariffs, and receiving donations (Table 5).

(5) Fostering FDI through the Public-Private Partnerships (PPPs)

Lao PDR has limited financial resources. To make an economic recovery more resilient and growth more sustainable, attracting more FDI is crucial for Lao PDR. In the past, FDI flowed mainly into the natural resource sectors, such as mining and hydropower electricity development. Those investments failed to help Lao PDR to reduce poverty and sustain economic growth as expected. Experts showed that the services sector, including ICT, finance and banking, logistics, health care, and transportation, are important and relevant for the post-COVID-19 recovery. Public-private partnerships (PPPs) in the ICT sector, and roads and hospitals, are the main sectors to ensure an efficient and smooth post-pandemic recovery (Figure 11 and Figure 12).

24. **Sri Lanka was the first Asian country to face a debt default and financial collapse in the wake of the COVID-19 pandemic** (Perera, 2022). In addition, some observers also see Pakistan, Bangladesh, Mongolia, the Maldives, Papua New Guinea, and Lao PDR as the countries most likely to face default in Asia (CNBC, 2020; The Economist, 2022). However, there are some unique economic structures in Lao PDR that differ markedly from Sri Lanka.

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108 The 414 km railway journey between Vientiane and Boten is expected to take less than four hours which is four times less than by car.

25. **First, Lao PDR has borrowed heavily from hydropower dams to generate electricity for domestic consumption and export.** More than 70 percent of land area in Lao PDR is mountainous and Lao PDR has a low population density, which make it suitable for developing electricity from hydropower dams. In addition, the government holds shares in independent power producer (IPP) hydropower projects. The IPP hydropower projects are delivered on a build-operate-transfer basis. Therefore, these hydropower projects still belong to the government. In the case of an emergency, the government could sell its shares from the projects to finance debt servicing.

26. **Second, Lao PDR is rich in mineral resources.** However, the government has not allowed exploration and mining for almost 10 years. Since 2021, the government has given the green light for foreign and domestic investors to conduct exploration and mining. Most raw minerals were for export. This initiative could increase foreign currencies flowing into Lao PDR and reduce the pressure on the exchange rate.

27. **Third, the tourism sector is now recovering.** Due to the removal of almost all travel restrictions and the official opening of the Lao PDR-China railway project at the end of 2021, the number of foreign tourist arrivals has increased significantly. The increase in foreign tourists is a major source of foreign currency, helping Lao PDR to reduce the depreciation of the local currency. In addition, the Lao PDR-China railway also promotes trade and investment in Lao PDR. FDI has increased significantly since 2021, and trade with China has also increased significantly. The government could increase the revenues from trade and investment, which would help to increase the country's ability to cover its debt servicing costs.

28. **In addition, the government is negotiating with partners for debt restructuring and privatizing state-owned enterprises (SOEs).** The government is also undertaking fiscal reforms, including the strengthening of revenue collection and limitations on public expenditure. As a result, the possibility of debt default seems to be diminishing.

29. **The COVID-19 pandemic has caused major damage to Lao PDR's social and economic development.** During the crisis triggered by the pandemic, the effectiveness of government responses is crucial. In addition, in the post-pandemic period, economic recovery strategies are essential. This chapter has investigated government responses during the pandemic in the case of Lao PDR, and recommends policies and procedures for sustainable economic recovery in Lao PDR going forward.

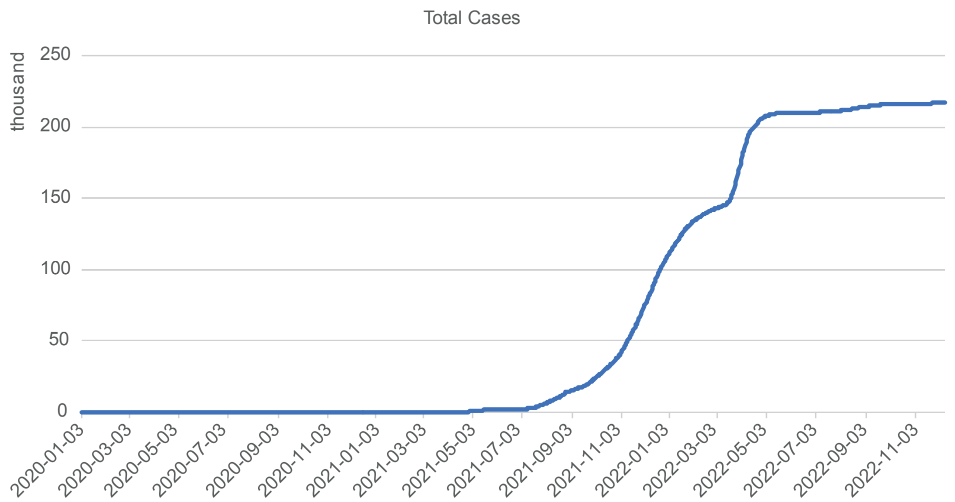
30. **The Government of Lao PDR responded to the COVID-19 pandemic quickly.** In addition, the government implemented various measures, including a nationwide lockdown, the closure of international and domestic borders, and travel restrictions. These policies were successful in controlling the COVID-19 pandemic, given that Lao PDR had zero-COVID-19 cases for almost 12 months. However, this policy response also brought with it significant economic costs. Economic growth fell from 5.5 percent in 2019 to 0.2 percent in 2020, and recovered slightly to 2.2 percent in 2021, increasing the poverty rate.

31. **The government issued Prime Minister Agreement No. 31/2020 to address the economic impact of the pandemic.** To respond to the severe impact on economic growth, the government issued Prime Minister Agreement (No. 31/2020) on Policy and Measures to Mitigate the Impact of the COVID-19 pandemic on the economy. This agreement covered a wide range of policies, including fiscal policy, social protection policy, and SME support. However, due to a lack of budget resources and limitations on fiscal space, the policies failed to produce an optimal outcome. Moreover, the recent surge in international fuel and food prices has triggered high inflation and a further devaluation of the Lao PDR currency, the kip.

32. **There is now an urgent need for a new package of policies to stabilize inflation and exchange rate volatility to avoid a debt crisis.** Medium-term policies should focus on maximizing the use of the new Lao PDR-China railway for boosting exports, improving the business climate, and promoting greater FDI. In addition, the Lao economy has some unique characteristics, including being rich in natural resources (high potential in hydropower and mining), the potential positive impact of the Lao PDR-China railway project, and monetary and fiscal reforms, making its case quite different from that of Sri Lanka. As a result, the possibility of a debt default is lower than it might have been otherwise.

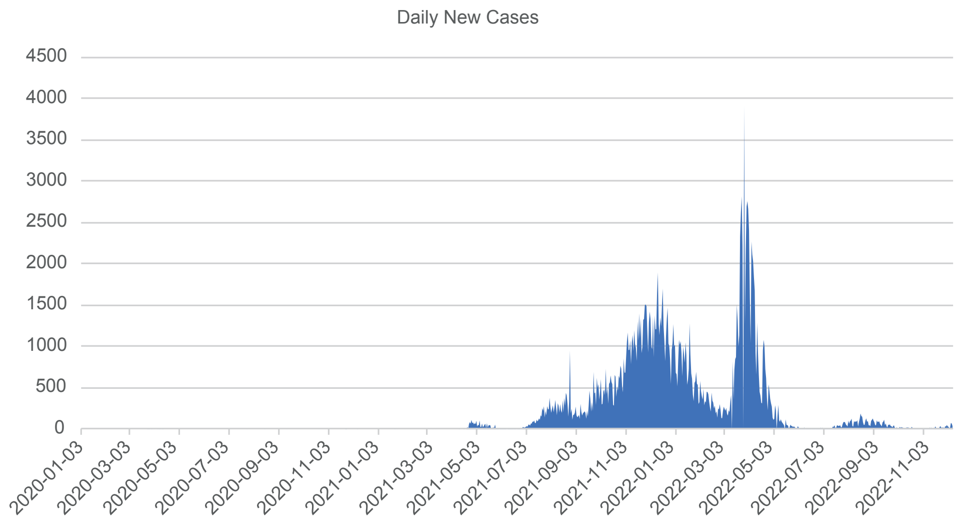
Appendix 1. Selected Figures

Figure 1 Total COVID-19 cases in Lao PDR



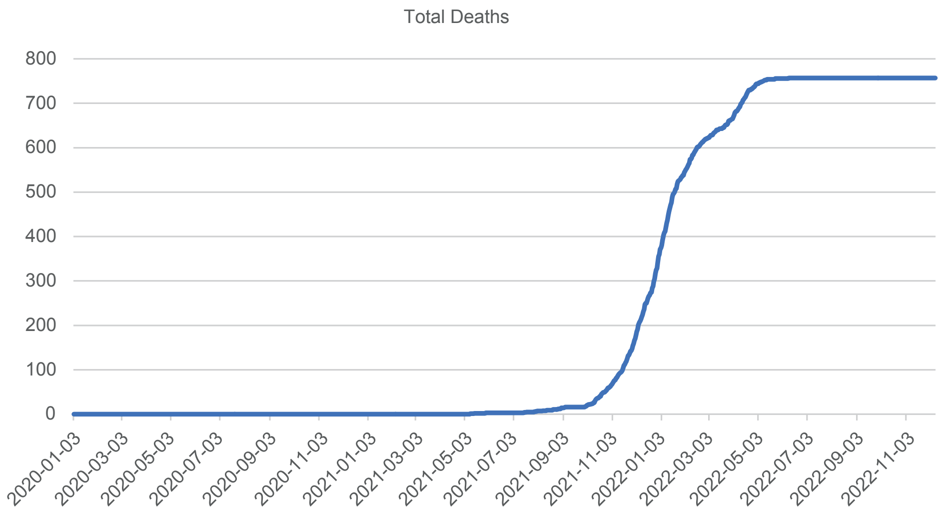
Source: World Meter (https://www.worldometers.info/coronavirus/country/laos/).

Figure 2 Daily new cases in Lao PDR



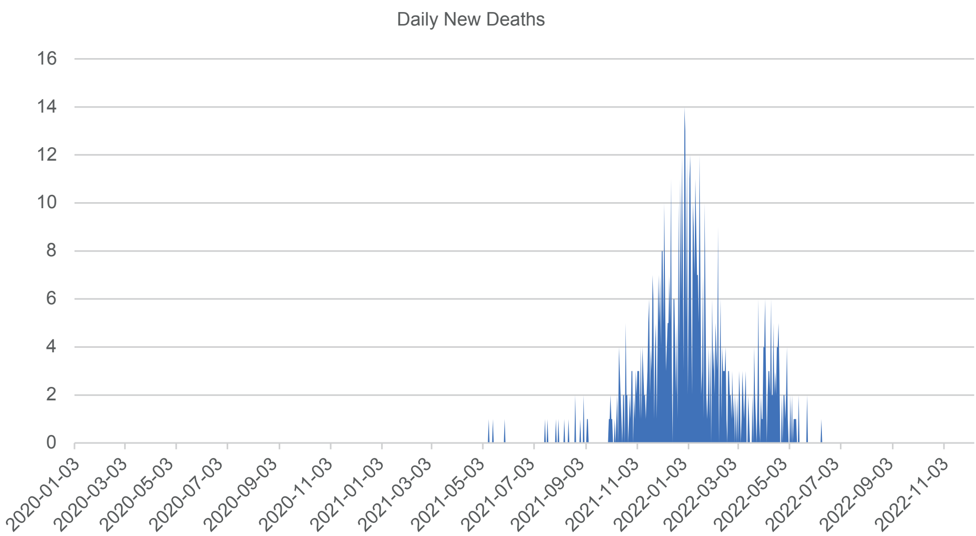
Source: World Meter (https://www.worldometers.info/coronavirus/country/laos/).

Figure 3 Total COVID-19 deaths in Lao PDR



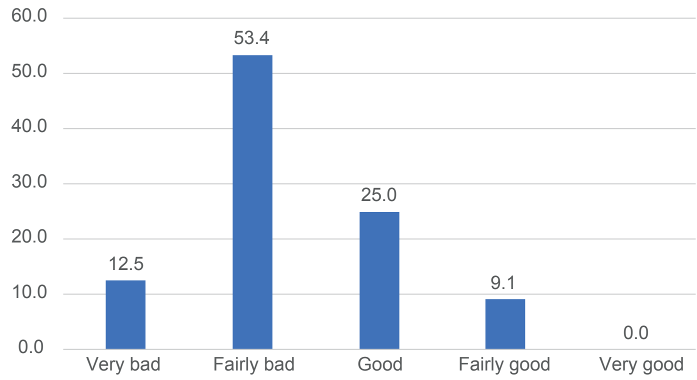
Source: World Meter (https://www.worldometers.info/coronavirus/country/laos/).

Figure 4 Daily deaths in Lao PDR



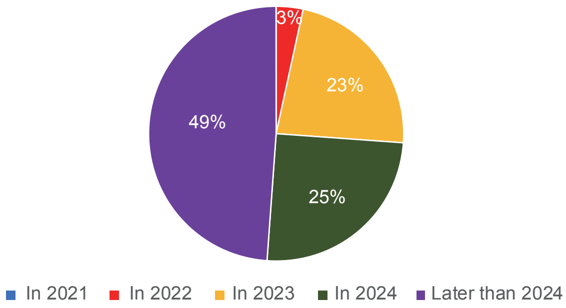
Source: World Meter (https://www.worldometers.info/coronavirus/country/laos/).

Figure 5 The conditions of the economy



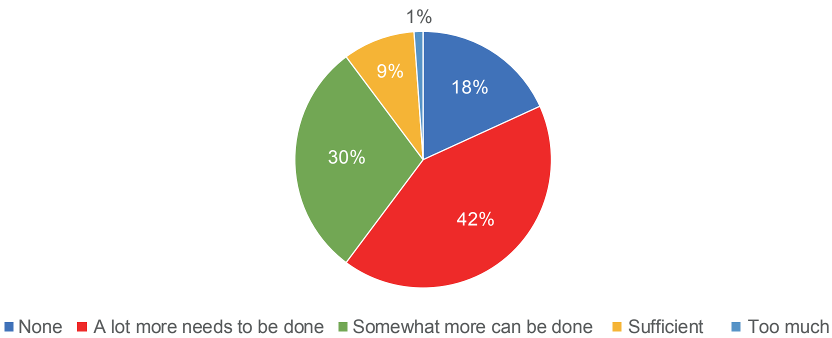
Source: The author's summary of the survey of experts.

Figure 6 Lao PDR's economic recovery to pre-pandemic levels



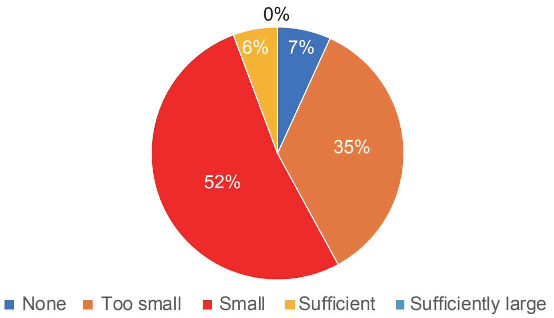
Source: The author's summary of the survey of experts.

Figure 7 Government's support to the economy since the COVID-19 outbreak



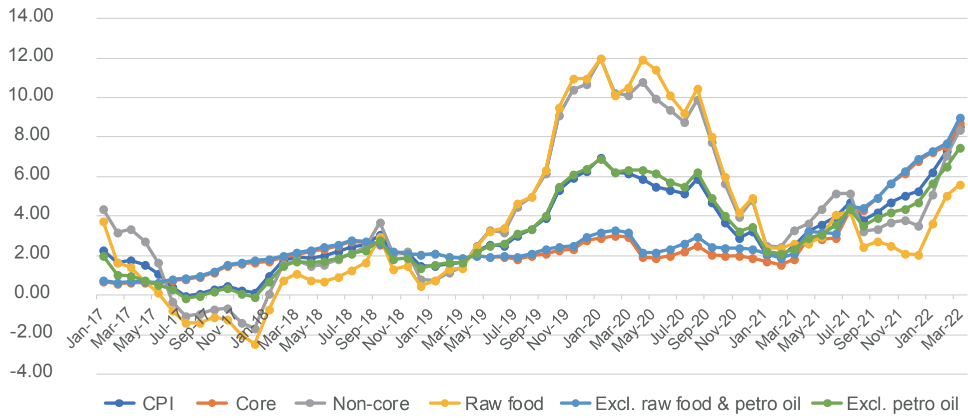
Source: The author's summary of the survey of experts.

Figure 8 Fiscal stimulus packages



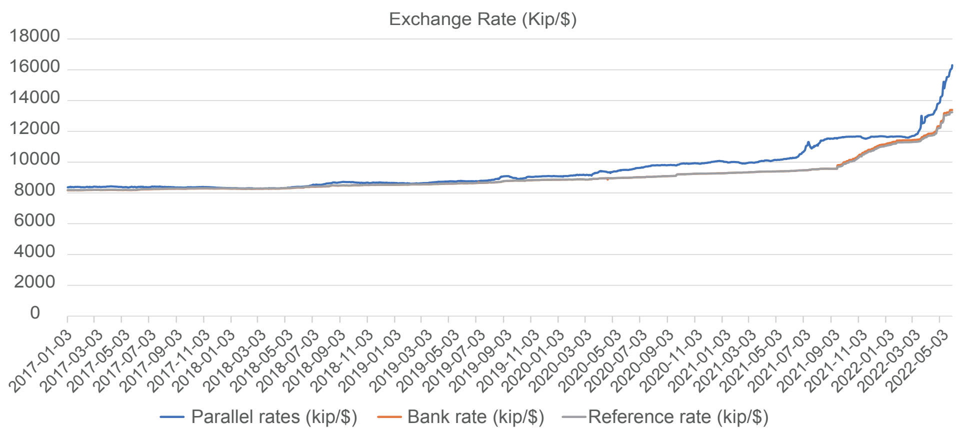
Source: The author's summary of the survey of experts.

Figure 9 Consumer Price Index (CPI), Dec 2015=1



Source: IMF (2022).

Figure 10 Exchange rate (LAK/US$)



Source: IMF (2022).

Figure 11 Public-Private Partnerships (PPPs) in response to COVID-19

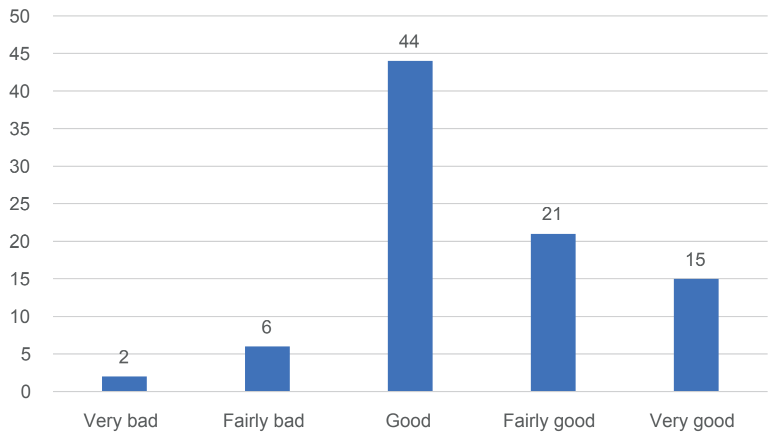


Figure 12 Level of PPPs in the following sectors to ensure efficient and smooth COVID-19 recovery

PPP projects	Importance	Relevance	Viability
Airports	3.8	3.7	3.4
Electricity	4.3	4.3	3.8
ICT	4.4	4.3	4.0
Railways	4.2	4.0	3.9
Roads	4.5	4.3	4.0
Water supply	4.2	4.0	3.8
Hospital	4.6	4.5	4.1
School/University	4.4	4.3	4.0

Appendix 2. Selected Tables

Table 1 Lao PDR Economic Indicators

	2019	2020	2021	Projections 2022	2023	2024
Real economy	Percent change yoy					
Real GDP growth	5.5	0.5	2.5	3.8	4	4.2
Agriculture	1.2	3.2	2.3	2.2	2.5	2.6
Industry	5.6	4	7.6	5.2	4	3.4
Service	6.9	-3.5	-2.2	2.9	4.4	5.7
Inflation (period average)	3.3	5.1	3.8	6	5.5	5
Fiscal account*	Percent of GDP					
Revenues	15.6	12.7	13.9	14.1	14.6	15
Domestic revenue	13.8	11.2	12.4	12.8	13.3	13.9
Taxes	10.9	9.2	9.6	9.9	10.4	10.9
Non-tax	2.9	2	2.8	2.9	2.9	3
Grants	1.7	1.5	1.5	1.3	1.3	1.1
Expenditures	18.8	18	15.4	17	17.2	17.4
Current expenditure	12.6	11.5	10.8	12.3	12.4	12.5
Wages	6.4	6.2	6	6	6	6
Non-wage, non-interest expenditure	4.5	3.8	3.6	3.7	3.7	3.7
O/W interest payment	1.8	1.5	1.2	2.7	2.8	2.8
Current expenditure without interest	10.9	10	9.5	9.6	9.6	9.7
Capital expenditure	6.2	6.5	4.6	4.6	4.8	4.9
Domestic finance	2.6	2	1.9	1.9	2	2.1
Foreign finance	3.6	4.5	-1.4	2.7	2.8	2.8
Fiscal balance	-3.3	-5.2	-0.2	-2.9	-2.6	-2.3
Primary balance	-1.5	-3.7		-0.2	0.1	0.5
Selected monetary accounts	Percent change yoy					
Broad money	18.9	16.3	24			
Credit to the economy	7.4	4.3	11.5			
Balance of payments	Percent of GDP					
Current account balance	-12.1	-5.9	-3.2	-3.5	-4.9	-5.5
Trade balance	-7.9	-1.3	1.7	2.2	1.1	0.5

	2019	2020	2021	Projections		
				2022	2023	2024
Export of G&S	37.6	35.2	42.1	48.6	50.2	50.7
Import of G&S	45.5	36.5	40.4	46.4	49.1	50.2
Primary income: net	-5.8	-5.9	-6.1	-6.9	-7.4	-7.4
Secondary income: net	1.6	1.4	1.6	1.3	1.5	1.5
Gross international reserves	997	1,319	1,263	1,282	1,313	1,334
Months of G&S import cover	1.4	2.3	2	1.9	1.8	1.7
Memorandum items						
Nominal GDP (Billion kip)	162,657	171,741	182,572	197,126	213,587	231,641

Source: World Bank (2022).

Table 2 The risks for Lao PDR's economy

Risks	Likelihood of occurrence	Severity on the economy, society, and geopolitics
A complete lockdown due to another wave of COVID-19 outbreak	3.50	3.92
A partial lockdown due to another wave of COVID-19 outbreak	3.99	3.78
Household debt crisis	3.90	3.92
Sovereign debt crisis	4.13	4.13
Increased overall prices due to expansionary fiscal and monetary policies	3.94	3.95
Property bubble	3.63	3.57
Commodity shocks	4.18	4.25
Youth unemployment	4.15	4.09
Erosion of social cohesion	3.27	3.39
Gender inequalities on wage, employment, and access to other opportunities	3.22	3.16
Digital inequalities	3.43	3.20
Cybersecurity failure	3.19	3.15
Climate change and extreme weather conditions	3.35	3.36
Growing practices of protectionism (inward-looking policy agenda)	3.52	3.72
Healthcare breakdown in health facilities	3.50	3.67
Overburden of healthcare to households	3.67	3.76
Increase in education disparity	3.66	3.64
Overburden of education responsibilities to households	3.76	3.69
Others	0	0

Source: The author's summary of the survey of experts.

Table 3 Budget (LAK million)

	2020			2021		
	Budget	Supplementary	Realized	Budget	Supplementary	Realized (Estimate)
1. Revenue	22,252,249		21,845,750	26,138,078		16,150,319
1.1. Taxes	19,915,249		15,764,605	19,984,897		12,030,849
1.2. Social contributions	50,000	14,877	64,877	0		375
1.3. Grants	2,287,000	278,283	2,565,283	2,420,000		1,794,382
1.4. Other revenue						
2. Expenditure	33,292,319		30,854,994	31,583,000		16,957,574
2.1. Current expenditure	21,689,986		19,732,439	21,277,000		12,734,148
2.1.1. Interest payment	3,618,000		2,609,480	3,838,000		1,360,806
2.2. Capital expenditure	11,602,333		11,122,555	10,306,000		4,223,426
3. Fiscal balance	-11,040,070		-9,009,244	2,441,078		1,621,413

Source: IMF.

Table 4 Financing COVID-19-related stimulus package (LAK million)

	2020	2021
1. Reallocation of budget	53,980	100,000
2. Spending cuts		
3. Revenue (tax, fee) increase		
4. Borrowing (including bond)		
5. Reserve funds (saving)		100,000
6. Financial aid from overseas		
7. Others (private donation)	80,000	
Total	233,980	200,000

Source: IMF.

Table 5 The policy responses to help recovery efforts

Policy responses	Importance	Relevance	Viability
Cash transfers	3.5	3.3	2.6
Cash-for-work programs	3.8	3.6	3.0
Subsidies to business	3.5	3.4	2.6
Skills training programs	4.0	3.9	3.3
Low-interest loans from SMEs fund	4.1	3.8	3.3
Income tax exemption	4.2	4.0	3.7
Profit tax exemption	4.0	3.9	3.5
Exemption of customs duties	4.1	3.9	3.8
Deferring payment	4.0	3.9	3.6
Reducing the electricity prices	4.3	4.1	3.6
Unemployment allowance	4.0	3.8	3.0
Reducing administrative expense	3.8	3.7	3.5
Receiving the donation	4.3	4.3	3.9

Source: The author's summary of the survey of experts.

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2022 KIPF-AMRO Joint Research

The Impact of COVID-19 on Regional Economies and Policy Responses

Chapter

9

Malaysia

Chapter
9

Malaysia[109]

Following successive COVID-19 waves of infection and high daily new cases and deaths per million population, the pandemic was brought under control through a successful vaccination program that covered 78 percent of the Malaysian population by the end of 2021. The vaccination rollout success together with other public health considerations enabled the Malaysian government to announce the transition to an endemic phase with effect from 1 April 2022. The prolonged pandemic and accompanying containment measures had a severe impact on the economy, which contracted by -5.6 percent in 2020. As the pandemic restrictions were eased amid increasing vaccination coverage, the economy recovered only moderately and expanded below expectations, at just 3.1 percent in 2021, in tandem with the global recovery, successive interest rate cuts by the central bank in the previous year, and eight fiscal packages implemented over the two years. The fiscal packages totaled RM 530 billion with direct government spending amounting to RM 77 billion, or 5.2 percent of GDP. A sizeable 71 percent share of the fiscal support was directed at households, while the business sector accounted for 23 percent, with the remainder going to public health spending, including the vaccination rollout and support for the economy. Among other consequences, pandemic-related spending had raised Malaysia's fiscal deficit and debt levels, thereby reducing its fiscal space to cope with future crises. Its fiscal buffer will need to be rebuilt and the more severely impacted low-income households and small and medium enterprises rehabilitated through structural and fiscal reforms, along with a gradual fiscal consolidation process as laid out in the revised Medium-Term Fiscal Framework.

1. COVID-19 development

1. **The first waves of the COVID-19 pandemic were successfully contained in Malaysia, but resurgences continued until the national vaccination rollout.** Following the first few cases that were detected in late January 2020, Malaysia was confronted with successive waves that were increasingly more severe, with the latest deadly wave finally subsiding from October 2021 onwards, following the successful rollout of the national vaccination program (Figure 1). With the adult population fully vaccinated and severe cases falling sharply despite the spike in daily new cases due to the more infectious

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Omicron variant in early 2022, the government announced the transition of the pandemic to an endemic phase beginning 1 April 2022. This heralds the end of the two-year-long main struggle against the COVID-19 pandemic. The transition to the endemic phase marked the beginning of the economic rebuilding challenges and amelioration of the scars inflicted on the economy and society. A total of 2.76 million, or 8.4 percent of the population, had contracted the disease and 31,487 had perished as of the end of 2021 (Figure 2).

2. **To contain the successive COVID-19 waves, nationwide lockdowns, known locally as Movement Control Orders (MCO), were implemented.** The first MCO lasted nearly two months (18 March – 3 May). It successfully brought down the daily new cases to single digits for more than one-third of the days in the June to August period, before the onset of the third wave in early September 2020. At the end of the second wave on 30 June, the total number of confirmed cases had risen to 8,639 cases with 121 deaths. The successful containment of the first two waves won Malaysia international praise for its handling of the pandemic. The mitigation strategy and containment measures implemented by the government were found to accord with the seven pillars recommended by the World Health Organization (WHO) that included nationwide lockdowns, health protocols such as the mandatory wearing of facemasks and social-distancing measures, and the implementation of standard operating procedures, testing, contact tracing and quarantine activities (Ang et al., 2021).

3. **As new daily cases fell following each MCO, the pandemic restrictions were relaxed in a phased manner.** The MCO (18 March – 3 May 2020) progressed to state-level Conditional MCO (4 May – 9 June 2020) and Recovery MCO (10 June – 31 December 2020), depending on the number of new daily cases, hospitalization resource availability and utilization, and the risk characteristics of each state. However, Malaysia was struck by the third wave (8 September 2020 – 29 March 2021) attributed to a failure to contain the outbreak that had spread to other parts of the country following the Sabah state election. Daily new cases averaged more than 1,600 a day compared with only 70 cases a day in the second wave. A second nationwide lockdown was imposed on 11 January – 4 March 2021. At the end of the third wave, stretching to 29 March 2021, the cumulative cases had risen 40-fold to 340,000, while deaths had increased 10-fold to 1,260, from 8,600 cases and 121 deaths, respectively, at the end of the second wave.

4. **The fourth wave was identified from 30 March to 21 June 2021, during which the daily cases shot up to more than 4,000.** The continuing high transmission together with public hospitals nearing full capacity in treating severe COVID-19 cases prompted the government to implement the third MCO (MCO 3.0). The lockdown took effect from 12 May through to 28 June 2021. Despite the nationwide lockdown, the fourth wave morphed into a fifth wave that saw record-high cases. During the fifth wave from 22 June 2021 onwards, the daily new cases averaged 12,000 with the maximum recorded at 24,599 cases in a day. The lockdown surprisingly did not dent the rise in infection rates. The number of daily new cases rose from an average of 5,987 in June to 11,655 in July and a further rise to 20,419 in August, before easing to 16,648 in September 2021 and further downwards until the onset of the Omicron wave in early 2022.

5. **Pandemic restrictions were relaxed in a phased manner from Conditional MCO to Recovery MCO to enable social and economic activities to normalize, while avoiding a resurgence of COVID-19 cases.** As each infection wave was suppressed, the MCO restrictions were relaxed under Conditional MCO (CMCO) from 4 May to 9 June 2020, and in subsequent periods after the second and third MCO. The "lockdown" regulations under MCO were relaxed with the aim of reopening the economy in a controlled and conditional manner. Under CMCO, most economic sectors were allowed to operate and movement restrictions were more relaxed subject to specific conditions. Instead of one person from each household under MCO, two people were allowed to leave home to purchase food and supplies within the defined locality. However, religious activities, weddings, schools, theaters and conferences involving large group gatherings and service activities in enclosed spaces such as gyms, and beauty and hair salons, remained prohibited. Likewise, inter-state and inter-district travel was prohibited unless the travel was work-related, whereupon written authorization from employers or the relevant authorities was needed to be shown to enforcement personnel manning roadblocks. Regulations on dining in were also relaxed and two people per table were permitted, but not encouraged for high-risk groups.

6. **The severity of the restrictions under the various MCO phases is reflected by the Stringency Index.** The stringency of the measures adopted by the government to contain the pandemic is reflected by the Oxford COVID-19 Government Response Stringency Index. During the three MCO periods, the average score was 77 in the Stringency Index, which ranged from 0 (least stringent) to 100 (most stringent). By comparison, the scores during the Conditional MCO (CMCO) and Recovery MCO (RMCO) averaged 72 and 59, respectively. Based on the Google Mobility Reports for the country, the MCO phases on average showed a decline in movements by 53 percent at retail and recreation centers, 65 percent in transit stations, 46 percent in parks, and 40 percent in workplaces, while movements in residential areas rose by 26.4 percent (Figure 3). As restrictions eased, the decline in activities was less under Conditional MCO and less still under Recovery MCO.[110]

7. **The national vaccination rollout was the key to pandemic containment.** The ramp-up in mass vaccinations resulted in sharp reductions in daily new cases and fatalities, culminating in the transition to the endemic phase and the lifting of most pandemic restrictions on 1 April 2022. On average, daily new cases were reduced by more than half to 7,290 in October 2021, declining further to 5,370 and 4,042 cases in the final two months of 2021, respectively. Besides the public health protocols and various containment measures mounted by the government, the main factor for the sharp decline in cases can be ascribed to the quick ramp-up of the national vaccination program, which commenced in March 2021 (Figure 4). At the end of June, only 7 percent of the population were fully vaccinated with two doses of the Sinovac, Astrazeneca, or Pfizer vaccines. The share of the vaccinated population increased to 21 percent in

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110 The strictest form is the Enhanced MCO (EMCO) which is a total lockdown applied to a specific area or location to contain localised outbreak. Measures include prohibition of all movements and activities and testing of all residents.

the following month, and doubled to 46 percent by the end of August. By the end of 2021, the fully vaccinated population had increased to 78 percent. Booster shots were administered from mid-October 2021 onwards.

8. **The vaccination success was aided by access to vaccines and budgetary resources.** The early procurement and availability of vaccines from multiple sources, together with the budget allocation under the National Immunisation Programme, enabled the high vaccination coverage and resulted in Malaysia being ranked among the world's top countries in terms of COVID-19 vaccination rates. At the end of 2021, there were 2.76 million confirmed cases, accounting for 8.4 percent of the population, and 31,487 deaths, with a fatality rate of 1.2 percent (Figure 5). Both the infection and fatality rates relative to population size are among the highest globally, as well as among the ASEAN countries. Despite the surge in infection cases towards the end of 2021 and early 2022, the average number of hospital patients and critical care patients (in intensive care unit or ICU patients) continued to decline or remained low as the fully vaccinated population reached nearly 80 percent. With the stabilization of hospitalization and fatality rates, the authorities continued with a further easing of pandemic restrictions, culminating in the government announcing the transition of the pandemic to an endemic phase that took effect from 1 April 2022.

2. The economic impact of the pandemic

9. **The pandemic and the accompanying containment measures had a severe impact on the country's economy.** As in most countries, the supply, demand, trade, and financial shocks caused by the pandemic triggered a deep recession in Malaysia in 2020 (-5.6 percent GDP contraction) followed by a weak recovery in 2021 (3.1 percent GDP growth) as pandemic restrictions were tightened and then eased subsequently to deal with successive surges in COVID-19 infections in 2021 (Table 1). The shutdown of businesses, compliance with public health protocols, social and economic activity restrictions, including travel, and loss of consumer and business confidence created a combination of supply and demand shocks that were further propagated by income and employment losses. As reflected in the Stringency Index, the lockdown periods coincided with the sharp contraction in the country's gross domestic product (GDP). During the first MCO, the country's GDP fell sharply by -17.2 percent year-on-year (y/y) in Q2 of 2020 and contracted by -5.6 percent for the full year, before recovering to 3.1 percent in 2021. Correspondingly, income (GDP) per capita declined by -17.4 percent in Q2 of 2020 and by -5.6 percent for the full year before improving to 2.9 percent in 2021. Likewise, the second MCO delayed the recovery in Q1 of 2021, which remained in negative territory, although only marginally at -0.5 percent. Following a sharp 16.1 percent rebound in Q2 of 2021 largely due to the base effect, the third and fourth MCO resulted in a -4.5 percent contraction in Q3 GDP of 2021 (Figure 6).

10. **Demand shocks arising from the health risks and pandemic restrictions contributed to the sharp economic downturn in 2020.** The pandemic-related movement restrictions,

fear of contracting the COVID-19 virus, and job and income losses resulted in cutbacks in household and business spending. Private consumption shrank by -4.3 percent in 2020 and picked up slightly to register a 1.9 percent increase in 2021. The pandemic shock on investment was sizeable, as indicated by the -14.5 percent drop in gross fixed capital formation in 2020, followed by a smaller decline of -0.9 percent in 2021. Private investment accounted for a decline of 1.9 percentage points in the -5.6 percent GDP contraction in 2020, and contributed a relatively small 0.4-of-a-percentage-point rise to a 3.1 percent growth rate in 2021, suggesting the lingering impact of the pandemic on investment activities during the prolonged pandemic (Figure 7). Similarly, the contraction in private consumption accounted for a sizeable decline of 2.6 percentage points in GDP growth in 2020 and an increase of 1.1 percentage points in GDP growth recovery in 2021, pointing to the deleterious impact of the pandemic on domestic demand.

11. **On the supply side, the productive sectors were impacted unevenly during the recession in 2020 while ensuing recovery in 2021.** The pandemic-induced downturn in 2020 was led by sharp declines in construction (-19.4 percent), mining output (-10.6 percent), and services (-5.5 percent), while the manufacturing and agriculture sectors recorded smaller declines of -2.6 and -2.2 percent, respectively (Figure 8). The recovery in 2021 was weak and uneven, with support emanating from the manufacturing sector, which grew by 9.5 percent and contributed 22.6 percent to real GDP in 2021. The uneven and multi-speed recovery is evidenced by the wide dispersion in the growth rates of industries within each sector (Figure 9).

12. **The two leading sectors—manufacturing and services—which accounted for over 80 percent of GDP, exhibited an uneven recovery reflecting differences in external and domestic growth sources.** The manufacturing downturn in 2020 was uneven and the recovery speed in 2021 varied across industries, with the export-oriented industries, especially the rubber gloves industry, bucking the trend, while the large electronic components and consumer electronics industry recorded positive growth in 2020 (3.7 percent), followed by a stellar performance in 2021 (16.0 percent) on the back of global supply shortages and a recovery in global demand. The domestic-oriented services sector was impacted by the curtailment of social and economic activities, as well as travel restrictions and the closure of borders. The services sector, which accounts for nearly 60 percent of GDP, suffered from more severe domestic demand shocks during the nationwide lockdown periods and continuing restrictions on mass gatherings, travel, social and business activities (Figure 10). Not surprisingly, compared with the mild industry downturn in 2020 and the strong rebound in 2021 in the export-oriented manufacturing, the largely domestic-oriented services sector contracted by -5.5 percent in 2020 followed by a soft recovery in 2021 as the pandemic restrictions continued in varying degrees during the year. The mobility data published by Google show that activities in retail and recreation, parks, transit stations, and workplaces were sharply curtailed, with the most severe declines recorded during the first MCO.

13. **The demand shocks caused sharp declines in the performance of the services industries.** In particular, the accommodation (hotel) industry value added fell by -50.3 percent in 2020 and a smaller decline of -24.3 percent in 2021. Likewise, the food and

beverage industry contracted by -20.6 percent in 2020 and by -8.9 percent in 2021. Reflecting the impact of movement restrictions, the transportation industry, motor vehicles, and the wholesale and retail trade registered output declines in 2020. The weak economic recovery in 2021 is reflected by the slow growth in the wholesale, retail, and transportation industries as pandemic-related protocols prevailed during the year, as reflected in the high Stringency Index score. The industries that were less affected by the pandemic restrictions through the adoption of work-from-home, on-line and home delivery activities, include information and communication (2020 at 6.0 percent, 2021 at 6.3 percent), finance (2020 at 2.4 percent, 2021 at 9.5 percent), insurance (2020 at 3.6 percent, 2021 at 12.3 percent), government (2020 at 4.5 percent, 2021 at 5.4 percent), and water and sewerage (2020 at 7.2 percent, 2021 at 6.1 percent) industries.

14. **The agriculture, mining, and construction sectors, which collectively account for around 18 percent of Malaysia's GDP, were similarly affected to varying degrees by the pandemic.** The agricultural value-added output fell slightly by -2.2 percent in 2020 and marginally by -0.2 percent in 2021, largely due to the lockdown and shortage of foreign workers as recruitment came to a halt amid border closures. While the rubber and oil palm plantation industries experienced declines in 2020 and 2021, livestock and food agriculture industries continued to expand to meet basic needs. The mining sector contracted by -10.6 percent in 2020 and recovered to record a marginal increase of 0.7 percent in 2021, led largely by the expansion in natural gas production (6.6 percent). The pandemic had a huge impact on the construction sector, which experienced a -19.4 percent contraction in 2020 and a smaller -5.2 percent decline in 2021. Workplace shutdowns, demand uncertainties amid probable pandemic-induced behavioral and life-style changes, and difficulties in securing foreign workers all contributed to the downturns in 2020 and 2021. Only specialized construction activities rebounded strongly in 2021, while the other industries, residential, non-residential, and civil engineering activities continued to decline in 2021 following a double-digit contraction in 2020.

15. **The pandemic-triggered downturn hit the labor market severely, causing the unemployment rate to rise to its highest level since 1990, and worse than during the 1997/98 Asian financial crisis.** During the economic downturn in 2020, the total number of unemployed peaked at 791,000, with the unemployment rate hitting 5.1 percent in Q2 of 2020, up from 3.5 percent in Q1 of 2020 (Table 2). The unemployment rate averaged 4.5 percent in 2020 and 4.7 percent in 2021 compared with the pre-pandemic average of 3.3 percent. While trending down, the unemployment rate of 4.3 percent in Q4 of 2021 was about 1 percentage point higher than the pre-pandemic level of 3.3 percent in 2018 and 2019. Job losses stemmed largely from manufacturing (21.7 percent), wholesale and retail (14.9 percent), accommodation, food and beverage (11.4 percent), professional and technical services (8.9 percent), administrative and support services (7.4 percent), construction (7.6 percent), and transportation (6 percent) bearing the brunt of the employment losses (Figure 11). The job losses in terms of occupation were characterized by professionals (27.2 percent), technicians and associate professionals (19.7 percent), managers (14.3 percent), plant and machine operators and assemblers (11.1 percent), and clerical support workers (9 percent) (Figure 12).

16. **Inflation turned negative during the downturn but normalized quickly as the economy recovered.** The pandemic-induced economic downturn in 2020 was accompanied by a decline in headline consumer price inflation, which fell by -1.2 percent following below trend inflation in the previous two years (2018 at 1.0 percent, and 2019 at 0.7 percent). Demand-induced deflation was evident in Q2 of 2020, whereby the Consumer Price Index (CPI) declined by -2.6 percent as the economy contracted by -17.2 percent, before recovering gradually in subsequent quarters. The headline inflation rate turned positive in Q1 of 2021 and surged to 4.2 percent in Q2 in tandem with the sharp rebound in GDP growth by 16.1 percent. Core inflation, however, did not turn negative but inched below 1 percent in Q4 of 2020 and stayed below 1 percent throughout 2021, again pointing to weak demand and low underlying inflation, as opposed to a stagflation phenomenon had the pandemic caused widespread supply disruptions and shortages. As GDP growth turned negative (-4.5 percent) in Q3 of 2021 following the 15.1 percent rebound in Q2 of 2021, the headline CPI inflation eased to 2.1 percent in Q3 before rising to 3.2 percent in Q4 of 2021, contributed largely by the surge in oil prices and improving demand as reflected in the GDP growth of 3.6 percent in the same quarter. Nonetheless, price pressures continued to rise as indicated by high producer prices, which rose by over 11 percent annually in the last three quarters of 2021. Likewise, the broadest indicator of prices in the economy, the implicit GDP deflator, rose by 5.7 percent in 2021 from -0.8 percent in 2020, with the quarterly increases trending up and hitting 8.2 percent in Q4 of 2021 (Table 3).

17. **The global recovery in 2021 boosted commodity prices and generated a positive terms-of-trade effect on the economy.** A significant factor moderating the adverse economic impact of the pandemic was the strong recovery in commodity prices in 2021, particularly crude oil, natural gas, palm oil, and rubber, following price slumps in 2020, and served to boost Malaysia's export earnings. The economy also benefited from an improvement in the terms of trade, which rose by 6.0 percent in 2021 from a 0.5 percent increase in 2020. The surge in oil and natural gas exports, besides strengthening the coffers of the national oil company and alleviating hardships faced by oil and gas industry players during the downturn in 2020, also strengthened the government's revenue position and averted a widening of the fiscal deficit. Palm oil earnings, which sustain over 650,000 smallholders and over 2 million employed in the industry, recorded strong price increases throughout 2020 (30.4 percent) and 2021 (59.9 percent). The implication is that the government's COVID-19 assistance packages for households would likely have needed to be enlarged without the surge in commodity prices in 2021.

18. **The pandemic was less disruptive to financial markets.** The key factors underpinning Malaysia's financial stability included the resilience of the banking system and the aggressive monetary policy response of the central bank, which acted quickly to reduce its overnight policy rate by a cumulative 125 basis points to 1.75 percent by Q3 of 2020 (Table 4). Despite lower interest rates, deposits in the banking system expanded by 4.4 percent in 2020 and 6.3 percent in 2021. Deposits by households grew at a steady pace of 6.6 percent in 2020 and 4.9 percent in 2021, while deposits by businesses were flat in 2020, but rose by 10.5 percent in 2021, pointing to business recovery. The less disruptive impact of the pandemic on the financial system is also evidenced by the continuing

credit flows in 2020 and 2021. Business loans growth slowed to 1.0 percent in 2020 but recovered to 4.9 percent in 2021, while household loans grew at a steady pace of 5.0 and 4.3 percent in 2020 and 2021, respectively (Table 5). Due to the loan moratorium implemented under the various COVID-19 support and stimulus packages mounted by the government, the ratio of impaired loans and financing to total loans and financing remained low at 0.96 percent in 2020 and 0.90 percent in 2021. Despite the economic downturn in 2020, the stock market index and capitalization rose by 2.4 and 6.2 percent in 2020 respectively, thereby averting possible negative wealth spillovers on households and businesses. However, the stock market gains were reversed in 2021. As indicated by the quarterly changes, the stock market experienced wide swings over the two-year pandemic.

3. Policy measures in response to COVID-19

19. **The government implemented stimulative fiscal policies in concert with unprecedented monetary policy easing to mitigate the adverse economic impact of the prolonged pandemic.** The country's COVID-19 fiscal policy response during the 2020–21 period comprised eight discretionary fiscal packages and budgetary allocations totaling RM 530 billion (Figure 13). The total amount constituted 35.8 percent of the country's annual GDP (average of 2020 and 2021 GDP).[111] The 'above-the-line' or 'on-budget' spending amounted to RM 77 billion, or 5.2 percent of GDP, while the 'below-the-line' spending comprising revenue foregone, loans, guarantees, and retirement savings withdrawal amounted to RM 453 billion, or 30.6 percent of GDP. A broad classification of the measures shows that people's welfare was the primary focus, receiving the largest share of 71.8 percent of the total amount in 2020 and 70.8 percent in 2021 (Figure 14). The business sector was the second-largest recipient, accounting for 23.2 percent of the total aid in 2020 and 22.5 percent in 2021. Measures aimed at supporting the economy accounted for 3.9 percent of the total amount in 2020 and 1.3 percent in 2021, while health spending rose from 1.0 percent in 2020 to 5.4 percent in 2021 due principally to the funding for the national vaccination program that covers the local population of 32 million people and over 2 million foreign workers in the country.

20. **The relatively large number of fiscal packages and their timing are reflective of the uncertainty over the prolonged pandemic, and its social and economic impacts.** Each package was crafted in response to the severity caused by the successive waves of COVID-19 infections and restrictions imposed. Despite the political turbulence and uncertain economic impact at the beginning of the outbreak, the government responded early by rolling out the first fiscal package on 27 February 2020 (Ministry of Finance, 2020). At the time of announcement of the first COVID-19 fiscal package, the cumulative COVID-19 cases stood at only 23 cases. Besides boosting public health spending in response to the epidemic threat, which was then yet to be declared a pandemic by WHO, the early government response was motivated by the softening

111 Part of the unspent COVID-19 allocation for 2021 has been carried over to the following year.

economy that had slowed in the preceding year due to the United States-China trade dispute. The other motivating factor was Malaysia's large exposure to trade and investment with China, the ground zero of the COVID-19 outbreak.

21. **The fiscal support was multi-faceted and aimed at alleviating specific stresses.** Under the people-centric (households) category, the fiscal initiatives can be grouped into: (i) income protection; (ii) direct cash assistance; (iii) loan moratoriums; (iv) tax relief and incentives; (v) direct in-kind assistance, and (vi) medical and insurance. Under the income protection initiative, the measures implemented covered enhanced benefits under the employee insurance scheme where the insured receives 80 percent for the first month, 50 percent for the second month, 40 percent for the third and fourth months, and 30 percent for the fifth and sixth months. The second measure was the employee retention program where eligible employees in the affected sectors were given a subsidy of RM 600 for three months. The severity of the impact of the pandemic on the economy far exceeded the adequacy of existing social protection schemes such as the national unemployment insurance schemes and income transfer programs to the bottom 40 percent (B40) households to alleviate the rising cost of living.

22. **Direct income transfers or cash handouts to low-income households were a key measure to alleviate financial distress faced by low-income households.** Under the direct cash assistance initiative, eligible recipients in the low- and middle-income groups were given one-off cash aid ranging from between RM 350 and RM 1,800 that varied slightly for each fiscal package.[112] In addition to the cash handouts, the contributors to the Employees Provident Fund (EPF) were allowed to take out up to RM 10,000 from their retirement savings under i-Lestari and RM 10,000 under the i-Sinar withdrawal program.[113] Under the tax relief and incentives initiative, special tax relief was given for the purchase of mobile phones, computers, and tablets (one-off, RM 2,500), sales and services tax exemption for passenger vehicles for 12 months, an increase in scope for health screening tax relief to include COVID-19 screening from RM 500 to RM 1,000, and real property gains tax exemption for houses sold after six years.

23. **Fiscal packages contained various in-kind support to complement cash disbursements.** The direct-in-kind initiative included the provision of: (i) food baskets and kitchen aid (one-off, RM 100), (ii) one-off, laptop and devices to students; (iii) internet access subsidy (one-off, RM 300); (iv) free 1GB internet (more than six months); (v) free travel passes (public transport); and (vi) rent-to-own scheme for first-time home buyers (5,000 units of government-built affordable housing). The B40 households were provided with free health care and a one-off RM 50 voucher for a medical checkup.

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112 The absence of populist and political pressure in Malaysia for cash assistance to be extended to all income groups in contrast to Korea's experience can be attributed to the higher income inequality in Malaysia (Gini index 41.1 in 2015) compared with Korea (Gini index 31.4 in 2016) as shown by the World Bank Development Indicators.

113 There were altogether 3 EPF withdrawal schemes implemented between 2020 and 2022: (i) i-Lestari where a total of RM 20.8 billion was withdrawn; (ii) i-Sinar RM 58.7 billion; and (iii) i-Citra RM 21.4 billion. Another withdrawal was approved for the January – June 2022 period, involving a total amount estimated at around RM 50 billion. The total number of beneficiaries is estimated at 7.3 million.

The medical insurance coverage for the B40 group was expanded to include the cost of medical devices, such as stents for the heart or prosthetics. Overall, the automatic loan moratorium and reliefs accounted for the largest share of the total aid packages for households, followed by withdrawals from the Employees Provident Fund (EPF), direct cash handouts, and a reduction in the minimum EPF contribution (Figure 15).

24. **The second category of fiscal support focused on businesses.** The measures included cash aid, liquidity support, wage subsidies, and tax relief to enable businesses to better cope with the impact of the pandemic and the ensuing economic downturn (Figure 16). The initiatives encompassed the provision of financial assistance, tax relief, employment support, subsidies, and exemptions or waivers. The types of financial assistance included: (i) loan moratoriums; (ii) targeted loan repayment assistance; (iii) microfinancing schemes; (iv) a tourism fund; (v) one-off grants for SMEs; and (vi) loan guarantees. The tax reliefs or waiver included: (i) zero tax rate for new manufacturing investments; (ii) an extension of the timeline for tax filing; (iii) flexibility to revise tax estimates and reduce instalment payments; (iv) deferment of tax instalment payments; (v) special tax relief for business premise rentals; and (vi) tax exemptions for the tourism sector. The financial support for employment covered: (i) the wage subsidy program, where eligible employees were given RM 600 per month for up to six months; and (ii) a RM 2 billion allocation for reskilling and upskilling programs. A summary of the total number of employers and employees benefiting from the wage subsidy programs is tabulated in Table 6. Over 2 million employees, or about 14.4 percent of the total employed in 2020, received the wage subsidy benefits. Under the digitalization initiative, the measures consisted of smart automation grants of up to RM 200,000 each and a loan facility for high-technology investment of up to RM 5 million per applicant. Under subsidies and exemptions, businesses in the tourism sector were given electricity discounts, while late payment charges for business license renewal were exempted, and the Human Resources Development Fund levy was waived.

25. **The bulk of the support for businesses was indirect in nature.** Similar to the fiscal relief for households, the loan moratorium was the largest component of the support directed at businesses, followed by financial guarantee facilities, wage subsidies, special financing relief, and various financing schemes for SMEs. The bulk of the support for businesses was indirect, being implemented by financial institutions through loan moratoriums, access to financing and financial guarantee facilities, and by utility companies through tariff discounts.

26. **The third broad category of fiscal support encompassed various measures to boost selected sectors of the economy.** The health-care sector was enhanced through increased allocations to contain the pandemic, including funding the National COVID-19 Vaccination Programme and increasing allowances for frontline staff (Figure 17). The tourism sector was supported with tax and soft loan incentives, while food security was strengthened with an allocation of RM 1 billion for the agriculture sector. To support small contractors that rely on government projects, RM 2 billion was allocated to generate small-scale projects for infrastructural maintenance and upgrading. The largest support for the economy comprised government funding for small-scale projects, followed by

allocations for enhancing food security and economic recovery.

4. Assessment of policy responses and future challenges

27. **In assessing the timeliness, adequacy, and efficacy of the public health response to the pandemic, it is noted that the pandemic containment measures were implemented quickly in line with the protocols recommended by WHO.** An early and timely response was evident in the strict nationwide lockdown instituted for two months during the early phase of the outbreak in 2020, whereby the daily new cases numbering in the hundreds were brought down to single digits. However, the containment measures were less successful in dealing with subsequent waves, especially the more deadly Delta variant and the more transmissible Omicron variant, as evidenced by the higher COVID-19 cases and deaths per million compared with other countries. The probable causes include insufficient testing, contact tracing, and quarantine of infected individuals, lockdown fatigue syndrome, non-compliance with pandemic protocols, state elections, social gatherings, and religious events that gave rise to infection clusters in workplaces and communities. In addition, the government response to the twin pandemic and economic shocks could have been more focused without the political uncertainty emanating from unexpected changes in the ruling coalition party.[114]

28. **The critical success factor in containing the pandemic was undoubtedly the high vaccination coverage that reached 78 percent of the total population by the end of 2021, among the highest in the world.** This was achieved through early procurement of different vaccines and mass rollout after overcoming teething operational hiccups at the start of the national vaccination program in early March 2021. While the daily COVID-19 cases remain high, the relatively low number of severe cases, and adequate hospitalization capacity, especially critical-care facilities, prompted the government to declare a transition to an endemic status with effect from 1 April 2022, leading to further removal of restrictions on social and economic activities, including cross-border travel. The future challenge is to increase the annual budget allocation for the under-funded public health system and enhance its capability and capacity to deal with the threat of new COVID-19 variants and other pandemic diseases. Other necessary initiatives include the mobilization of private hospitals and clinics in facing public health crises and leveraging digital technology, including telemedicine to increase health-care efficiency, improve access, and reduce costs. Preventive health care and healthy living also need to be advanced as an integral part of the long-term challenge to face future public health risks, and rising medical and health-care costs associated with population ageing in Malaysia.

29. **The fiscal response to the pandemic was mounted relatively early.** In mitigating the impact of the pandemic on the Malaysian economy, it is noted that the government's

114 During the two-year long pandemic, there were three different prime ministers leading the country.

fiscal and monetary policy responses were mounted quickly as evidenced by the rollout of the first COVID-19 fiscal package on 27 February 2020, which preceded the nationwide lockdown in the following month. Likewise, the central bank's overnight policy rate (OPR) was lowered by a cumulative 1.25 percentage points by July 2020 to a historical low of 1.75 percent. To ensure good governance and alignment with international best practices, the government legislated the establishment of a COVID-19 Fund in September 2020 to finance economic stimulus packages and recovery plans in addressing the COVID-19 crisis. In addition to creating a legal framework for funding and spending, the dedicated trust fund was governed in accordance to transparent reporting standards. In December 2020, the expenditure of the COVID-19 Fund was increased from RM 45 billion to RM 65 billion. A further increase to RM 110 billion was approved by parliament in 2021 to take into consideration the additional spending under the 2022 Budget.

30. **Closer and more effective policy coordination is a necessity, albeit an insufficient condition, for better health, social, and economic outcomes.** Synchronized health, monetary, and fiscal policy responses are crucial in providing more effective income and spending support, as well as providing a backstop against sliding consumer and business confidence. The coordinated fiscal and monetary response is seen to be more effective in bolstering consumer and business confidence, while also ensuring that vulnerable groups such as low-income households, SMEs, and the informal sector receive the needed assistance. Importantly, the COVID-19 fiscal measures were directed predominantly at the household sector, which accounted for 71 percent of the aggregated value of the COVID-19 fiscal packages. The main focus of the government assistance, especially income transfers (cash handouts), was directed at the B40 income group. The disbursements through direct bank transfers and counter services were facilitated by the existing administrative system that was already in place to register and verify recipients under previous budget initiatives before the pandemic. The key challenge facing cash handouts, wage subsidies, and small business grants was a lack of awareness and difficulties in access for various reasons. An unknown number of qualified recipients "fell through the cracks" due to a lack of awareness and difficulties in access, or no access, especially for those living in remote areas. Adequacy is another issue, as the cash amount and wage subsidy are small relative to the monthly expenditure and income of households and businesses. Those in the informal sector are also hard to reach, pointing to the need for a comprehensive database on eligible aid recipients that requires continuous review and updating.

31. **A total of eight fiscal packages were delivered over the 2020–21 period in response to the evolving pandemic situation, public health, and economic needs.** There were four fiscal packages mounted each year, giving rise to the need to consider the advantages and disadvantages of incremental fiscal doses versus fewer but larger injections. Due to the uncertain progression and containment of the pandemic, a flexible policy stance is therefore advantageous in crafting fiscal responses that are proportionate to the various impacts that can be predicted with a high degree of confidence or those that have materialized. While fiscal capacity remains an over-riding factor in evaluating the size of fiscal support, a more aggressive approach is usually desirable to enhance consumer and investor confidence in crisis situations. It is however difficult to assess whether

consolidating the eight fiscal packages over the two years into fewer but larger packages would have been more effective in countering the severe impact of the pandemic on the economy.

32. **The fiscal measures mounted over 2020–21 derailed the pre-pandemic improving fiscal trend and caused a significant deterioration in the government's fiscal position.** The federal government's fiscal position deteriorated sharply in 2020 as revenue fell by -14.9 percent, while total expenditure including additional spending on COVID-19 assistance and stimulus packages, shrank marginally by -1.0 percent, causing the fiscal deficit to nearly double to -6.2 percent of GDP in 2020, from -3.4 percent in 2019 (Table 7). In 2021, despite a 2.5 percent rise in government revenue in line with the economic recovery, expenditure expanded by 5.9 percent, causing the fiscal deficit to widen to an estimated -6.5 percent. On a quarterly basis, the deficit widened to -10.0 percent of GDP in Q1 of 2021 before improving to -0.7 percent of GDP in tandem with the economic recovery in Q4 2021 (Figure 18). The increase in deficit spending during the two pandemic years was funded largely by borrowing. Government debt grew by 10.9 percent in 2020 and a further 11.4 percent in 2021. Correspondingly, the government debt-to-GDP ratio jumped nearly 10 percentage points to 62.1 percent in 2020 and edged further up to 63.5 percent in 2021 (Table 1). An additional source of COVID-19 funding came from the National Trust Fund, which was established in 1988 to raise government savings and provide alternative financing for development expenditure. Of the nearly RM 20 billion accumulated in the trust fund, about half came from contributions by the national oil company (Petronas). A sum of RM 5 billion from the fund was approved by parliament for the purchase of vaccines in 2021. While modest relative to Malaysia's natural resource endowments that include oil and gas, this alternative source of emergency funding nevertheless attests to the importance of setting aside reserves as a fiscal strategy to counter future crises.

33. **Effective targeting and the judicious relaxation of restrictions on business and production activities are key to reducing the economic impact.** In retrospect, it can be seen that relaxing judiciously the restrictions on business and production activities, including the differentiation between essential and non-essential industries, could have lessened the impact on the economy. The shutdown of production activities deemed non-essential across all economic sectors accentuated the combined supply and demand shocks on the economy, as evidenced by the sharp contraction in Q2 of 2020 following the imposition of the first nationwide lockdown. Therefore, the early decision to allow factories, especially those involved in global supply chains, to resume operations subject to compliance with the prescribed health protocols, such as the mandatory wearing of masks and social-distancing measures, averted more serious damage to the economy with strong linkages to global and regional supply chains.

34. **Fiscal measures that draw on retirement savings will have long-term consequences.** A COVID-19 fiscal policy response that could have long-term negative consequences is the measure to lower the employees' contribution rate and allow the withdrawal of the mandatory retirement savings from the Employees Provident Fund (EPF). The three withdrawal schemes included in the COVID-19 packages, excluding the one approved

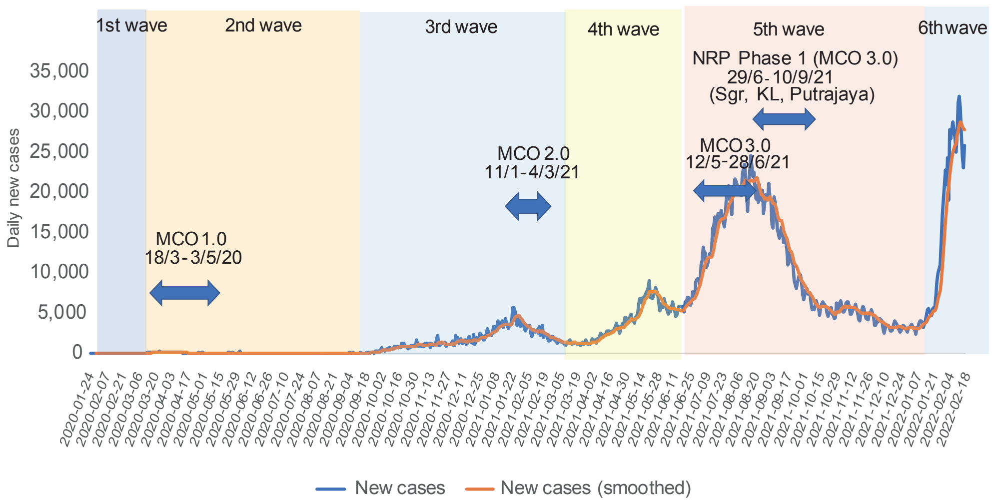
in early 2022, have resulted in total withdrawals estimated at RM 100.9 billion. This has reduced the national mandatory retirement savings pool by 10.9 percent (based on 2019 total assets of RM 925 billion). Given that only 18 percent of EPF contributors are found to have adequate retirement savings, the government will have to provide for higher social spending and implement a more comprehensive social safety net to avert a looming old-age poverty crisis arising from inadequate retirement savings.

35. **Another major consequence of the COVID-19 fiscal response is the narrowing of the country's fiscal space, thereby increasing its vulnerabilities to future shocks to the economy.** The country's elevated fiscal deficit and debt levels will have to be reduced gradually so as not to imperil the economic recovery or miss the opportunities to rebuild a more resilient post-pandemic economy through well-designed fiscal spending. Given Malaysia's large external sector, the pace of fiscal consolidation is dependent on the state of the global economy, as well as its ability to implement structural and fiscal reforms, covering taxation and expenditure rationalization. It is commendable that the government has enacted a Fiscal Responsibility Act that includes the adoption of an updated Medium-Term Fiscal Framework (MTFF) to guide the fiscal consolidation process.

36. **Both expenditure and revenue reforms are crucial to rebuild the country's fiscal buffers and increase fiscal resilience to future crises.** While pursuing a gradual process of fiscal consolidation under the revised MTFF, the reform priorities include raising the revenue level, diversifying sources, and broadening the tax base to meet higher expected social and development spending in the coming years. A crucial imperative is the re-introduction of the consumption-based or value-added tax system (Goods & Services Tax or GST, as it is known locally) as a means to broaden the tax base and achieve a judicious balance between direct and indirect tax revenue. On the expenditure side, capping operating expenditure from rising further, including limiting the size of the civil service, while raising spending and government service delivery efficiencies through the greater use of digital technologies, are some of the necessary restructuring imperatives. While subsidies and social assistance are unavoidable, there is a need to reduce the dependency of recipients on income support on the one hand, and the government's reliance on populist measures to garner political support on the other hand. Such dependencies lead to delays in implementing tough reforms that entail short-term pain but provide long-term gains, especially increased robustness to face another major shock to the economy.

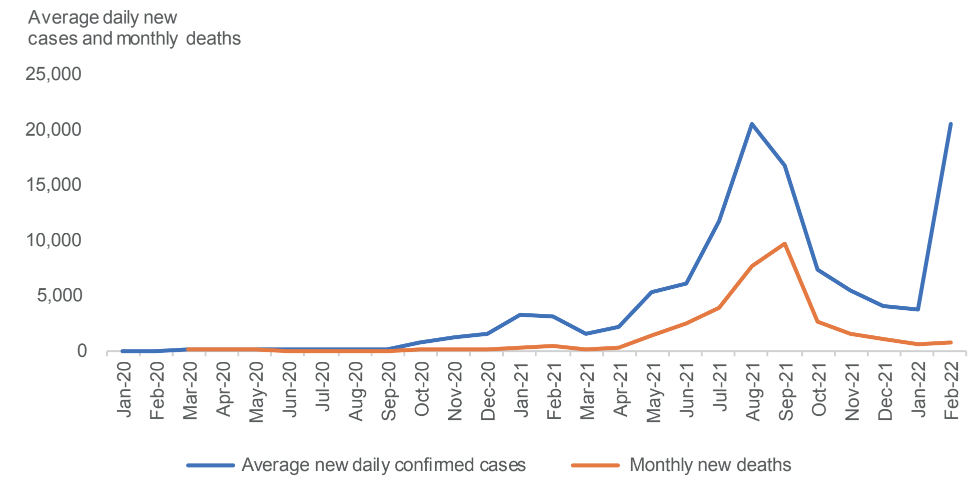
Appendix 1. Selected Figures

Figure 1 COVID-19 developments and pandemic progression in Malaysia



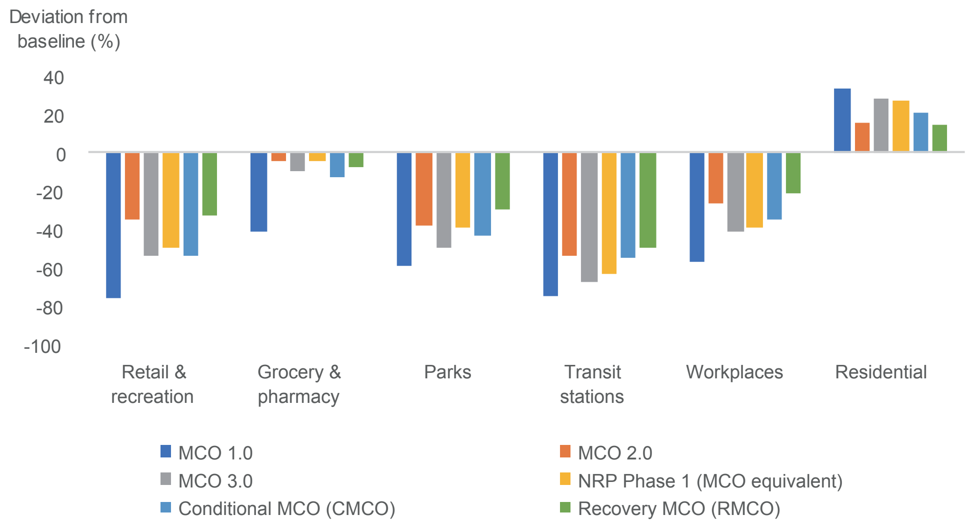
Source: Our World in Data, Ministry of Health Malaysia COVID-19 datasets; Malaysian government announcements on MCO.

Figure 2 Average daily new cases by month and monthly new deaths



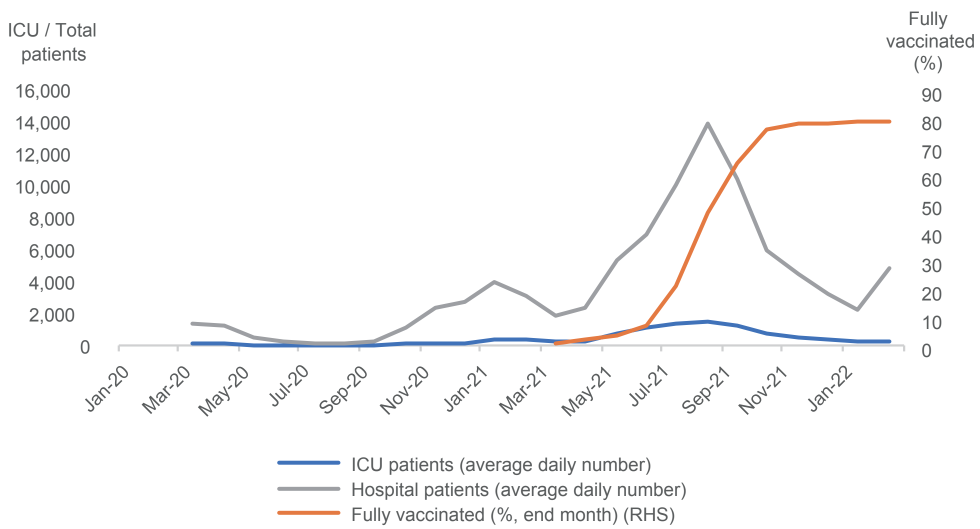
Source: Our World in Data, Ministry of Health Malaysia COVID-19 datasets.

Figure 3 Google mobility data by MCO periods



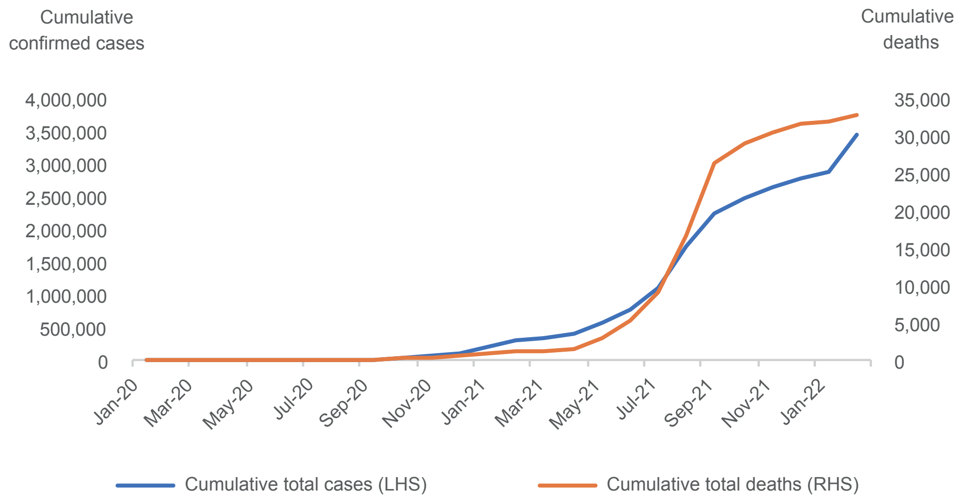
Source: Department of Statistics Malaysia.

Figure 4 ICU and hospital patients and vaccination rate



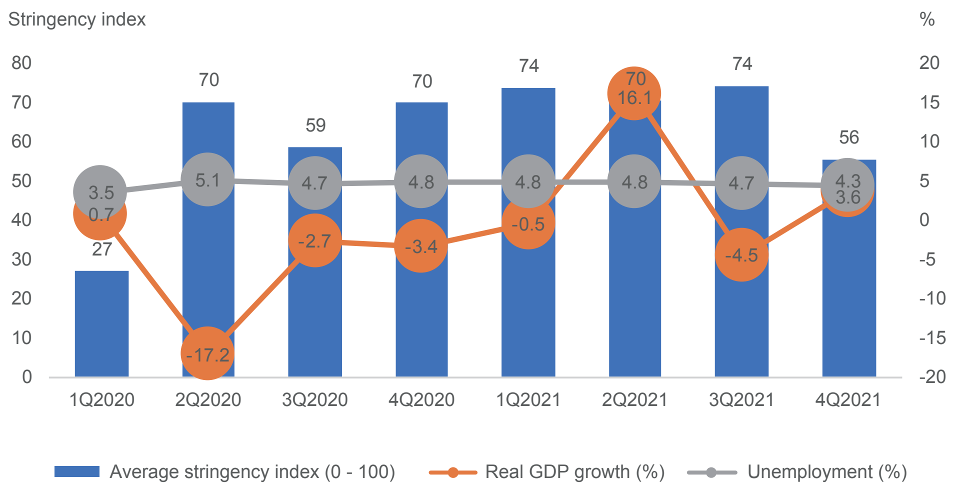
Source: Our World in Data, Ministry of Health Malaysia COVID-19 datasets.

Figure 5 Cumulative COVID-19 cases and deaths



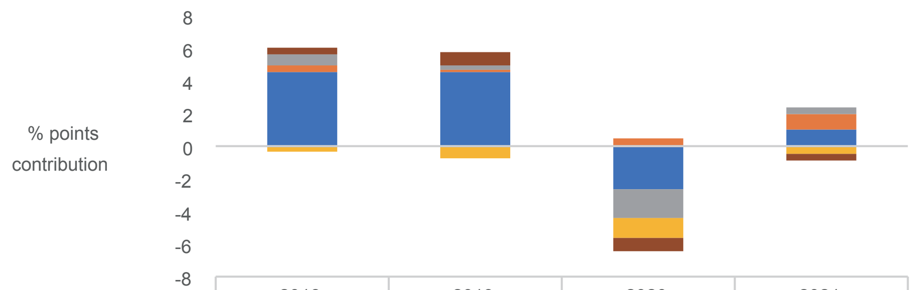
Source: Our World in Data, Ministry of Health Malaysia COVID-19 datasets.

Figure 6 Stringency Index, GDP growth, and unemployment rates



Source: Our World in Data, Department of Statistics Malaysia.

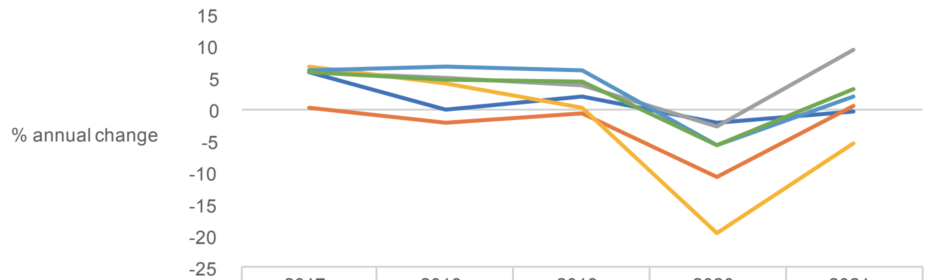
Figure 7 GDP growth contribution by demand component



	2018	2019	2020	2021
Net trade	0.4	0.8	-0.8	-0.3
Public investment	-0.4	-0.7	-1.1	-0.5
Private investment	0.7	0.3	-1.9	0.4
Government consumption	0.4	0.2	0.5	0.9
Private consumption	4.5	4.5	-2.6	1.1

Source: Department of Statistics Malaysia.

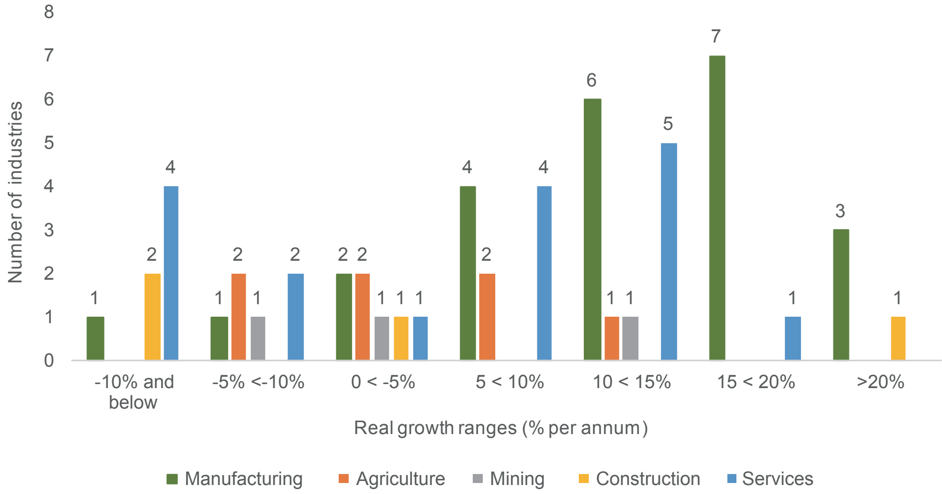
Figure 8 Uneven pandemic downturn and recovery



	2017	2018	2019	2020	2021
Agriculture	5.9	0.1	2.0	-2.2	-0.2
Mining & quarrying	0.4	-2.2	-0.6	-10.6	0.7
Manufacturing	6.0	5.0	3.8	-2.6	9.5
Construction	6.7	4.2	0.4	-19.4	-5.2
Services	6.3	6.9	6.2	-5.5	1.9
GDP	5.8	4.8	4.4	-5.6	3.1

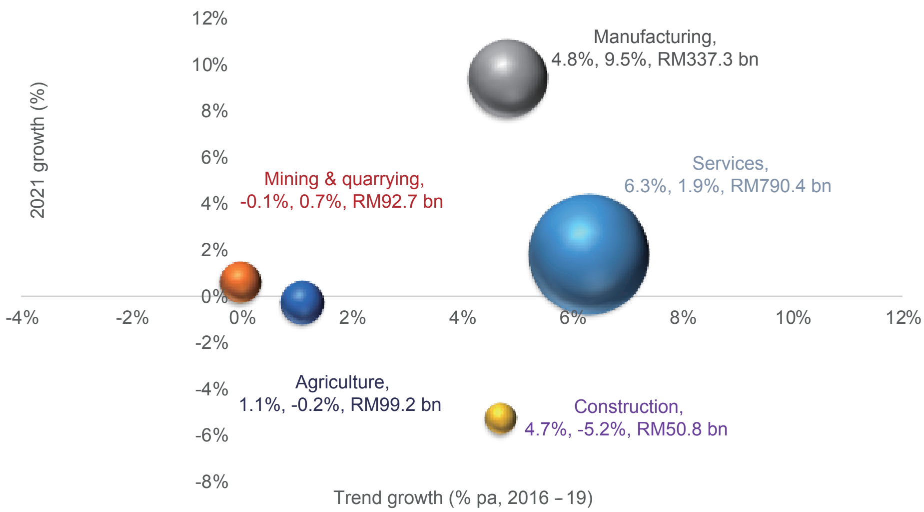
Source: Department of Statistics Malaysia.

Figure 9 Industry growth distribution within each sector in 2021



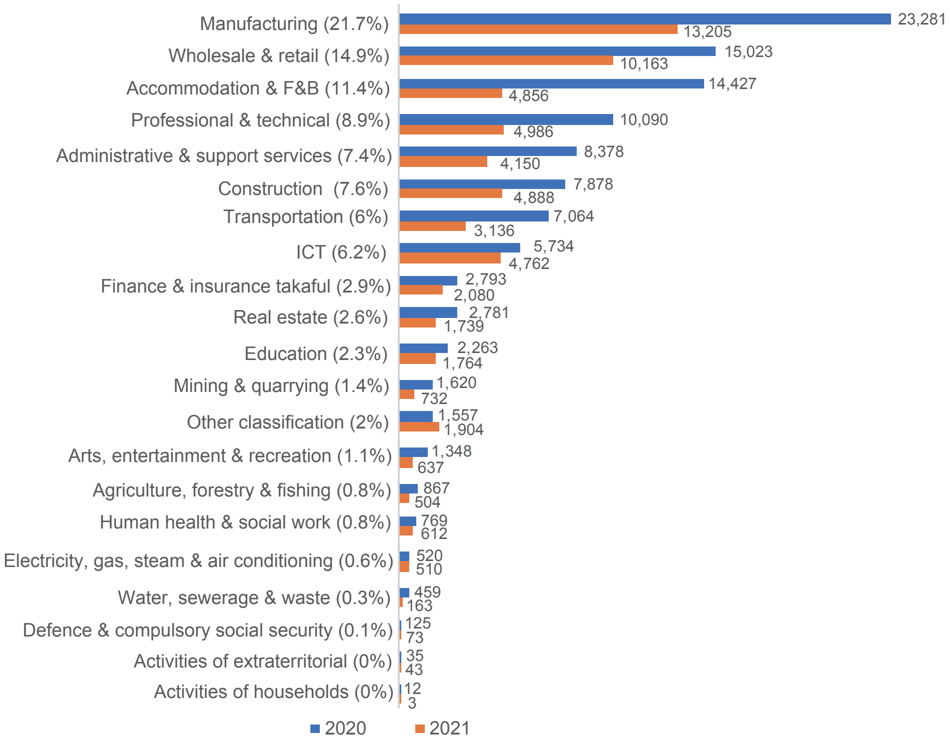
Source: Department of Statistics Malaysia.

Figure 10 Recovery in 2021 driven by manufacturing while domestic-based services remained weak



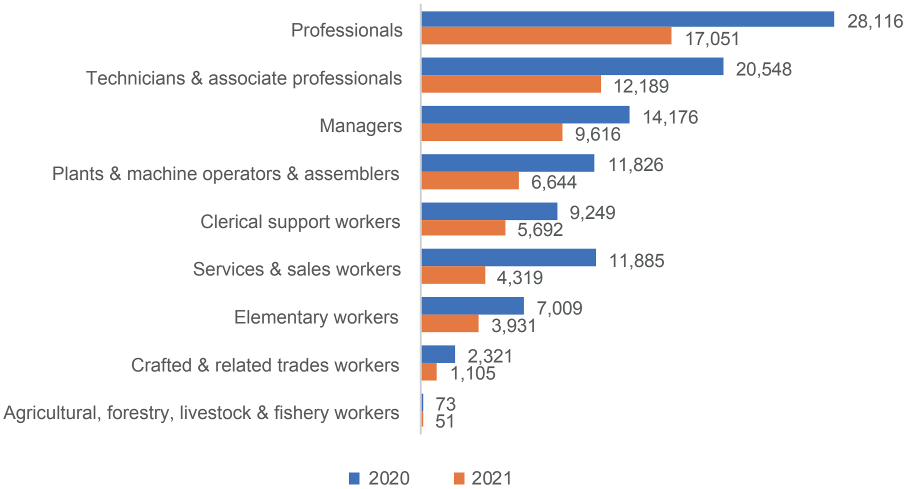
Source: Department of Statistics Malaysia.

Figure 11 Job losses reported under the Employment Insurance Scheme



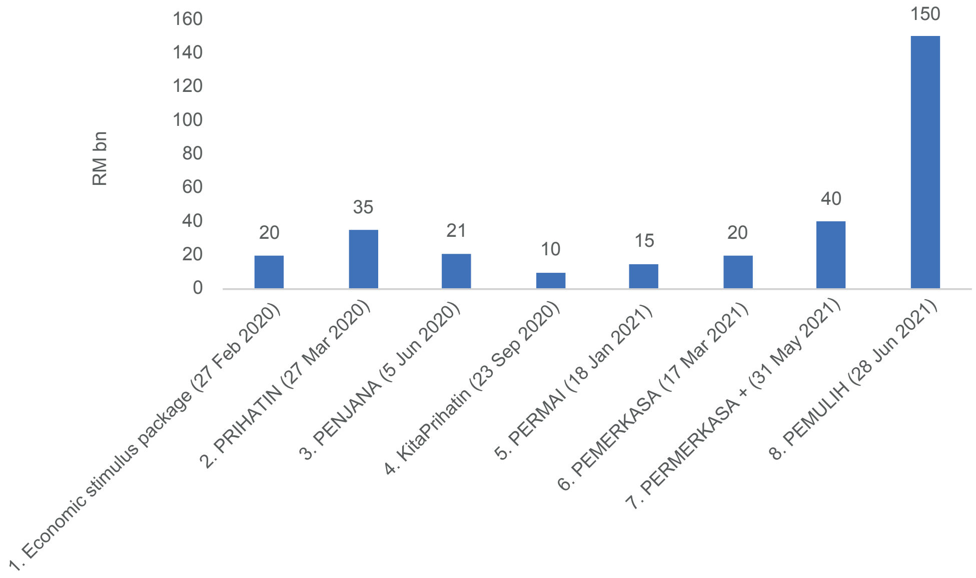
Source: Employment Insurance Scheme, SOCSO.

Figure 12 Loss of employment by occupation in 2020 and 2021



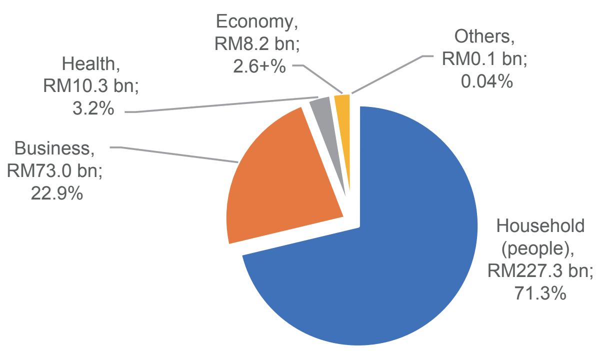
Source: Employment Insurance Scheme, SOCSO.

Figure 13 Eight COVID-19 fiscal support and stimulus packages



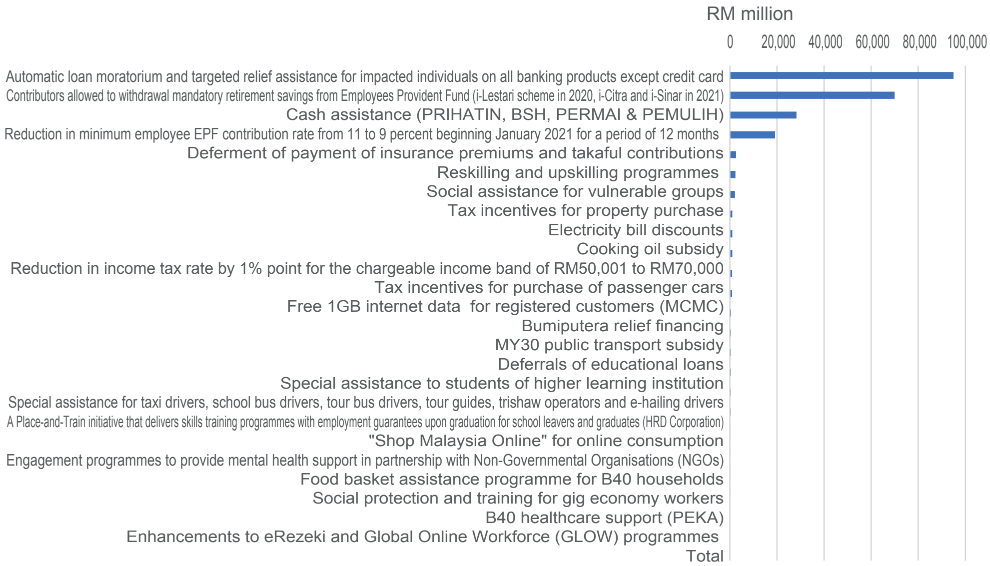
Source: Ministry of Finance, Malaysia.

Figure 14 Total COVID-19 pandemic fiscal support by sector for 2020 and 2021



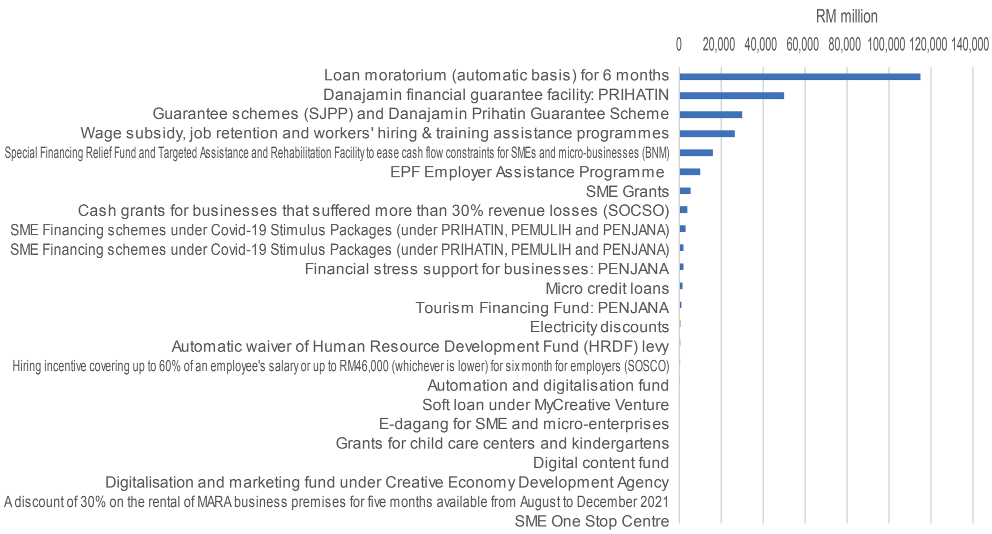
Source: Ministry of Finance, Malaysia.

Figure 15 Fiscal and other support measures for households (people)



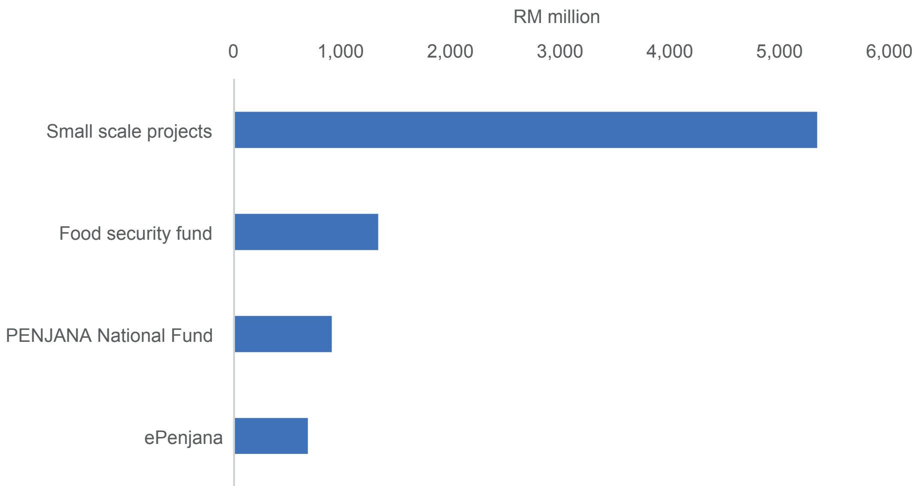
Source: Ministry of Finance, Malaysia.

Figure 16 Support measures for businesses



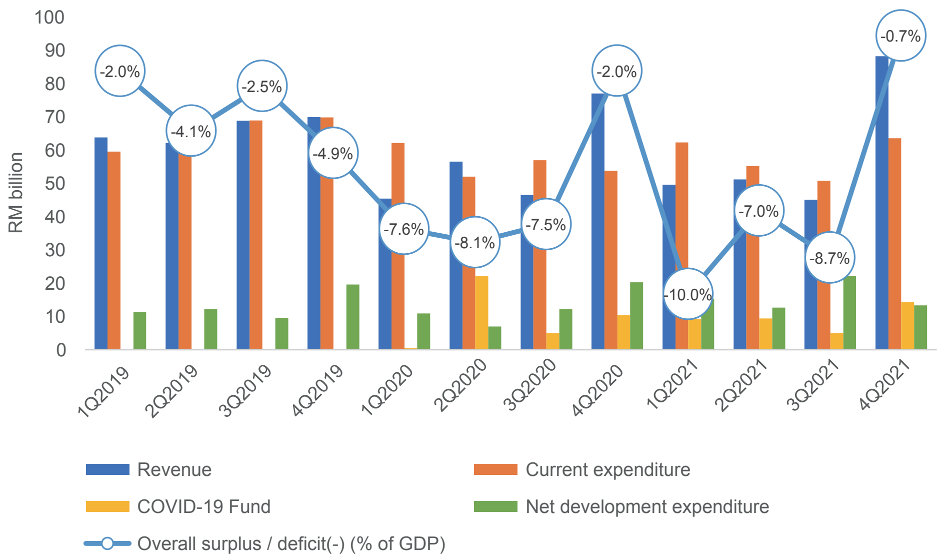
Source: Ministry of Finance, Malaysia.

Figure 17 Support measures for the economy



Source: Ministry of Finance, Malaysia.

Figure 18 Quarterly federal government finance, COVID-19 fund, and overall fiscal balance



Source: Bank Negara Malaysia Monthly Statistical Bulletin.

Appendix 2. Selected Tables

Table 1 Selected Economic Indicators

	2017	2018	2019	2020	Estimate 2021
Real Sector and Prices	(Annual percentage change)				
Real GDP	5.8	4.8	4.4	-5.6	3.1
By industry origin					
Agriculture	5.9	0.1	2.0	-2.2	-0.2
Mining	0.4	-2.2	-0.6	-10.6	0.7
Manufacturing	6.0	5.0	3.8	-2.6	9.5
Construction	6.7	4.2	0.4	-19.4	-5.2
Services	6.3	6.9	6.2	-5.5	1.9
By expenditure					
Private consumption	6.9	8.0	7.7	-4.3	1.9
Private investment	5.7	4.3	1.6	-11.9	2.6
Government consumption	9.0	3.4	1.8	3.9	6.6
Government investment	0.3	-5.0	-10.7	-21.3	-11.4
Export of goods & services	8.7	1.9	-1.0	-8.9	15.9
Import of goods & services	10.2	1.5	-2.4	-8.4	18.5
GDP deflator	3.8	0.6	0.1	-0.8	5.7
CPI inflation (average)	3.8	1.0	0.7	-1.1	2.5
CPI inflation (end of period)	3.5	0.2	1.0	-1.4	3.2
External Sector	(In millions of USD, unless otherwise specified)				
Current account balance	8,905	8,003	12,775	14,276	12,905
(In percent of GDP)	2.9	2.4	3.7	4.5	3.9
Trade balance	27,233	28,406	30,112	32,999	41,083
Exports	186,352	205,727	197,288	185,005	235,907
Imports	159,119	177,322	167,176	152,006	194,824
Services, net	-5,315	-4,341	-2,625	-11,288	-14,739
Primary income, net	-8,989	-11,172	-9,534	-6,800	-11,148
Secondary income, net	-4,023	-4,889	-5,178	-635	-2,291
Financial account balance	-1,100	2,833	-9,179	-18,117	7,158
Foreign direct investment	3,760	2,504	1,582	655	7,929

	2017	2018	2019	2020	Estimate 2021
Other investment	-4,860	329	-10,761	-18,773	-772
Overall balance	3,816	1,923	2,032	-4,591	11,013
Gross international reserves	96,421	103,980	102,376	102,830	117,489
(Months of imports)	7.3	7.0	7.3	8.1	7.2
External debt	205,844	228,748	228,714	227,940	258,313
(Percent of GDP)	68.1	67.7	66.5	71.3	77.2
Fiscal Sector	(Percent of GDP)				
Revenue and grants	16.9	17.1	18.6	16.9	17.1
Direct tax revenue	8.9	9.5	9.5	8.6	9.5
Indirect tax revenue	4.7	3.2	3.2	2.8	3.1
Nontax revenue	3.0	3.7	5.6	4.9	3.9
Other revenue	0.2	0.6	0.3	0.6	0.6
Expenditure	20.2	21.0	22.3	23.4	24.9
Current non-interest expenditure	14.6	14.7	16.2	14.3	14.3
Interest payments	2.1	2.2	2.3	2.6	2.8
Capital expenditure (development)	3.5	4.1	3.8	3.7	5.0
COVID-19 fund	0.0	0.0	0.0	2.8	2.8
Overall fiscal balance	-3.2	-4.0	-3.7	-6.5	-7.8
Primary balance	2.4	2.4	2.4	2.6	2.8
Public debt	52.8	54.3	55.7	65.4	70.7
Monetary and Financial Sector	(Annual percentage change, end-period)				
Domestic credit	6.4	10.7	4.6	5.9	4.7
Credit to private sector	5.8	8.4	4.4	3.5	3.8
Broad money	4.9	9.1	3.5	4.0	6.4
Reserve money	4.3	5.5	2.6	-16.1	14.7
Memorandum Items					
Nominal GDP (RM billion)	1,301	1,364	1,424	1,344	1,386
Nominal GDP (US$ million)	302.5	338.0	343.8	319.7	334.5
GDP per capita (US$)	9,965	11,080	11,231	10,343	11,413
Exchange rate (RM/US$, average)	4.300	4.035	4.142	4.203	4.143
Exchange rate (RM/US$, end of period)	4.062	4.139	4.093	4.013	4.176

Table 2 Impact of the pandemic on the labor market

	Annual change (%)[1]				Quarterly change (% year-on-year)[1]							
	2018	2019	2020	2021	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
Labor market												
Total unemployed ('000)	516.5	512.2	760.7	694.4	546.6	791.8	745.0	760.7	771.8	764.9	746.2	694.4
Unemployment changes	1.7	-0.8	48.5	-8.7	5.8	52.1	45.5	48.5	41.2	-3.4	0.2	-8.7
Unemployment (percent of labor force)	3.3	3.3	4.5	4.7	3.5	5.1	4.7	4.8	4.8	4.8	4.7	4.3

Source: Department of Statistics Malaysia and Bank Negara Malaysia Monthly Statistical Bulletin.
Note[1]: % unless stated otherwise.

Table 3 Consumer price inflation and commodity price changes

	Annual change (%)[1]				Quarterly change (% year-on-year)[1]							
	2018	2019	2020	2021	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
Prices												
Consumer Price Index (CPI)	1.0	0.7	-1.2	2.5	0.9	-2.6	-1.4	-1.5	0.5	4.2	2.1	3.2
Core CPI	1.0	1.1	1.1	0.7	1.4	1.2	1.1	0.7	0.7	0.7	0.6	0.9
Producer Price Index (PPI)	-1.1	-1.4	-2.7	9.5	0.6	-4.9	-3.4	-2.9	3.0	11.3	11.8	11.9
GDP deflator	0.6	0.1	-0.8	5.7	0.7	-1.9	-1.1	-1.0	1.3	6.2	7.1	8.2
Crude oil (weighted blend)	30.3	-8.0	-36.7	68.4	-14.7	-61.4	-32.3	-36.4	10.3	150.9	69.8	89.9
Rubber (SMR 20)	-23.0	1.2	-2.7	20.3	-2.5	-23.6	-4.7	10.8	21.1	39.1	29.3	13.8
Palm oil (MPOB)	-17.1	-10.8	25.4	54.7	31.0	16.3	24.0	29.1	26.5	67.3	61.1	58.5

Source: Department of Statistics Malaysia and Bank Negara Malaysia Monthly Statistical Bulletin.
Note[1]: % unless stated otherwise; SMR = Standard Malaysian Rubber; MPOB = Malaysian Palm Oil Board.

Table 4 Monetary and financial development

	Annual change (%)[1]				Quarterly change (% year-on-year)[1]							
	2018	2019	2020	2021	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
Overnight policy rate (%)	3.25	3.00	1.75	1.75	2.50	2.00	1.75	1.75	1.75	1.75	1.75	1.75
Change in OPR (bps)	0.15	-0.25	-1.25	0.00	-0.50	-0.50	-0.25	0.00	0.00	0.00	0.00	0.00
Deposit rate (3-month, % pa)	3.14	2.98	1.95	1.56	2.57	2.03	1.62	1.60	1.57	1.56	1.56	1.56
Average lending rate (% pa)	4.93	4.88	3.94	3.44	4.55	4.05	3.66	3.51	3.47	3.45	3.43	3.43
Ringgit exchange rate (RM/US$)	4.04	4.14	4.20	4.14	4.18	4.32	4.20	4.11	4.06	4.13	4.20	4.18
Money supply												
M1	1.2	5.8	15.7	10.4	7.9	13.1	18.2	15.7	19.0	12.2	9.7	10.4
M2	8.9	3.5	4.5	6.3	3.8	6.1	6.8	4.5	6.3	3.4	4.6	6.3
M3	9.1	3.5	4.0	6.4	3.7	5.6	6.4	4.0	6.1	3.4	4.7	6.4
Private domestic credit	8.4	4.4	3.5	3.8	3.9	4.1	4.5	3.5	3.9	3.2	2.9	3.8
Bank loans	7.1	4.2	3.2	4.5	4.1	4.1	4.3	3.2	3.7	3.3	2.8	4.5
Debt securities	18.5	5.7	6.0	-0.6	3.1	4.4	6.1	6.0	4.7	2.9	3.2	-0.6

Source: Bank Negara Malaysia Monthly Statistical Bulletin.
Note[1]: % unless stated otherwise.

Table 5 Banking system deposit and loans growth, non-performance loan ratios and capital market performance

	Annual change (%)[1]				Quarterly change (% year-on-year)[1]							
	2018	2019	2020	2021	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
Deposit growth	9.2	2.9	4.4	6.3	2.7	4.4	5.2	4.4	5.9	3.9	4.7	6.3
Businesses	8.4	-1.4	0.0	10.5	-1.8	0.9	2.1	0.0	2.9	3.3	6.0	10.5
Household	5.7	5.5	6.6	4.9	5.4	6.7	6.9	6.6	6.6	4.3	4.5	4.9
Others	14.6	4.4	6.5	4.0	4.2	5.2	6.3	6.5	8.3	4.0	3.5	4.0
Loans growth	7.7	3.9	3.4	4.5	4.0	4.1	4.4	3.4	3.9	3.4	2.9	4.5
Business loans	6.7	2.7	1.0	4.9	4.4	5.0	3.2	1.0	1.4	0.8	2.5	4.9
Household loans	8.3	4.7	5.0	4.3	3.7	3.5	5.2	5.0	5.7	5.2	3.2	4.3
Non-performing loans and provisions												
Ratio of net impaired loan (%)	0.87	0.94	0.96	0.90	0.98	0.90	0.82	0.96	0.98	1.00	0.97	0.90
Ratio of total provisions to total loans (%)	1.37	1.25	1.70	1.86	1.35	1.40	1.51	1.70	1.77	1.83	1.90	1.86
Stock market												
Bursa Malaysia Composite Index	-5.9	-6.0	2.4	-3.7	-17.8	-10.2	-5.0	2.4	16.5	2.1	2.2	-3.7
Bursa Malaysia Mkt Capitalization	-10.8	0.7	6.2	-1.5	-20.3	-9.9	-2.1	6.2	31.3	10.3	10.0	-1.5

Source: Bank Negara Malaysia Monthly Statistical Bulletin.
Note[1]: % unless stated otherwise.

Table 6 Impact of Employee Retention Programme and Wage Subsidy Programmes (WSP)

Month	Employee Retention Programme (ERP)		WSP 1.0 2020		WSP 2.0 2020		WSP 3.0 2021	WSP 4.0 2021
	Number of employers	Number of employees	Number of employers	Number of employees	Number of employers	Number of employees	Number of employees	Number of employees
Mar-20	2,952	19,724						
Apr-20	27,875	248,565	259,797	2,082,462				
May-20	5,553	58,191	46,473	403,995				
Jun-20	1,006	9,267	14,290	124,484				
Jul-20			7,475	77,548				
Aug-20			2,131	21,109				
Sep-20			1,765	15,421				
Oct-20					55,884	558,116		
Nov-20					23,257	236,820		
Dec-20					17,424	180,459		
Jan-21							443,582	
Feb-21							333,309	
Mar-21							127,498	
Apr-21							56,927	
May-21							42,446	
Jun-21							376,996	
Jul-21							472,405	
Aug-21								1,480,175
Sep-21								387,461
Oct-21								320,291
Total	**37,386**	**335,747**	**331,931**	**2,725,019**	**96,565**	**975,395**	**1,853,163**	**2,187,927**

Source: Employment Insurance System, Pertubuhan Keselamatan Sosial (SOCSO).

Table 7 Fiscal impact of the pandemic

	Annual change (%)[1]				Quarterly change (% year-on-year)[1]							
	2018	2019	2020	2021	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
Fiscal position												
Federal government revenue	5.7	13.5	-14.9	2.5	-28.8	-9.1	-32.5	10.1	9.3	0.8	10.9	-5.2
Federal government expenditure	9.8	10.4	-1.0	5.9	3.7	4.7	-5.6	-5.6	17.9	-4.8	5.2	-12.1
Fiscal balance (% of GDP)	-3.7	-3.4	-6.2	-6.5	-7.6	-8.1	-7.5	-2.0	-10.0	-5.4	-7.0	-0.3
Government debt growth	7.9	7.0	10.9	11.4	6.0	6.9	8.6	10.9	11.4	12.2	10.9	11.4
Government debt-to-GDP ratio (%)	51.2	52.4	62.1	63.5	58.2	60.3	61.7	62.1	59.4	62.1	62.8	63.5

Source: Ministry of Finance, Malaysia.
Note[1]: % unless stated otherwise.

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Chapter

10

The Philippines

Chapter 10

The Philippines[115]

The Philippines fell into a sharp recession in 2020, as strict lockdowns at the start of the COVID-19 pandemic froze economic activity, with the economy only partially recovering as mobility restrictions and social-distancing measures continued into the following year. The government's fiscal response had initially focused on addressing the public health emergency and providing temporary relief to vulnerable workers and households, and small firms, but then later expanded to include more traditional stimulus spending and corporate tax cuts. The government adopted a relatively conservative fiscal strategy, which limited the fiscal impact of the COVID-19 crisis. However, the country still witnessed a severe fiscal deterioration during the period, as revenues shrank, with the government debt-to-GDP ratio inevitably breaching the government's implied cap (of 60 percent) by 2021. In the current scenario, the challenge is how to continue spending to minimize economic scarring amid a weakened domestic environment and given potentially large external disturbances. Having a sound medium- to long-term fiscal strategy will be key in keeping the country's economy on a stable footing.

1. COVID-19 development

1. **After multiple COVID-19 waves and prolonged lockdowns, confirmed cases of the COVID-19 virus in the Philippines finally subsided near the end of Q1 of 2022.** This occurred roughly two years after the country saw its first local death on 11 March 2020, the same day when the World Health Organization (WHO) declared COVID-19 a global pandemic. Public health conditions improved from around the end of 2021, allowing a loosening of mobility restrictions, but the new Omicron variant fueled a resurgence of COVID-19 infections in early 2022. Daily confirmed cases peaked at nearly 40,000 in mid-January 2022 due to the rapid spread of the Omicron variant, but fell below 400 by the last week of March (Figure 1) and had fallen further at the time of writing. The ratio of deaths to confirmed cases declined considerably during this Omicron surge, indicating milder infections, in contrast to the higher mortality rates seen several months earlier.

2. **Although COVID-19-related measures have considerably loosened compared with virtual lockdowns and the closure of borders at the start of the pandemic, the**

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country's public health policies remain among the most stringent in the region. Until end-March of 2022, the Philippines still had among the strictest "lockdown style policies" in developing Asia, based on the Oxford COVID-19 Government Response Tracker Stringency Index. Figure 2 shows that such policies were relatively more severe in the Philippines than in ASEAN peers, from the start of the pandemic through to the tail end of the period sample. Two years earlier, the government had placed the National Capital Region (NCR, or Metro Manila) and nearby regions (Region III, and Region IV-A or CALABARZON), which produce about three-fifths of the country's GDP, under Enhanced Community Quarantine (ECQ) or the strictest lockdown level.[116] This lasted for over two months, from 16 March 2020 to the middle of May (Figure 3a). The country's capital and other key areas endured further lockdowns in succeeding periods, in response to the clamor by the country's health workers and during surges in infection rates in April and August of 2021, the latter due to the emergence of the contagious Delta variant (Figures 3a and 3b).[117] Metro Manila remained under the highest COVID-19 alert level (Alert Level 4, which had the strictest restrictions) until mid-October 2021, and saw a gradual re-opening thereafter, with only a mild setback in January 2022 due to the rapid spread of the Omicron variant (Figure 3b). Metro Manila joined most parts of the country under the lowest alert level (Alert Level 1) by March 2022. Foreign visitors were allowed to reenter the country only in February 2022, nearly two years after the initial COVID-19 outbreak.

3. **Because of protracted COVID-related restrictions, the Philippines also had low community mobility for a prolonged period, with work conditions only recently beginning to normalize under a loosening of public health measures.** Figure 4, which summarizes Google community mobility data, shows that Filipinos started to return to most places they used to frequent by Q4 of 2021, but had to retreat once again at the start of 2022 because of the Omicron surge in confirmed COVID-19 cases. They returned to their workplaces and to retail and recreation establishments at the start of February 2022, with mobility largely normalizing in March, a development mirrored by a revival of activity in transit stations at close to pre-pandemic levels. However, the same data source also shows Filipinos opting to stay in their residences, indicating continued social distancing, yet visiting parks at a higher rate than before, choices that may be partly explained by a change in lifestyle and shopping habits due to the pandemic experience, such as a rise in online/mobile shopping, home deliveries, and work-from-home arrangements.[118]

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116 Region III or Central Luzon comprises the provinces of Aurora, Bataan, Bulacan, Nueva Ecija, Pampanga, Tarlac, and Zambales. Region IV-A, a key industrial region, consists of the provinces of Cavite, Laguna, Batangas, Rizal, and Quezon.

117 Each ECQ period was followed by modified ECQ periods, which entailed milder public health and mobility restrictions. The Philippine government shifted NCR to an alert level system during the second half of September 2020 and the rest of the country by November of the same year.

118 As an indication, the Department of Trade and Industry (DTI) reported that the number of online businesses in the country had grown remarkably, from 1,700 in Q1 of 2020 to 93,318 by January 2021. The DTI has launched an e-Commerce Roadmap, hoping to raise the share of e-commerce in the economy from 3.4 percent in 2020 to 5.5 percent of GDP by 2022. Meanwhile, during the ECQ, businesses were similarly encouraged to adopt work-from-home arrangements, though mostly medium-sized and large firms in certain sectors had been able to adopt such a setup (ILO, 2020), a situation that has likely persisted given the structure of the economy (with output tilted toward services). Growth in digital transactions and online work has been hampered by poor connectivity, however, with low country rankings for mobile and fixed broadband internet speeds.

4. **While vaccination rollouts accelerated after a slow start that stemmed from initial procurement delays and vaccine hesitancy, the Philippine government has yet to meet its 70-percent vaccination target and will need to continuously encourage citizens to receive their booster shots.** By end-March 2022, the proportion of fully vaccinated individuals in the country approached 60 percent, from below 45 percent at end-December 2021 (Figure 5). Although still below the nationwide target, the ratio already exceeded 95 percent of the population in Metro Manila, the main hub of the country's economic activity. COVID-19-related public health efforts nonetheless fell short when benchmarked against the programs of other countries in developing Asia. The Philippines still has among the lowest immunization efforts (full vaccination, as well as booster shots) and testing ratios in the region and, until recently, had relied heavily on mobility restrictions (both within the country and across borders) to limit the impact of the pandemic.

2. The economic impact of the pandemic

5. **The Philippines experienced its deepest postwar recession after stringent lockdowns curtailed economic activity.** Output fell by 9.5 percent at the peak of the COVID-19 crisis in 2020, a sharper downturn than the country experienced during the mid-1980s debt and political crises; the 1991 recession that traced to power shortages, natural disasters, and political instability; the Asian financial crisis of 1997/98; and the more recent global financial crisis of 2008/09 (Figure 6). The Philippines was particularly vulnerable to a pandemic shock and the mobility restrictions needed to contain it, because of the way the economy is structured—with a large share of services in aggregate output, a large share of household consumption in aggregate demand, and a strong reliance on remittances from overseas Filipino workers to fuel this consumption.

6. **Household consumption uncharacteristically collapsed on the demand side at the peak of the pandemic, while services buckled on the supply side.** The fall in household consumption traced back to mobility restrictions, weakened remittances, and high business and consumer uncertainty. Household spending, which accounted for over 70 percent of aggregate demand, dropped by 8 percent annually in 2020 (Table 1), thus contributing negatively to output growth (Figure 7a). This was a rare occurrence, as consumer spending had held steady through most of the country's previous crisis episodes, declining by just 0.5 of a percentage point in 1985. Overseas workers' remittances, which helped fuel domestic consumption even through the global financial crisis, dipped by 0.8 percent during the first pandemic year. As in past crises, capital investment fell substantially in 2020, by 34.2 percent. Also, unusual, services output fell by 9.1 percent during the year (Table 1), after over two decades of moderate to high growth. This put a dent in overall output performance (Figure 7b), as the sector now accounted for over 60 percent of GDP, from below half in the 1980s. Within industry, the manufacturing and construction sectors fell because of public health measures that had to be implemented to contain the virus. Only producers of essential items such as medicines, medical supplies, medical equipment, and basic food were allowed to

operate during the ECQs, while construction activity was suspended.

7. **Net exports contributed positively to output growth in 2020, but this was simply due to imports declining faster than exports.** Improvement in the goods trade deficit could be traced to a sharp contraction in oil imports due to mobility restrictions and business closures, and in purchases of machinery and equipment, as investments were either postponed or cancelled. A smaller goods trade deficit, by offsetting weakness in services trade, especially in tourism, allowed the Philippines to post a US$11.6 billion current account surplus in 2020 (Table 1), compared with deficits in previous years, despite the dip in overseas workers' remittances. US dollar bond issuances and US dollar loan inflows from financing agreements by the national government to support its COVID-19 response also helped generate a balance-of-payments surplus of US$16 billion. Bolstered by gold revaluation gains, gross international reserves rose to a high of US$110 billion by the end of the year. An appreciating Philippine peso-US dollar exchange rate in the middle of a recession was a unique event for the country, though this eventually reversed by mid-2021 as conditions slowly normalized.

8. **The government initially responded to the pandemic by accelerating spending.** Through two laws enacted in March and September of 2020, Congress gave the President of the Philippines temporary emergency powers to tackle the pandemic, including the power to realign the national budget.[119] Policy responses were directed towards alleviating the damaging impact of the severe mobility restrictions on low-income households, providing protection to vulnerable workers, and launching critical medical response measures. Government spending, however, grew by just 10.5 percent in 2020, only slightly higher than spending growth during the previous year (9.1 percent in 2019) and lower than spending growth a couple of years earlier (13.4 percent in 2018).

9. **Although aggregate demand clearly fell, the COVID-19 pandemic had a mixed impact on inflation.** The collapse in world oil prices at the beginning of 2020, when global demand weakened due to the spread of the COVID-19 virus, and residual effects of a rice tariffication law, which removed quantity restrictions on imports, helped to soften consumer prices. Separating those effects, the pandemic-induced crisis had a more nuanced impact on inflation, as it stemmed from a complex mix of supply and demand shocks. In sectors where negative demand shocks dominated, such as in services (e.g., restaurants and hotels, recreation and culture, and clothing and footwear), inflation tended to fall, but in sectors where negative supply shocks dominated (e.g., in transport, where public health rules limited operations and constricted capacity), inflation tended to rise. Other unrelated supply-side factors eventually started to drive prices upward towards the end of the year, such as typhoons damaging agriculture areas and African Swine Fever reducing meat supply. As seen in Figure 8, inflation breached the upper end of the official target (3 percent +/- 1 percentage point) in 2021, as price pressures in food and transport continued and combined with a reversal of fuel prices due to a recovery in economies that were able to control the virus and launch a strong stimulus response (e.g., China and the United States).

119 See next section for a more detailed description of fiscal responses to the COVID-19 pandemic.

10. **Apart from health outcomes, the harshest impact of the pandemic was on jobs.** The unemployment rate rose to 17.6 percent in April 2020, from 5.1 percent the previous year, affecting about 7.2 million out of a total of 41 million workers. Jobs were shed in services and industry after the lockdowns, but were gained in agriculture, as farms absorbed unemployed workers who had returned to rural areas in their home provinces (Debuque-Gonzales et al., forthcoming). The trend was matched by a decline in the number of salaried workers, with a large number joining the informal sector and becoming self-employed. Although labor conditions subsequently improved, the unemployment rate remained elevated relative to pre-pandemic levels, indicating a still high level of income and job insecurity (Figure 9).

11. **The uncertain path of the COVID-19 virus and recurrent lockdowns made it difficult to engineer a strong recovery in 2021, with national output still below its pre-pandemic level.** As mentioned earlier, the emergence of the Delta variant led to a return of strict quarantines in Metro Manila and most parts of CALABARZON, which were placed under an ECQ in April and MECQ until mid-May 2021, and another lockdown by mid-August 2021. Public restrictions were gradually relaxed in subsequent months in the country's capital and nearby areas, though some rules (under various alert levels) remained in place until the end of the year. Coming from a low base in 2020, when the economy shrank by almost one-tenth in size, national output still managed to grow by 5.7 percent annually in 2021 despite intermittent lockdowns (Table 1 and Figure 6). The country's GDP expansion was mainly driven by a rebound in investment spending and a modest revival of household demand (Figure 7a). Gross capital formation rose by 20.3 percent in 2021 after contracting by over one-third in 2020, while personal spending increased by slightly above 4 percent after an 8 percent decline in the previous year. Government spending, in contrast, slowed during 2021, rising by 7.1 percent after a 10.5 percent increase in 2020. As domestic demand strengthened in 2021, imports started to grow faster than exports, by 13 and 8 percent, respectively, with the higher trade deficit pulling down growth. Agriculture was the only sector that continued to see a decline in production in 2021, as both services and industry recovered, bolstering growth (Table 1 and Figure 7b).

12. **The Philippine economy is expected to recover further in succeeding periods.** On average, the consensus is that GDP will grow by 6.7 percent in 2022 before settling at about 6.3 percent in the medium term (Table 2). Closely watched indicators, such as remittances, seen to lead household demand, and the headline Purchasing Managers' Index (PMI) for manufacturing that reflects new orders, including new export orders, support expectations of a revival in economic activity. After expanding by 5 percent in 2021, remittances still managed to grow during the first couple of months of 2022 despite a resurgence of COVID-19 infections worldwide, while the PMI has remained at 50 or above since Q4 of 2021 (at over 53 in March 2022), indicating continued industrial expansion. Still buoyed by investment and household demand, GDP expanded by 8.3 percent during Q1 of 2022, indicating robust growth for the year.

13. **Even bank lending has begun to recover, growing slightly during Q1 of 2022, after shrinking in H2 of 2021.** There had been worries about the procyclical behavior of banks during the pandemic crisis, as aggressive monetary easing failed to spur lending given

high uncertainties and risks faced by businesses and households, as well as banks and other financial intermediaries (Debuque-Gonzales, 2022). Judging by the latest central bank survey of senior bank loan officers (for Q1 2022), credit standards have loosened relative to conditions faced in mid-2020, while demand has risen from pandemic lows, for both enterprises and household loans. The jobs picture is also expected to improve further with a better macroeconomic environment.

14. **However, external risks to outlook have been elevated lately, including geopolitical risks (e.g., the Russian Federation's invasion of Ukraine and its effects on commodity markets) and other global inflation risks** (Asian Development Bank, 2022). For the moment, domestic inflation and exchange rate expectations appear manageable despite these events, with the central bank poised to raise policy rates. Despite the volatilities, external vulnerability indicators so far remain sanguine, with the central bank reporting a small balance-of-payments surplus in March 2022 (US$459 million) and continued remittance growth during Q1 of 2022 (by 2.4 percent), and the private sector expecting the current account deficit to remain steady (Table 2).

2.1. Fiscal picture during the pandemic

15. **The country's fiscal position deteriorated significantly during the pandemic despite limited public spending, as revenues collapsed due to a stalled economy.** The national government's fiscal deficit more than doubled from 3.4 percent in 2019 to 7.6 and 8.6 percent, respectively, in 2020 and 2021 (Figure 10), the latter figure being the country's biggest shortfall based on the available data (i.e., since 1986). Government spending rose by more than 10 percent during the pandemic (11.3 and 10.6 percent in 2020 and 2021, respectively), but this was relatively low compared with spending growth under past fiscal packages—over 15 percent in 2012, when the government tried to correct past underspending, and 11 percent in 2009, when it tried to prevent a recession during the global financial crisis. Public expenditure growth during the pandemic was also weaker than in more recent years when the government accelerated infrastructure spending. Recent widening of the fiscal deficit was instead largely due to an extraordinary decline in government revenues, which fell by 9 percent (in nominal terms) in 2020—when the Philippine economy shrank due to the closure of certain high-contact sectors, extensive mobility restrictions, and social distancing—and only a partial recovery in 2021 (by slightly over 5 percent). The national government continued to post a budget gap in Q1 of 2022 (equivalent to about 6.4 percent of GDP), in line with still large fiscal deficits programmed by the government over the next couple of years (Figure 11 and Table 3).

16. **Rising fiscal deficits inevitably led to greater domestic and external borrowing and a higher public debt-to-GDP ratio.** National government debt jumped to 54.6 percent of GDP in 2020 and breached policy makers' indicative cap of 60 percent by 2021 (Figure 12). The few times the country had exceeded this level after 1986 were in 1993 and during 2002–05, after fiscal deficits accumulated beginning in the early 2000s, notably after the Asian financial crisis in 1997/98. The debt-to-GDP ratio peaked at 71.6 percent of GDP in 2004, and then fell to safer levels by 2007, as the government exercised fiscal restraint and implemented a major tax reform (through the Reformed VAT Law, which

took effect in 2005). It then stabilized at about 40 percent for nearly half a decade prior to the COVID-19 pandemic.

17. **Escalation of public debt also widened debt service payments, indicating possible constraints to government spending that could limit future growth.** Total debt service (principal plus interest payments) as a proportion of national government revenues rose from 26.9 percent prior to the pandemic to 40.1 percent by 2022 (Figure 13). Interest payments also inched up from 11.5 percent of national government revenues to 14.3 percent during the period. Allowing conditions to radically worsen could severely limit public spending and eventually lower the country's growth path, as the country's past debt episodes have shown. The national government's debt-to-GDP ratio climbed sharply in the early to mid-2000s, during which nearly one-third of government spending was reserved for interest payments on debt. Saddled by debt built up prior to 1986, the Philippines had been in a similar situation during the late 1980s to early 1990s. The debt burden had drastically worsened following the economic crisis from 1983 to 1985, squeezing resources for development and other public and social service programs (Sicat, 2003). However, a positive angle is that risks associated with public debt have lessened considerably over the years, as the government lessened its exposure to external debt (from around half of total debt in the early 2000s to about 30 percent by 2020) and moved towards more balanced debt issuance in terms of maturity.[120]

3. Policy measures in response to COVID-19

18. **Monetary policy responses to the COVID-19 crisis consisted of measures to loosen domestic liquidity, provide regulatory relief to financial institutions, and support lending to smaller businesses.** Box 1 summarizes the monetary responses of the Bangko Sentral ng Pilipinas (BSP), the central bank, during the period, the highlights of which were sharp reductions in the policy rate and reserve requirement ratios. The BSP cut the policy rate by a total of 200 basis points (bps) in 2020, comprising a 25-bps cut as early as February; three consecutive 50-bps cuts from mid-March, during the lockdowns, until end-June; and a 25-bps cut in November spurred by heightened uncertainty due to a resurgence of COVID-19 cases globally and generally weak business and consumer sentiment. The country's monetary authority also rolled out less traditional measures meant to support liquidity (see Panel 1 of Box 1), aside from temporarily relaxing reporting rules and borrowing limits (Panel 2), encouraging lending to micro, small, and medium enterprises (MSMEs) through regulatory tweaks (Panel 3), and providing financial support to the national government (Panel 4). The latter comprised a PHP 300 billion short-term lending arrangement with the national treasury and PHP 20-billion

120 It is also quite well known historically that public debt, even the issuances denominated in foreign currency, had been largely held by the country's residents in domestic banks making it less susceptible to sudden stops (Guinigundo, 2012).

worth of advance dividends to the national government.[121] All things considered, the country's monetary policy responses have been relatively aggressive compared with the policy actions of other developing Asian economies (Figure 14). Swift and strong policy action is critical in any economic crisis because of the inherent non-linearities in behavior involved, especially in financial markets.

19. **Meanwhile, two laws that allowed realignment of the national budget by the President backed the country's fiscal response to the pandemic.** The first was the Bayanihan to Heal as One Law (Republic Act 11469, also known as Bayanihan I) signed on 24 March 2020, followed by the Bayanihan to Recover as One Law (RA 11494 or Bayanihan II) signed on 11 September 2020. Both laws also included provisions that helped further shape the country's monetary response to the pandemic, as described above, such as through forbearance policies in the payment of loans and regulatory relief for banks and other financial institutions.

20. **Bayanihan I provided a relief package containing a cash subsidy program for poor households, a wage subsidy for small businesses, and support measures for disadvantaged and displaced workers, including overseas Filipino workers.** The focal point had been the government's Social Amelioration Program (SAP), which provided PHP 5,000 to PHP 8,000 monthly for two months to low-income households and was allotted PHP 211.4 billion, or about 1.1 percent of GDP; and a small business wage subsidy program amounting to 0.3 percent of GDP (see Panel 1 of Box 2 for other elements).[122] During this period, the government also provided off-budget support to MSMEs and agriculture through credit guarantees worth about PHP 120 billion, for a total package of PHP 506.1 billion, or roughly 2.9 percent of GDP.

21. **Bayanihan II provided another fiscal package during the year to deliver further relief while introducing more traditional fiscal stimulus elements.** This amounted to PHP 165.5 billion (about 0.9 percent of GDP), comprising PHP 140 billion in supplemental spending for 2020 and a PHP 25.5 billion stand-by fund (Panel 2 of Box 2).[123] A large portion (PHP 39.5 billion) funded capital infusion of government financial institutions for wholesale lending of government banks. This was meant to ultimately support individuals and enterprises in COVID-stricken industries and to fund credit guarantee and low-interest-rate lending programs from the government. A substantial portion also funded health-related responses (PHP 30.5 billion), assistance to the agriculture and fisheries sectors (PHP 24 billion), and various jobs programs (PHP 18 billion). The availability of the funds had to be extended to H1 of 2021, however, as only PHP 109.2 billion of the PHP 140 billion allocation (78 percent) was released by end-December 2020.

121 The central bank charter allows it to make direct provisional advances to the national government to finance authorized spending. These should not exceed (in aggregate) one-fifth of the aggregate annual income of the borrower for the previous 3 fiscal years and should be repaid before the end of 3 months (but can be extended by another 3 months).

122 Under Bayanihan I, the President is authorized to provide an emergency subsidy for 18 million low-income households in the Philippines. This already covers 80 percent of all households in the country based on the current population count.

123 The latter fund can only be used if additional funds can be generated from savings or unused amounts.

Bayanihan II also allowed the BSP to provide further support to the national government, through additional provisional advances.[124]

22. **With relatively low public spending to address the impact of the pandemic, even at the peak of the public health and economic crisis in 2020, corporate tax cuts have instead been touted as the highlight of the country's fiscal stimulus package.** The country's fiscal policy response at the height of the pandemic crisis paled in comparison to that of its Asian neighbors, as greater weight was placed on demonstrating fiscal prudence (Figure 15). The fiscal stimulus incorporated in the succeeding year's national budget also turned out to be limited, with spending scheduled to grow by just 9.9 percent in 2021 (Panel 3 of Box 2) compared with expansions of over 10 percent in previous years. Instead, policy makers made the newly passed Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act the centerpiece of the country's fiscal package. This law reduced corporate income taxes from 30 to 25 percent generally, and further to 20 percent for smaller firms (Panel 4 of Box 2).

4. Assessment of policy responses and future challenges

23. **With little experience in dealing with epidemics, the country's public health response to the COVID-19 pandemic had been shaky, contributing to harsh outcomes for the economy.** As chronicled above, intermittent lockdowns and border closures characterized policy makers' efforts to curb the negative impact of the COVID-19 crisis, particularly in the initial stage. The country had to endure protracted lockdowns, as the government struggled to meet delays in vaccine procurement, and then had to deal with vaccine hesitancy, as well as continued uncertainties regarding vaccine supply, leading to a slow vaccination rollout (Debuque-Gonzales et al., 2021). Weaknesses stemming from past underinvestment in the public health-care system, leaving it unprepared and under-resourced, have persisted even in the later stages of the pandemic crisis, as manifested by unmet vaccination targets, weak booster shot uptake, and low COVID-19 testing rates compared with other developing countries in the region. In summarizing the lessons learned with regard to how to respond to a pandemic or a similar shock, Reyes et al. (2022), citing Abrigo et al. (2020), note the importance of aggressive containment efforts through better contact tracing, higher testing capacity, and timely health care for symptomatic cases in stopping outbreaks. They also emphasize the need to be mindful of the details in addressing public health crises—for instance, ensuring the smooth flow of goods and services through their respective supply chains in the case of a lockdown, correct implementation of health programs and monitoring of such programs at the local government level, a more humane approach to health protocols, strong support

124 Bayanihan II allowed additional provisional advances of up to 10 percent of the government's average income during the past three fiscal years "to finance expenditures authorized by law that will address and respond to the COVID-19 situation." This allowed it to commit PHP 540-billion worth of provisional advances to the national government in October 2020, after the original transaction was settled. This had been repeatedly rolled over until the succeeding year and expected to be reduced to PHP 300 billion in 2022.

for health-care workers, and "genuine and holistic" reforms in the health sector. Prompt containment efforts are crucial to soften the tradeoff between addressing the health consequences of a pandemic and reducing the severity of economic impacts by allowing/encouraging greater economic activity.

24. **While the country's strong monetary policy response helped relieve financial stress and avert financial instability, it failed to spur bank lending due to high uncertainty, and low levels of business and consumer confidence.** Credit conditions remained tight despite aggressive monetary easing, explaining the continued slowdown in bank lending. Production loans started to fall annually by the latter part of 2020 and persisted in doing so during H1 of 2021, while household consumption loans fell year-on-year beginning in 2021 and until Q1 of 2022. About PHP 1.9 trillion in liquidity (equivalent to 9.6 percent of GDP) had been injected into the domestic financial system by mid-October of 2020, but about PHP 1.5 trillion or greater had in turn been deposited by banks in the BSP's liquidity management facilities since the middle of the same year. Such procyclical behavior among risk-averse banks (and those increasingly constrained by their risk management systems), which opted to seek the safety of zero-risk instruments, suggests that policy makers may already be "pushing on a string"[125] where monetary easing fails to significantly raise both credit supply and demand. The government tried to absorb some of the risk in credit provision through credit guarantee programs for small businesses and the agriculture sector, as well as capitalization of state-owned financial institutions that would allow them to engage in cheaper wholesale lending (see Panels 1 and 2 of Box 2), but implementation has been slower than envisioned (IMF, 2021b; Debuque-Gonzales, 2022). Despite weak monetary transmission, however, it is well understood that maintaining loose monetary conditions may be necessary to avoid the unnecessary bankruptcy of firms and prevent households from being overly saddled with debt (Debuque-Gonzales, 2022).

25. **Spending difficulties and the generally prudent and increasingly targeted approach of government helped limit the fiscal fallout of the pandemic, but greater public investment will be needed to address economic scarring and prevent weakening of long-term economic growth**. The government, for example, met difficulties in delivering social protection, as it had embarked on a very broad relief program for households.[126] Cho (2021) noted that the SAP, by its sheer coverage, counted among the largest cash transfers in the world. However, a project of such scale would naturally experience hiccups, which in the Philippine case included incomplete beneficiary lists, the absence of a national identification system or a unified database, and the lack of a modern (i.e., digital) delivery system, which meant the physical handling of cash, making distribution unsafe (even from a public health perspective) and prone to corruption and leakage. The government also found it difficult to implement its "Build, Build, Build" program during the COVID-19 pandemic, which resulted in the public infrastructure program shrinking

125 In economics, pushing on a string specifically refers to a situation where expansionary monetary policy is ineffective at raising an economy out of a recession.

126 The Bayanihan I Law authorized the Philippine President to provide an emergency subsidy for 18 million low-income households in the Philippines. Given the current population count, this already covers about 80 percent of households in the country.

by an amount equivalent to 1.6 percent of GDP in 2020 (World Bank, 2020). There were also widespread concerns about the efficiency and adequacy of public health spending during the period, which may have critically affected economic outcomes, as research has shown that countries with large first-year responses through higher health-care spending exhibited steeper economic recoveries and a sharper decline in unemployment after the crisis period (e.g., Ma et al., 2020). Policy makers inevitably leaned towards permanent tax cuts for corporations as a way to encourage a private-sector-led economic recovery. Overall, this crisis episode highlights the need for a better balance between the country's monetary and fiscal responses by fixing the impediments revealed in implementing the Philippines' relief and recovery package during the pandemic.

4.1. Fiscal outlook and pressures

26. **Fiscal outlook remains benign thus far, despite the sharp rise in debt during the pandemic.** Policy makers have penciled in a 7.6 percent fiscal deficit for 2022, which would slowly taper to 6.1 percent in 2023, 5.1 percent in 2024, and 4.1 percent in 2025 (Table 3). They expect revenue growth to remain below the pre-pandemic average (about 11 percent in the last half-decade) in the near term, especially given the impact of the corporate tax cuts (from the CREATE law) meant to give the economy a (supply-side) boost during the pandemic.[127] Planned spending, however, will be much slower than the pre-pandemic average (about 14 percent), with government disbursements slated to rise rather unevenly by 6 percent in 2022, 2.6 percent in 2023, 6 percent in 2024, and 6.1 percent in 2025. This would occur despite planned high investment in infrastructure, at over 5 percent of GDP. The private sector's view on the trends in fiscal deficits is similar to that of the government, albeit consistently lower on all time horizons (Table 2).[128]

27. **Nonetheless, the consensus view is that national government debt will continue to breach policy makers' suggested cap of 60 percent of GDP in the near to medium term.** Private forecasters expect that, after hitting 60.5 percent in 2021, the debt-to-GDP ratio will further rise to 62.3 percent in 2022, peak at 62.8 percent in 2023, and then decline to 61.2 percent by 2026 (Table 2). Based on debt sustainability analysis (DSA) of the Philippines, the International Monetary Fund (IMF) in a staff report for the latest Article IV consultation (IMF, 2021b) expects that general government debt, which has typically been lower than national government debt by about 3 percentage points over the past decade, will peak at 61.9 percent of GDP in 2024, and then decline to 61.1 percent in 2025 with a reduction in budget deficits and growth recovery. The report suggests that the Philippines still has some fiscal space based on the results of

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127 Tax effort in the Philippines declined to around 14 percent during the pandemic, from 14.5 percent of GDP in 2019, and will likely remain below the recommended level of 15 percent (Gaspar, Jaramillo, and Wingender, 2016) in the near to medium term.

128 Private sector expectations likely still factored in some underspending by the national government, a common occurrence in the past that was attributed to poor planning and procurement difficulties (Manasan, 2017). Actual government spending (or cash disbursements) during 2011–15 fell short of the amount programmed by government by 1.1 percent of GDP on average (DBCC, 2017) though the gap already narrowed in later years with improved budget execution. Source: FocusEconomics. 2022, Consensus forecast: Philippines (April).

the analysis. A paper from the Philippine Institute for Development Studies (Debuque-Gonzales et al., 2022) similarly expects the national government debt-to-GDP ratio to reach its highest point at 66.8 percent during 2023–24, before gradually dipping to 65.7 percent by 2027 (Figure 16). The study, which likewise uses a standard DSA, notes that a large portion of the debt accumulated at the height of the COVID-19 crisis had been due to the government's build-up of cash buffers from its domestic and external borrowings, which accounted for a large part of the increase in the debt-to-GDP ratio (greater than 6 of the 15-percentage-point upsurge in 2020). This strategy, the authors note, has been adopted by policy makers as a precautionary move in the event of a long-haul pandemic crisis. Since a hefty portion of the accumulated debt comprises liquid assets, a substantial amount should be reversible. Therefore, the debt-to-GDP ratio will likely be kept closer to recommended levels once public health and macroeconomic risks subside.

28. **Fiscal gap computations for the Philippines suggest that bringing debt back to pre-pandemic levels may not be feasible, but fiscal reaction functions provide some assurance that fiscal policy will respond to rising indebtedness in a way that minimizes the likelihood of a debt crisis.** Even assuming the mildest fiscal consolidation path in fiscal gap estimation,[129] reducing the national government debt-to-GDP ratio to 40 percent by 2031 would require primary balance adjustments ranging from 1.4 to 3.4 percent of GDP (from most optimistic to most pessimistic scenarios), while extending the timeframe to 2041 would lower the range to -0.10 (a reduction) to 1.9 percent of GDP (Debuque-Gonzales et al., 2022).[130] The results suggest that it may not be reasonable to aim for a low debt-to-GDP ratio immediately, as further public spending would be necessary to recover from the COVID-19 shock and prevent economic scarring. However, they also underscore the need for a sound medium- to long-term fiscal consolidation plan. Estimated fiscal reaction functions, meanwhile, have positive and statistically significant coefficients on lagged debt of between 0.06 and 0.09 for the Philippines, slightly higher than those seen in the literature on emerging market countries, and between 0.04 and 0.08 for major developing countries in ASEAN (of which the Philippines is a member state).[131] According to the literature (Bohn, 1998, 2008; from D'Erasmo et al., 2016), such systematic behavior—i.e., methodically responding to higher indebtedness by improving primary balances—already indicates responsible fiscal policy and guarantees fiscal solvency.[132]

129 The fiscal gap measure represents the adjustment needed annually (through a constant share-of-GDP increase in taxes or a reduction in non-interest expenditure, or both) to achieve a target debt/GDP ratio over a particular time horizon, given projected economic growth and fiscal performance.

130 Further extending the period to 2051 would bring the range down to -0.58 to 1.3 percent of GDP.

131 The estimated fiscal reaction functions have the ratio of the primary balance to GDP as dependent variable and lagged public debt-to-GDP ratio as independent variable along with other determinants (i.e., the output gap, various government spending measures, inflation, the real effective exchange rate or REER, the ratio of current account to GDP, foreign interest rates, and various crisis dummies).

132 Bohn (1998, 2008) showed that, in a linear fiscal reaction function, a positive and statistically significant response of the primary balance to outstanding debt is sufficient to satisfy the government's intertemporal budget constraint.

4.2. Post-COVID-19 policy challenges

29. **While the COVID-19 pandemic may soon be considered endemic, developing countries including the Philippines still need to prepare for a resurgence of the disease and the possible emergence of another pandemic.** At the time of writing, cases have risen again in certain parts of the world, such as in China, and the COVID-19 virus seemingly remains on an uncertain path, leaving a trail of variants in its wake. Given the severity of the pandemic's economic fallout worldwide—beginning with sharp declines in economic activity and large job losses, and culminating with high inflation due to both supply and demand disturbances—greater spending on disease prevention and health care and social service delivery systems seems warranted. Valuable public investments in this area would be on last-mile vaccination and administration of booster doses for COVID-19, the further development of testing and tracing capacity and reach to cover the more remote areas of the country, and digital delivery of social protection, which can help minimize corruption and other leakages, as well as lower infection risk.

    One cannot overemphasize the urgency of preventing a highly contagious disease from spreading in large populations with weak public health systems, where virus mutations may also go on uncontrolled. As seen in the Philippines and similar developing countries, the alternative of a blanket lockdown to contain the COVID-19 disease was extremely costly in terms of never-before-seen drops in household spending and business investment, and the curtailment of services, with some subsectors inevitably closing and unlikely to be revived. Earlier in the COVID-19 pandemic, researchers such as Alon et al. (2020) already warned that such restrictive measures were less suited to developing economies, which typically had younger populations, more hand-to-mouth households, under-resourced health-care systems, large informal sectors, and limited fiscal space.

30. **Policy makers will need to optimally time the Philippines' exit strategy for COVID-19 support measures to minimize macroeconomic risk.** Premature withdrawal of monetary and fiscal support could derail economic recovery and heighten business uncertainty, while long-drawn-out support could lead to longer-term financial fragility. The first pivotal period had been the initial COVID-19 outbreak during the early part of 2020, when lockdowns were first implemented. The BSP then had to provide quick liquidity support to loosen financial conditions and avert instability through policy rate and reserve requirement cuts and regulatory relief. It also entered a short-term lending arrangement worth PHP 300 billion (about 1.5 percent of GDP) with the national government to help fund pandemic relief, a move that also helped to stabilize the bond market. The Bayanihan I and II laws, as stated earlier, provided the basis for relief spending during this period and the next.

    The second crucial period spanned the persistent lockdowns that prolonged economic weakness, heightening the risk of negative spillovers into the financial sector. This lasted for a period of roughly two years.

    The third critical period could occur with the unwinding of monetary and fiscal policies, the timing of which may be difficult to ascertain as external risks have multiplied.

Spillovers from high US inflation, for instance, have already translated into steeper yield curves in the Philippines, potentially leading to tighter domestic credit conditions (IMF, 2021b). This in turn could weaken economic momentum. The Russian Federation's invasion of Ukraine, meanwhile, has set off world oil and commodity prices, pushing up domestic inflation and potentially requiring contractionary policy in the Philippines in the near term.

With macroeconomic conditions fluctuating, clear policy messaging is needed for an orderly unwinding of pandemic-related measures. In particular, the Philippines will have to be prepared for the possibility of worse-than-expected macro-financial impacts when it begins the process of unwinding macroeconomic policy support. Only after the removal of forbearance measures, for example, can one observe the extent of deterioration in asset quality of banks and other financial institutions, though take-up appears minimal because of reputational cost while a law is already in place to minimize the fallout.[133]

Keeping support measures longer than necessary, on the other hand, could lead to the eventual loss of monetary and fiscal credibility. This holds especially for the monetary-fiscal financing arrangement of the central bank and the national government which, if kept for too long, may heighten the risk of perceived fiscal dominance and loss of monetary independence.[134] Such a scenario could ultimately weaken inflation control.

31. **The government will have to spend more to avert the risk of economic scarring due to a protracted pandemic crisis, but it will also need to have a sound fiscal strategy to maintain macroeconomic stability.** Economic scarring, or impairment of the country's long-term growth potential, may occur through productivity losses due to shutdowns of high-potential firms (those that would have likely survived after the pandemic); the closure of high-contact services sector businesses; the de-skilling of workers because of prolonged unemployment; and disruptions in education, training, and planned investment (Boissay and Rungcharoenkitkul, 2020). Spending on highly affected households and businesses may be one way to help mitigate the scarring. Another way may be through investments in: (i) education to develop the country's workforce; (ii) social protection, particularly in improving service delivery; and (iii) the public health-care system to help prevent, or at least lessen, the severity of another pandemic crisis in the future. Structural reforms, such as those that were recently passed that raise competition in retail trade and public services in the Philippines, would also help revitalize the

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133 The Financial Institutions Strategic Transfer (FIST) Act of 2021 patterned after the Special Purpose Vehicle Act of 2002 incentivizes banks and other financial institutions to offload their nonperforming loans and other nonperforming assets to newly formed private asset management companies called FIST corporations. This removes risk from balance sheets of financial institutions and frees up capital, improving liquidity and lending capacity.

134 To date, the BSP has granted the government's request for five provisional advances: PHP 300 billion in March 2020 (settled in September 2020); PHP 540 billion each in October 2020 (settled in December 2020), January 2021 (settled in June 2021), and July 2021 (settled in December 2021); and PHP 300 billion in January 2022. The latter was slated to be settled in June 2022 but was settled ahead of schedule in May 2022.

economy.[135] The government may combine such reforms with greater infrastructure spending, which also has relatively higher short-term multiplier effects, to help the country regain its pre-crisis growth path.

DSA projections indicate that the country's debt remains manageable. The available analyses nonetheless highlight the need to build up fiscal space, apart from the unwinding of COVID-19-related support, especially with emerging risks on both the revenue and spending sides. For instance, the government's Fiscal Risks Statement 2022 (DBCC, 2022) notes the negative revenue impact of CREATE, which also forms part of the government's planned structural reform but entails near-term revenue losses (estimated at 0.7 and 0.5 percent of GDP in 2021 and 2022, respectively). One can also flag possible spending uncertainties on account of the Supreme Court ruling on the Mandanas petition in 2019, which will begin to reflect in the 2022 budget, as this would require a rebalancing of fiscal responsibilities through phased fiscal devolution.[136] Fiscal gap analysis, as suggested earlier, underscores the need for a sound fiscal consolidation strategy. Such a strategy provides an assurance of the national government's commitment to fiscal prudence and responsibility. This would allow a gradual reduction of budget deficits and an eventual decline in public debt to safer levels.

Finally, the different ways of examining fiscal sustainability emphasize the importance of retaining policies that allow the Philippine economy to remain inherently strong. An important observation is how the finding of sanguine fiscal conditions (i.e., guaranteed fiscal solvency based on fiscal reaction functions) rests on the absence of structural breaks in relation to fiscal policies and institutions. With the country just recently emerging from a presidential election, this serves as an important reminder to the new administration to avoid policy reversals, which the winning president hinted at during the campaign, particularly critical reforms that helped lower fiscal risk in the past, such as the deregulation/liberalization of key sectors in agriculture (rice) and energy (oil and power).[137]

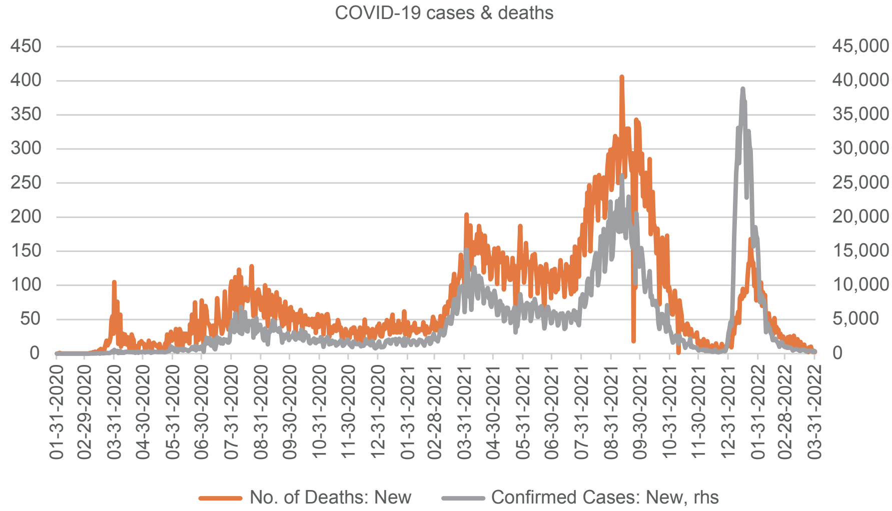
135 Aside from the CREATE law, recent legislation meant to "further liberalize and modernize the economy and upskill the country's workforce" include amendments to the Retail Trade Liberalization Act, Public Service Act, and Foreign Investments Act (Department of Finance Press Statement, 5 April 2022. Available online: https://www.dof.gov.ph/president-duterte-has-masterfully-steered-phl-economy-towards-global-competitiveness-says-dominguez/).

136 The Supreme Court ruling on the Mandanas versus Ochoa petition changed revenue sharing with local government units (LGUs) by including national taxes (with some exclusions allowed by law) in the base for determining LGU allotment and has necessitated a devolution of some fiscal responsibilities to LGUs. The National Tax Allotment (NTA) of LGUs is set to increase by PHP 239.8 billion to a total of PHP 959 in 2022, or nearly one-fifth of the national budget.

137 In a promising gesture, the newly elected Philippine President in his first State of the Nation address (in July 2022) pledged to reform the country's tax system and strengthen tax administration, initially highlighting a VAT on digital services, while continuing to boost infrastructure spending to support economic growth.

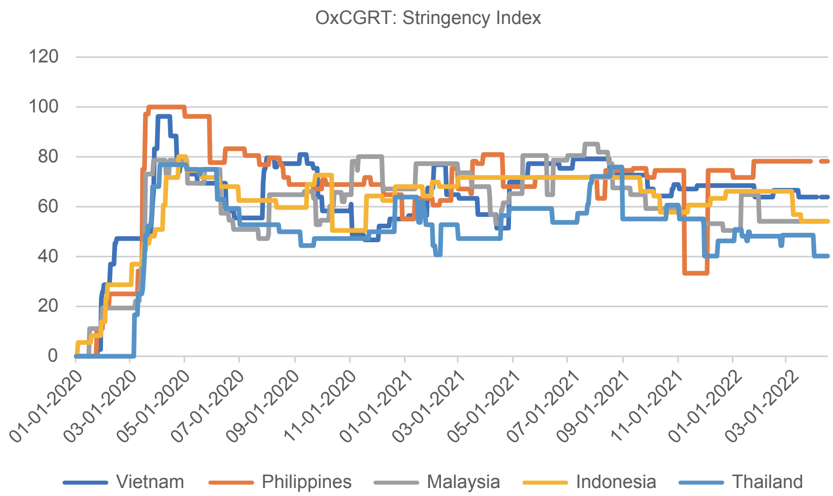
Appendix 1. Selected Figures and Boxes

Figure 1 COVID-19 cases and deaths



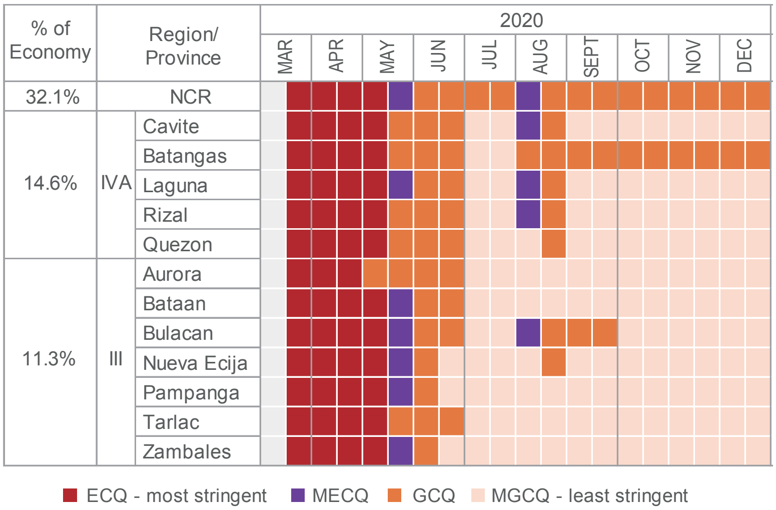
Source: Gonzales, Corpus, and Miral (2021); Inter-Agency Task Force (IATF) updates.

Figure 2 COVID-19 policy stringency in ASEAN-5



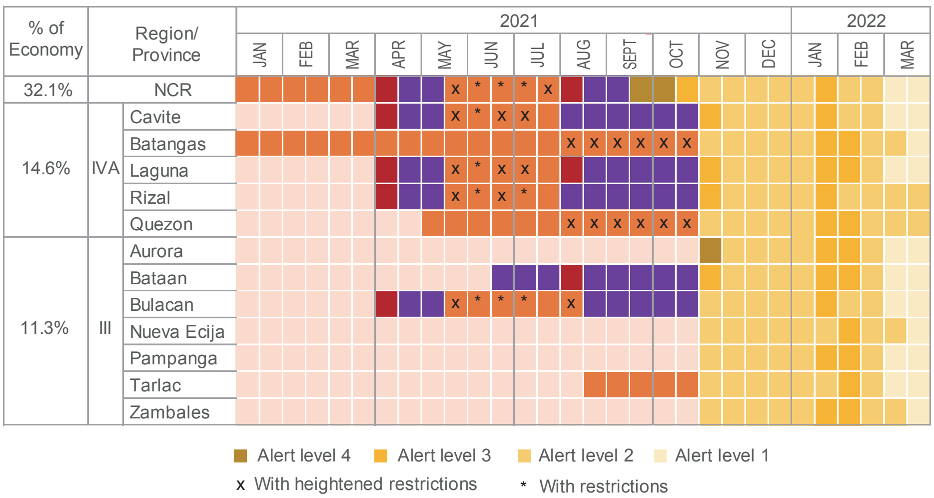
Source: Gonzales, Corpus, and Miral (2021); IATF updates.

Figure 3a COVID-19 quarantines in 2020



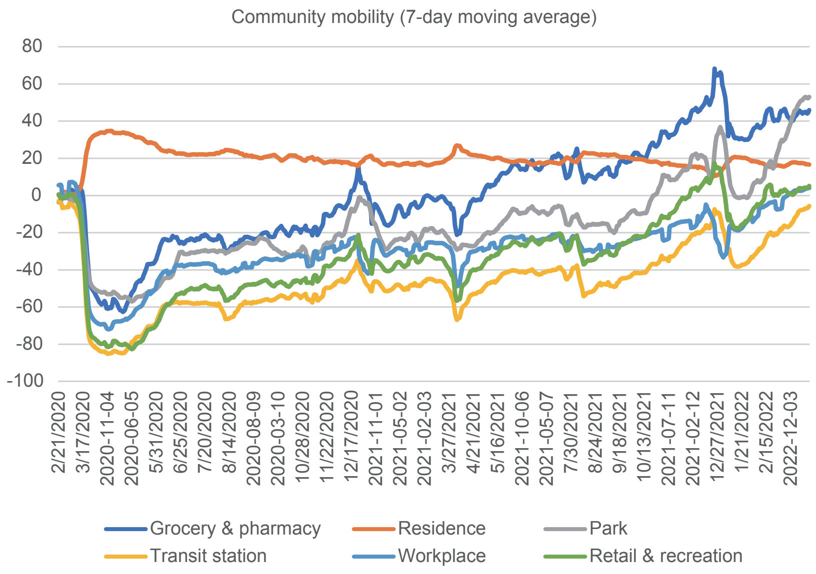
Source: Blavatnik School of Government, University of Oxford.

Figure 3b COVID-19 quarantines in 2021–2022Q1



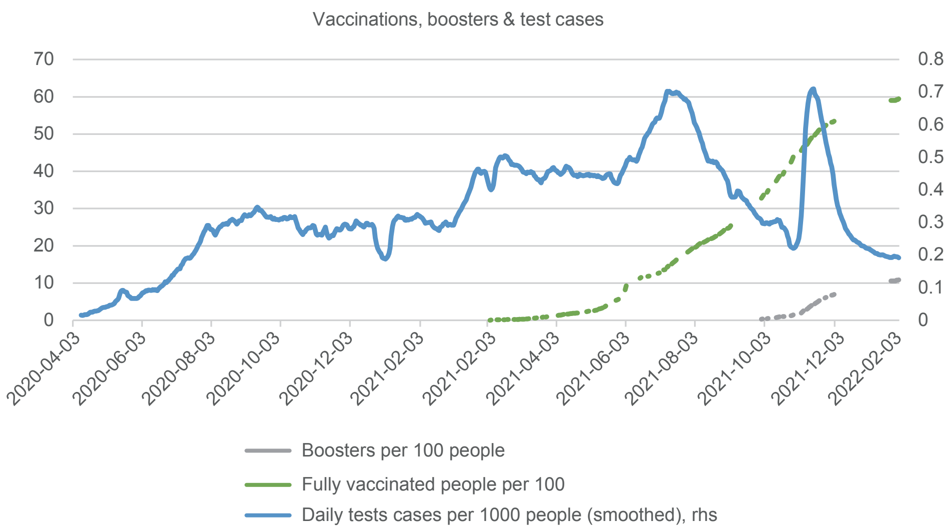
Source: Google Community Mobility Database.

Figure 4	Community mobility in the Philippines



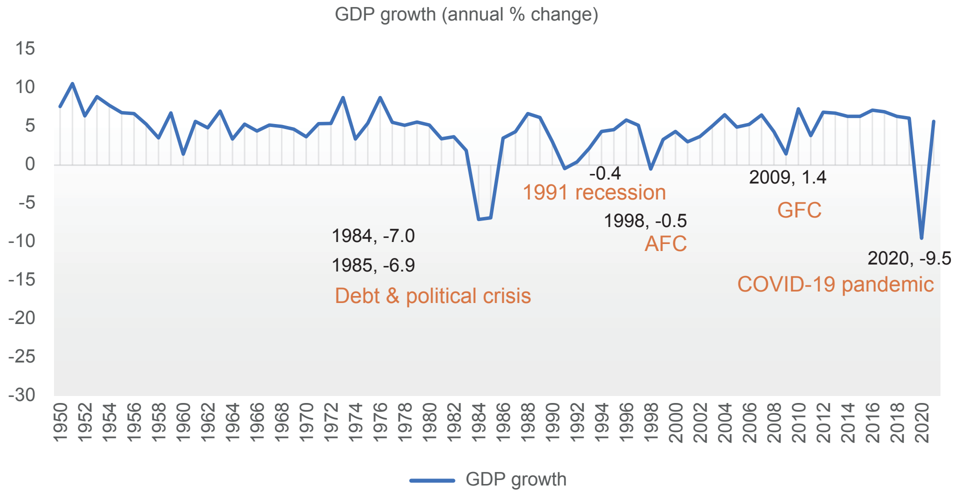
Source: Our World in Data; Department of Health, Philippines.

Figure 5	COVID-19 vaccination and testing



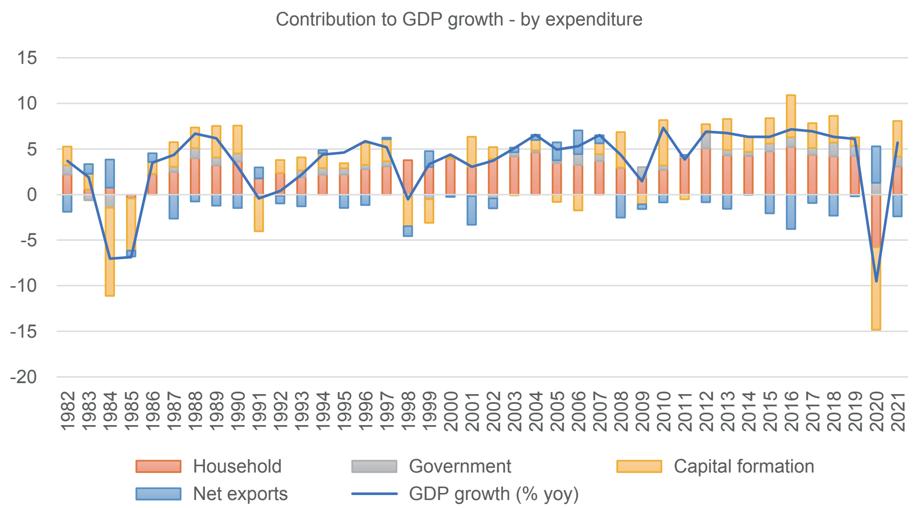
Source: Our World in Data; Department of Health, Philippines.

Figure 6 GDP performance, 1950–2021



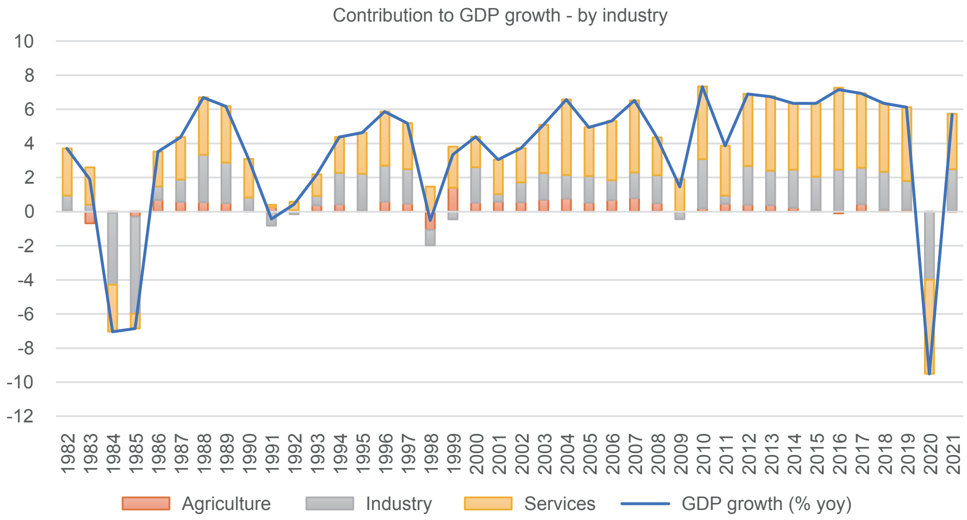
Source: Philippine Statistics Authority.

Figure 7a Contribution to GDP growth by expenditure



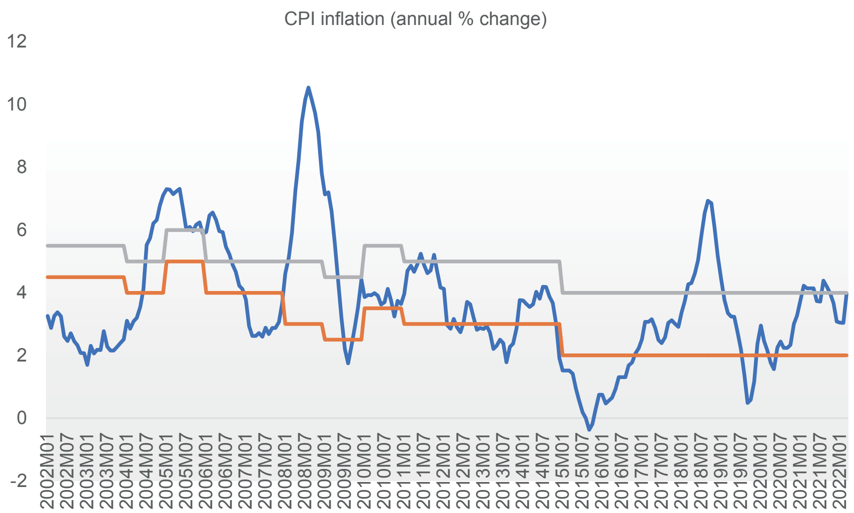
Source: Philippine Statistics Authority.

Figure 7b Contribution to GDP growth by industry



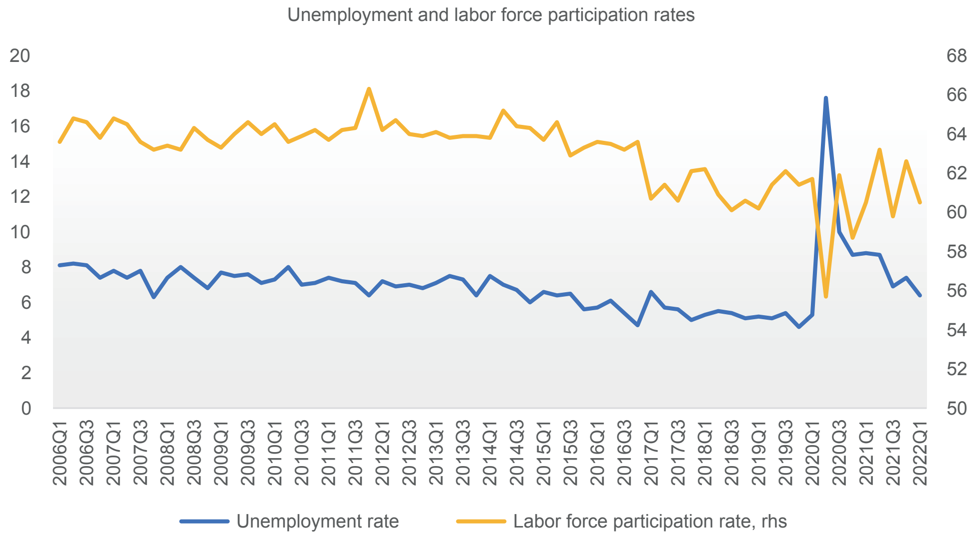
Source: Philippine Statistics Authority.

Figure 8 Inflation rate and target band



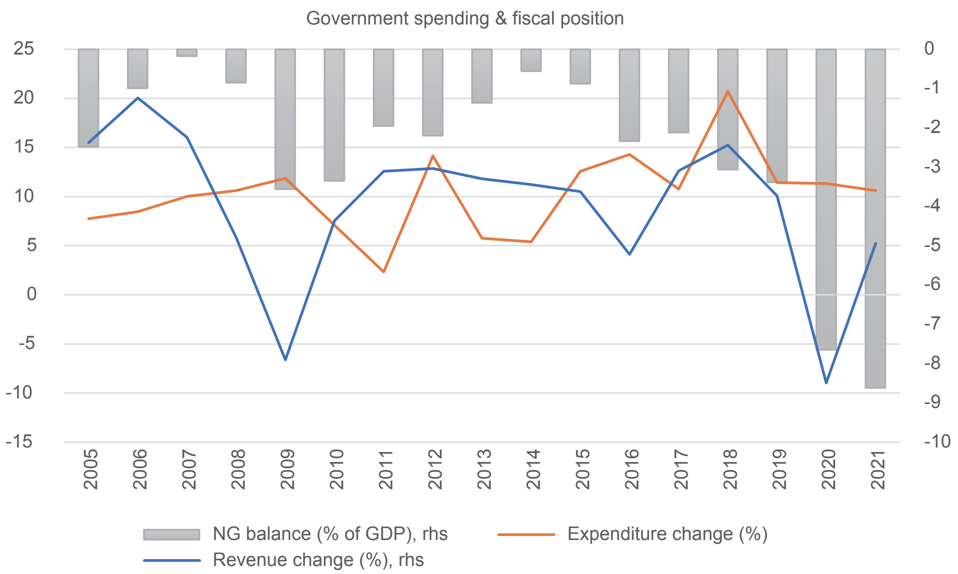
Source: Philippine Statistics Authority.

Figure 9 Employment indicators



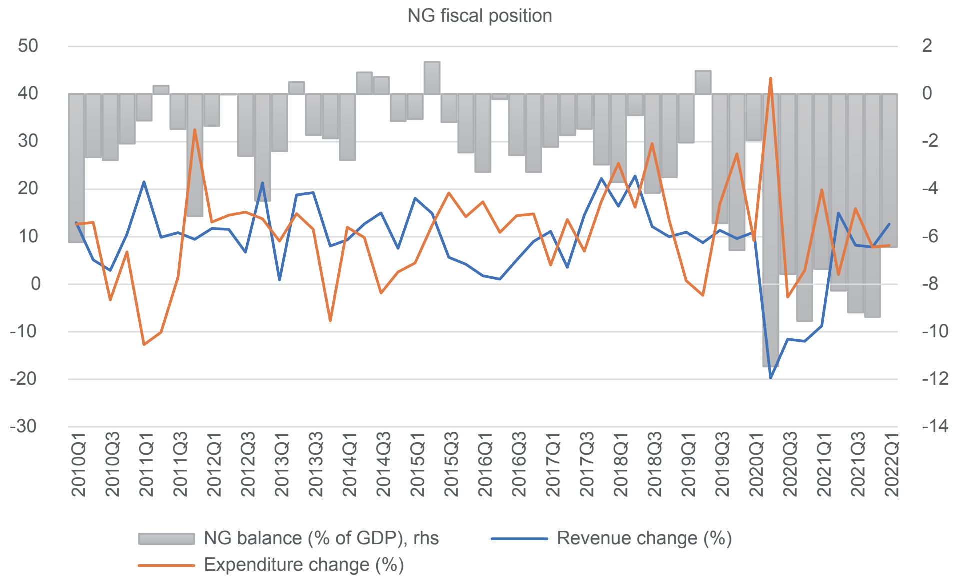
Source: Philippine Statistics Authority.

Figure 10 National government's fiscal position



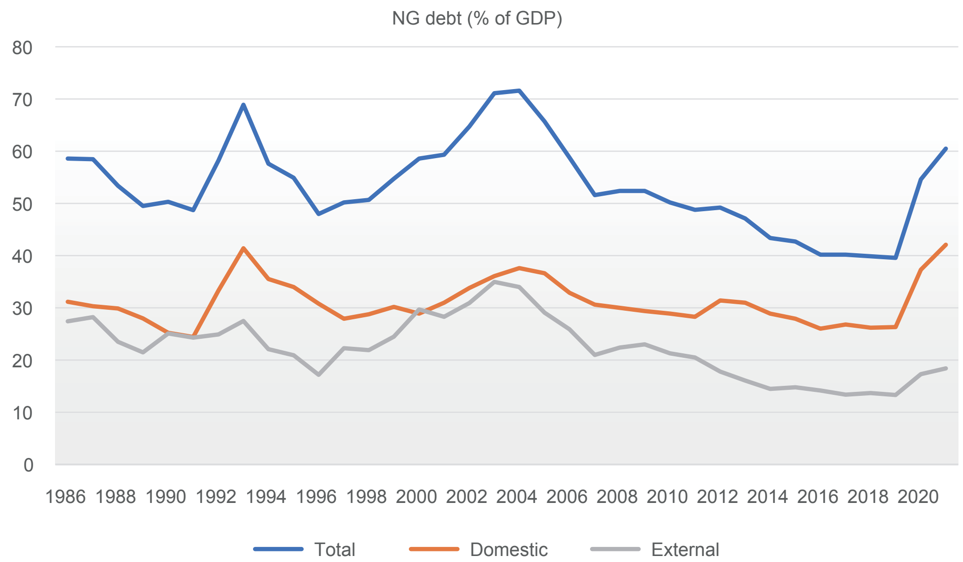
Source: Bureau of Treasury; Philippine Statistics Authority.

Figure 11 Fiscal update, 2010Q1–2022Q1



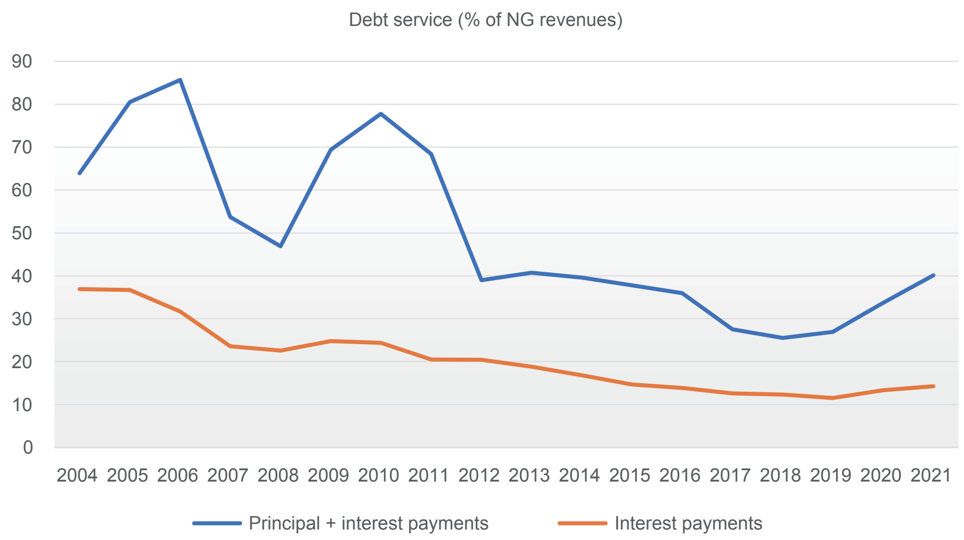
Source: Bureau of Treasury; Philippine Statistics Authority.

Figure 12 National government debt ratio



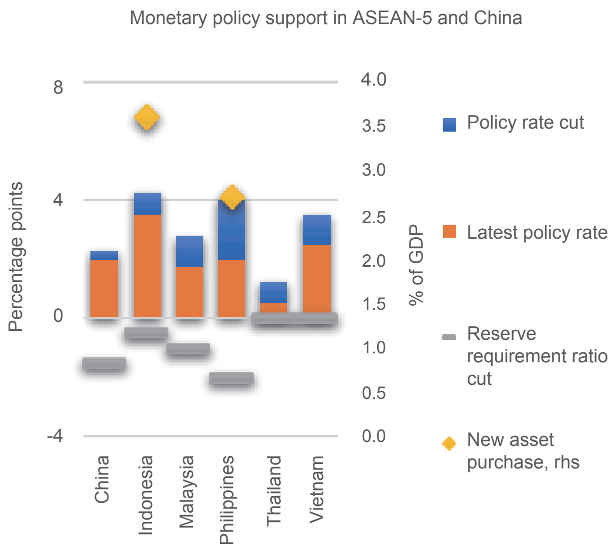
Source: Bureau of Treasury; Philippine Statistics Authority.

Figure 13 National government debt service



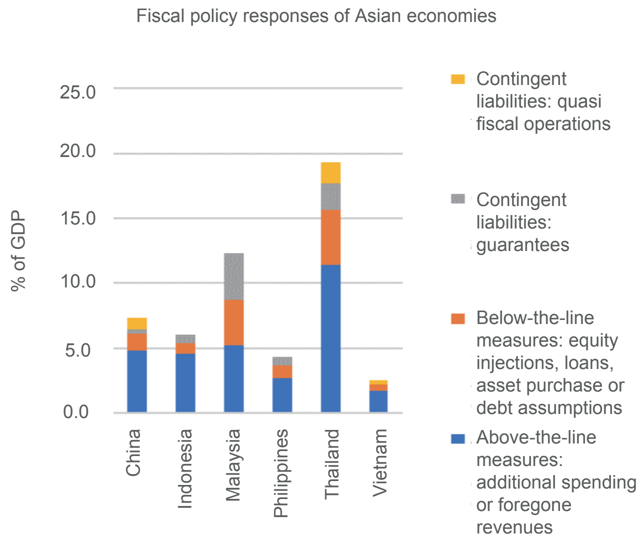
Source: Bureau of Treasury; Philippine Statistics Authority.

Figure 14 Monetary responses of developing Asian economies



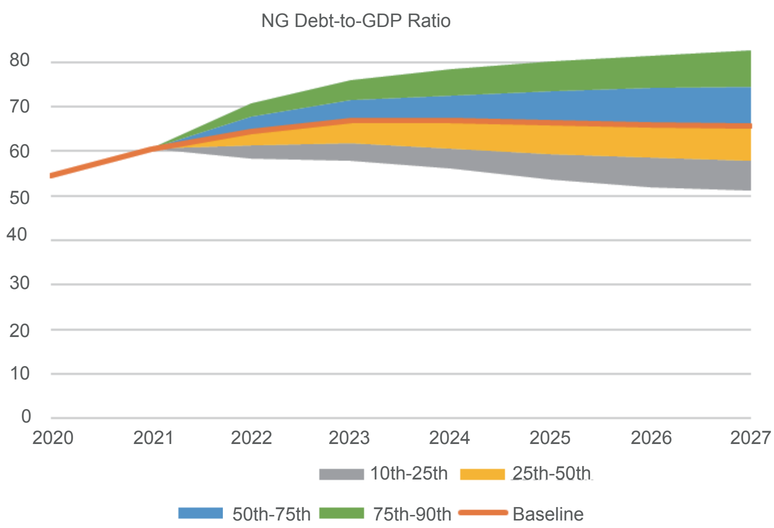
Source: IMF; World Bank; CEIC.

Figure 15 Fiscal responses of developing Asian economies



Source: Fiscal Monitor, IMF; World Bank.

Figure 16 National government debt trajectory



Source: Debuque-Gonzales et al. (2022).

Box 1 Summary of monetary policy responses

Liquidity support

- Policy rate cuts:
  - Key policy rate lowered 5 times in 2020, by 200 bps total (to overnight RRP rate = 2%)
  - On Feb 6 (25 bps), Mar 19 (50 bps), Apr 16 (50 bps, off-cycle), Jun 25 (50 bps), Nov 19 (25 bps)
- Reserve requirement ratio cuts:
  - BSP Governor authorized by MB to cut the RRR by up to 400 bps in 2020 (Mar 23)
  - RRR lowered by 200 bps to 12% for U/KBs (Mar 24, effective Apr 3)247
  - RRR lowered by 100 bps for thrift and rural/cooperative banks to 3% and 2%, respectively (Jul 21, effective Jul 31)
- Other measures include:
  - Temporarily suspended TDF auctions for certain tenors (Mar 17)
  - Temporarily reduced the term spread on peso rediscounting loans relative to the overnight lending rate to zero (Mar 19)
  - Opened daily 1-hour window for purchases of highly traded and liquid government securities in the secondary market (Mar 24)
  - Expanded range of eligible GS for purchase to cover all peso-denominated GS in the secondary market and reduced the daily overnight RRP volume offering (Apr 8)
  - Reduction in minimum liquidity ratio for stand-alone thrift banks, rural banks, and cooperative banks from 20% to 16% (April 7)

Regulatory relief

- Regulatory relief granted to banks whose clients were affected by the Asian Swine flu and COVID-19 (Feb 26)
- Temporary relaxation of BSP rules on compliance reporting by banks, calculation of penalties on required reserves, and SBLs (Mar 19)
- Relaxation of documentary and reporting rules for FX operations of banks (Mar 27)
- Prudential accounting relief measures to reduce the impact of mark-to-market losses on the financial condition of BSP-supervised financial institutions (Apr 8)
- Temporary relaxation of the borrowing limit of pawnshops from 50% to 70% until December 2021 (Jun 18)
- Further easing of regulatory requirements on bank operations until Mar 2021, including temporarily easing the SBL from 25% to 30% (Jul 21)
- Exemption of debt securities acquired as a result of market-making activities of BSP-supervised financial institutions from the SBL (Jul 22)
- Increase in the limit on U/KBs' real estate loans, from 20% to 25% (Aug 20)
- Regulatory relief granted to branches of foreign banks by suspending sanctions for breach of SBL (Dec 29)

MSME-related lending support

- Loans to MSMEs permitted to be counted as part of banks' compliance with reserve requirements (Apr 16)
- Relaxation of regulatory capital treatment of banks' exposures to MSMEs (May 5):
  - Temporary reduction in the credit risk weights of loans granted to MSMEs that are current in status from 75% (diversified MSME portfolio with at least 500 borrowers) and 100% (non-diversified MSMES portfolio) to 50% (subject to review by end-December 2021)
  - Assignment of a zero-percent risk weight for MSME loans that are covered by guarantees (by the Philippine Guarantee Corp. and also by the Agricultural Guarantee Fund Pool and the Agricultural Credit Policy Council) as complement to NG programs that support financing to small businesses and small farmers and fisherfolk
  - Deferred implementation of the revised risk-based capital framework for thrift banks and rural/cooperative banks which cater to MSMEs and clients in rural communities (to take effect in January 2023 instead of January 2022)

NG support / Others

- NG support:
  - BSP's P20B remittance of advanced dividend to the National Government even though it was no longer required to make dividend payments to the government under the newly amended BSP charter (Mar 2, Mar 26)
  - MB approval of PHP 300 billion 6-month repurchase agreement with the National Treasury (Mar 23)
  - Short-term (3-month) provisional advances to NG amounting to PHP 540 billion after the repurchase agreement was fully settled in September (Oct 1)
  - Extension of PHP 540 billion provisional advances to NG for another 3 months (Dec 28)
- Others:
  - Relaxation of KYC requirements to facilitate access to financial services (Apr 1)
  - Suspension of fees related to digital financial services (such as through online banking facilities and electronic money platforms) as added relief to BSP-supervised financial institutions affected by COVID-19 (Apr 28)
  - Ceiling set on credit card charges (Sep 25, effective Nov 3)

bps = basis points; BSP = Bangko Sentral ng Pilipinas; KYC = know-your-customer; MB = Monetary Board; NG = national government; RRR = reserve requirement ratio; SBL = single borrower's limit; TDF = term deposit facility; U/KBs = universal and commercial banks

Source: Bangko Sentral ng Pilipinas (various years); International Monetary Fund (2020), Debuque-Gonzales (2022).

Box 2 Summary of fiscal policy responses

Relief

- Bayanihan I signed March 24, 2020; 3-month effectivity (expired June 24, 2020)
- Bayanihan I total budget releases reported end-December 2020, PHP 386.142 bn (1.99% of GDP)

*COVID-related on-budget expenditures from Bayanihan I include:
- Social Amelioration Program & related measures, PHP 211.4 bn (1.1% of GDP)
- Small business wage subsidy & support measures for vulnerable workers (including OFWs and health workers), PHP 64.6 bn (0.3% of GDP)
- COVID-related medical responses, >PHP 50 bn
- Bayanihan grants to LGUs to fund emergency responses to COVID-19, PHP 37.0 bn
- Education spending for learning continuity, PHP 10.9 bn
- Various agri-related measures

*COVID-related off-budget measures include:
- Credit guarantees for small businesses and support to agri sector, PHP 120 bn (0.62% of GDP)

Relief + Recovery

- Bayanihan II signed September 11, 2020; availability of funds extended from December 19, 2020 to June 30, 2021
- Bayanihan II budget releases as of end-December 2020, PHP 109.2 bn (0.56% of GDP)
- *Budget appropriations in Bayanihan II, total of PHP 140 bn (0.72% of GDP) includes:
  - Capital infusion to GFIs, PHP 39.5 bn
    - LBP, PHP 18.5 bn
    - DBP, PHP 6 bn
    - PhilGuarantee, PHP 5 bn
    - SBC, PHP 10 bn
  - Health-related responses, PHP 30.5 bn
    - Includes hiring of 50,000 contract tracers, PHP 5 bn
  - Support to agriculture and fishery, PHP 24 bn
  - Cash-for-work programs & unemployment assistance for displaced workers, PHP 13 bn
  - Transport sector support, PHP 9.5 bn
  - Education support, PHP 8.9 bn
  - Financing of social protection programs, PHP 6 bn
  - Tourism sector support, PHP 4.1 bn
    - Includes cash-for-work programs, PHP 3 bn
  - LGU assistance, PHP 3.5 bn

*Standby fund in Bayanihan II, PHP 25.5 bn (0.13% of GDP):
- Covid-19 testing & procurement of medicines & vaccine, PHP 10 bn
- Capital infusion to LBP, PHP 9 bn
- Capital infusion to DBP, PHP 6.5 bn

*Tax change in Bayanihan II:
- NOLCO extension from 3 to 5 years (for net operating loss during 2020 and 2021), PHP 16.262 bn

Restructuring

Supply-side stimulus
- CREATE bill includes the following (in bicameral conference committee):
- Permanent CIT rate cut from 30% to 25% (effective July 1, 2020)
  - Lower CIT rate of 20% for corporations with net taxable income of not more than PHP 5 mn and total assets (not including land) of not more than PHP 100 mn
  - Temporary tax cuts (between July 2020 & June 2023):
    - For proprietary educational institutions and hospitals (from 10% income tax rate to 1%)
    - Minimum CIT (from 2% to 1%)
    - For taxpayers whose gross sales or receipts do not exceed the VAT threshold of PHP 3 mn (from 3% percentage tax rate to 1 %)
  - VAT exemptions on housing, e-books, drugs & medicine
  - Strengthening of FIRB

*Tax change in Bayanihan II
- Repeal of IPO tax, PHP 1.16 bn

"Reset" + "Rebound" + "Recover"

FY 2021 National Budget
- PHP 4.506 tr (21.8% of GDP, up 9.9% from FY 2020 budget)
- "Reset": Responding to the COVID-19 pandemic
  - Health sector budget, PHP 210.2 bn (up 19.6% annually)
  - Regular health programs include:
    - Health insurance premiums, PHP 71.4 bn
    - Medical assistance to indigent patients , PHP 17 bn
    - Deployment of doctors, nurses and other health workers to disadvantaged communities and national hospitals, PHP 16.6 bn
    - Infrastructure upgrade, PHP 14.7 bn (includes PHP 5.52 bn in unprogrammed funds and PHP 1.4 bn from ADB and World Bank funded projects)
  - New health programs/projects include:
    - Equipment and materials, PHP 5.7 bn
    - COVID-19 vaccines, PHP 2.5 bn (plus PHP 70 bn in unprogrammed appropriations for vaccine procurement and logistics)
    - Foreign-assisted projects addressing pandemic needs, PHP 5.3 bn
    - R&D, PHP 334.56 mn
- "Rebound": Reviving infrastructure development
  - DPWH core programs, PHP 317.7 bn
  - DOTR projects, including:
    - Rail transport, PHP 47.7 bn
    - Land transport, PHP 12.6 bn
- "Recover": adapting to post-pandemic life
  - Food security, PHP 57.2 bn
  - Industry and livelihood, PHP 27.9 bn
  - Education, PHP 22.9 bn
  - Social protection, PHP 134.6 bn
  - National ID and community-monitoring system, PHP 4.4 bn

bn = billion; CIT = corporate income tax; CREATE = Corporate Recovery and Tax Incentives for Enterprises; DBP = Development Bank of the Philippines; FIRB = Fiscal Incentives Review Board; FIST = Financial Institutions Strategic Transfer; FY = fiscal year; GDP = gross domestic product; GFIs = government financial institutions; GUIDE = Government Financial Institutions Unified Initiatives to Distressed Enterprises for Economic Recovery; IPO = initial public offering; LBP = Land Bank of the Philippines; LGUs = local government units; mn = million; NOLCO = net operating loss carryover; NPAs = nonperforming assets; OFWs = overseas Filipino workers; PHP = Philippine peso; SBC = Small Business Corp.; VAT = value-added tax

Source: Department of Budget and Management, Department of Finance, Debuque-Gonzales (2022).

Appendix 2. Selected Tables

Table 1 Selected Economic Indicators

	2017	2018	2019	2020	2021
Real Sector and Prices	(Annual percentage change)				
Real GDP	6.9	6.3	6.1	-9.5	5.7
Agriculture	4.2	1.1	1.2	-0.2	-0.3
Industry	7.0	7.3	5.5	-13.1	8.5
Services	7.4	6.7	7.2	-9.1	5.4
Household final consumption expenditure	6.0	5.8	5.9	-8.0	4.2
Government final consumption expenditure	6.5	13.4	9.1	10.5	7.1
Gross capital formation	10.9	11.3	3.5	-34.2	20.3
Exports of goods and services	17.4	11.8	2.6	-16.1	8.0
Imports of goods and services	15.1	14.6	2.3	-21.6	13.0
GDP deflator	96.4	100.0	102.2	104.3	107.0
CPI inflation (average)	2.9	5.2	2.4	2.4	3.9
CPI inflation (end of period)	2.9	5.2	2.4	3.3	3.1
External Sector	(US$ million, unless otherwise specified)				
Current account balance	-2,143	-8,877	-3,047	11,578	-6,922
(Percent of GDP)	-0.7	-2.6	-0.8	3.2	-1.8
Trade balance (goods and services)	-31,522	-39,364	-36,272	-19,909	-39,608
Exports	86,646	90,374	94,741	80,034	87,795
Imports	118,168	129,738	131,013	99,943	127,403
Services, net	8,693	11,608	13,039	13,866	14,174
Primary income, net	3,226	3,669	5,276	4,101	3,225
Secondary income, net	26,153	26,818	27,949	27,386	29,461
Financial account balance	-2,798	-9,332	-8,034	-6,906	-6,942
Foreign direct investment	-6,952	-5,833	-5,320	-3,260	-8,116
Other investment	1,750	-4,894	-67	-1,767	-6,268
Overall balance	-863	-2,306	7,843	16,022	1,345
Gross international reserves	81,570	79,193	87,840	110,117	108,794
(Months of imports)	7.8	6.9	7.6	12.3	9.6
External debt	73,098	78,960	83,618	98,488	106,428

	2017	2018	2019	2020	2021
(Percent of GDP)	22.3	22.8	22.2	27.2	27.0
Fiscal Sector	(Percent of GDP)				
Revenue and grants	14.9	15.6	16.1	15.9	15.5
Tax revenue	13.6	14.0	14.5	14.0	14.1
Nontax revenue	1.3	1.6	1.6	2.0	1.4
Grants	0.0	0.0	0.0	0.0	0.0
Expenditure	17.1	18.7	19.5	23.5	24.1
Current non-interest expenditure (*primary exp.)	15.2	16.7	17.6	21.4	21.9
Interest payments	1.9	1.9	1.8	2.1	2.2
Capital expenditure	4.3	5.3	5.3	4.9	6.0
Overall fiscal balance	-2.1	-3.1	-3.4	-7.6	-8.6
Primary balance	-0.2	-1.1	-1.5	-5.5	-6.4
Public debt (national government)	40.2	39.9	39.6	54.6	60.4
Public debt (general government)	38.1	37.1	37.0	51.7	59.1 (est.)
Monetary and Financial Sector	(Annual percentage change, end-period)				
Domestic credit	13.9	14.9	10.7	4.7	8.2
Credit to private sector	16.4	15.1	7.8	-0.2	3.8
Broad money (M4)	11.3	9.0	9.8	8.7	8.0
Broad money (M3)	11.9	9.5	11.5	9.6	7.9
Reserve money	13.7	6.4	-3.0	5.1	5.8
Memorandum Items					
Nominal GDP (PHP billion)	16,557	18,265	19,518	17,952	19,411
Nominal GDP (US$ million)	328,481	346,842	376,823	361,751	394,086
GDP per capita (US$)	3,153	3,280	3,512	3,326	3,576
Exchange rate (PHP/US$, average)	50.40	52.66	51.80	49.62	49.25
Exchange rate (PHP/US$, end of period)	49.92	52.72	50.74	48.04	50.77

Source: Philippine Statistics Authority; Bangko Sentral ng Pilipinas; Bureau of Treasury; Department of Budget and Management; CEIC.

Table 2 Consensus forecasts as of April 2022

	2018	2019	2020	2021	2022f	2023f	2024f	2025f	2026f
GDP growth	6.3	6.1	-9.6	5.6	6.7	6.3	6.3	6.2	6.2
Private consumption	5.8	5.9	-7.9	4.2	6.6	6.1	6.0	5.9	5.8
Government consumption	13.4	9.1	10.5	7.0	5.6	3.9	4.7	5.1	5.4
Fixed investment	12.9	3.9	-27.5	9.6	9.5	10.6	9.4	8.6	7.8
Exports	11.8	2.6	-16.3	7.8	8.7	9.0	7.9	7.1	6.2
Imports	14.6	2.3	-21.6	12.9	9.6	10.1	8.5	7.6	6.6
Manufacturing	5.1	3.8	-9.8	8.6	5.8	5.0	5.6	5.8	n.d.
Unemployment	5.3	5.1	10.4	8.0	6.5	5.8	5.4	5.2	5.0
Fiscal balance (% of GDP)	-3.1	-3.4	-7.6	-8.6	-6.9	-5.6	-4.7	-4.0	-3.3
NG debt (% of GDP)	39.9	39.6	54.6	60.5	62.3	62.8	62.4	61.8	61.2
Inflation	5.2	2.5	2.6	4.1	3.8	3.3	3.2	3.1	3.0
Policy rate	4.75	4.00	2.00	2.00	2.41	2.96	3.37	3.68	3.99
Exchange rate (PHP/USD)	52.7	51.8	49.6	49.3	52.0	51.6	51.2	50.6	50.0
Current account balance (% of GDP)	-2.6	-0.8	3.2	-1.8	-1.8	-1.8	-1.4	-1.3	-1.2
External debt (% of GDP)	22.8	22.2	27.2	27.1	25.7	23.5	22.0	n.d.	n.d.

Source: FocusEconomics Consensus Forecasts Philippines, April 2022.
Note: f = forecast; NG = national government.

Table 3 Government's medium-term fiscal program, FYs 2022–2025

Particulars	2020	2021	2022	2023	2024	2025
	Actual		Program	Projections		
Revenues (PHP billion)	2,856.0	3,005.5	3,304.1	3,632.9	4,062.7	4,548.7
% of GDP	15.9%	15.5%	15.2%	15.3%	15.6%	16.1%
Growth rate	-9.0%	5.2%	9.9%	10.0%	11.8%	12.0%
Disbursements (PHP billion)	4,227.4	4,675.6	4,954.6	5,085.8	5,392.2	5,723.0
% of GDP	23.6%	24.1%	22.8%	21.3%	20.8%	20.2%
Growth rate	11.3%	10.6%	6.0%	2.6%	6.0%	6.1%
Surplus/(Deficit) (PHP billion)	(1,371.4)	(1,670.1)	(1,650.5)	(1,453.0)	(1,329.5)	(1,174.3)
% of GDP	-7.6%	-8.6%	-7.6%	-6.1%	-5.1%	-4.1%
Infrastructure program (PHP billion)	869.9	1,123.6	1,199.5	1,280.6	1,397.1	1,490.8
% of GDP	4.8%	5.8%	5.5%	5.4%	5.4%	5.3%

Source: Development Budget Coordination Committee, 181st DBCC Meeting, 24 May 2022.

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2022 KIPF-AMRO Joint Research

The Impact of COVID-19 on Regional Economies and Policy Responses

Chapter

11

Vietnam

Chapter 11

Vietnam[138]

The Vietnamese economy has been severely impacted by the COVID-19 pandemic, especially since a fourth Delta-variant wave started in late April 2021. As such, various groups of people, workers, and businesses have faced severe difficulties, such as income reductions, job losses, and business and production disruptions. To support these groups and help nurture a recovery in the economy as a whole, the Government of Vietnam issued a number of policies and programs to prevent and control the pandemic, as well as mitigate its widespread negative impacts. Among these, fiscal policies have been designed and implemented, and initial evaluations show that they have been supportive of the beneficiaries. As other COVID-19 variants have emerged, however, a number of limitations of fiscal policies have also been observed, which need to be considered carefully if support to the targeted beneficiaries is to be implemented effectively and efficiently, as well as nurturing a timely recovery for the wider economy.

1. COVID-19 development[139]

1. **Initially, the COVID-19 pandemic developed relatively slowly in Vietnam in 2020, but saw a swift expansion after a fourth wave.** The COVID-19 pandemic in Vietnam has developed through five waves: The first wave was from 23 January 2020 through 24 July 2020, which had an average of 415 affected cases per day. The second wave was from 25 July 2020 to 27 January 2021, with an average of 1,136 affected cases per day. The third wave was from 28 January 2021 through 26 April 2021, with an average of 1,301 affected cases per day. The fourth and most serious wave, the Delta variant, was from 27 April 2021 to date, with an average of about 16,000 affected cases per day from 27 April 2021 to 31 December 2021. The latest fifth wave is the Omicron variant, with around 1,000 cases, which appeared in early January 2022. The total number of deaths to date was about 44,000 (Department of Preventive Medicine, Ministry of Health, 2021). The fourth COVID-19 wave added almost 10 million infected persons, with nearly 43,000 deaths (Figure 1).

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139 This chapter covers all related issues until December 2021 so there are no relevant discussions of the Vietnamese economy under the Omicron variant, which appeared for the first time in Vietnam in early January 2022.

2. **To counter the rapid spread of the Delta variant, various policies were issued and implemented.** From 19 July 2021 to mid-September 2021, 19 out of 22 provinces/cities in the southern region applied Directive 16 with strict social-distancing measures and even some lockdowns (GoV, 2020a), while some other provinces/cities across the country applied lower-level measures, such as social distancing with limitations on transportation. When the pandemic was under control for a certain period of time, many provinces/cities loosened the measures in order to bring life back to normal. Since 20 September 2021, 25 provinces have allowed health workers to return home. Offices, schools, and production and business establishments returned to normal operations, while some provinces continued to reopen, but more slowly to avoid further outbreaks. Because new infections were concentrated in provinces/cities such as Ho Chi Minh City and Binh Duong, so these provinces/cities partially reopened by implementing a "new normal" while trying to ensure pandemic safely. Especially since Resolution 128/NQ-CP on temporary regulations on "safely adapting, flexibly and effectively controlling the COVID-19 pandemic" was issued on 11 October 2021 (GoV, 2021), provinces reopened and allowed most economic activities to resume, albeit with safety measures against transmission of the virus in place.

3. **To date (as of May 2022), almost all economic and social activities have recovered.** In particular, the economic sectors that were most severely affected by the COVID-19 pandemic, such as tourism and hospitality, have recovered rapidly, with a strong recovery in domestic demand. Vietnam opened up to international travelers and businesses on 15 March 2022 and most of the COVID-19 control measures have now been removed.

2. The economic impact of the pandemic

4. **The COVID-19 pandemic had severely negative impacts on Vietnam's economy, labor productivity, and growth of the money supply (M2).** The fourth COVID-19 outbreak from April 2021 until December 2021 in the Southeast provinces and the Mekong Delta severely affected the Vietnamese economy due to a major economic slowdown in the last three quarters of 2021. The economic growth rate was only 2.6 percent in 2021, far lower than growth rates seen in the pre-pandemic period, which resulted in only a modest increase in GDP per capita (in current US$) (Figure 2). The second COVID-19 wave (Q2 of 2020) and the fourth wave (Q2 of 2021) had serious impacts on the quarterly economic growth rate (Figure 3). As a result, growth rates of labor productivity in 2020 and 2021 were the lowest in the 2010–21 period (Figure 4).

5. **The pandemic also had a serious impact on the labor market, resulting in a high level of job losses and a high unemployment rate due to business suspensions.** The impacts were clearly strong in Q3 and Q4 of 2021 (during the fourth wave of the pandemic), especially in the Southeast region (which includes Ho Chi Minh City, the most populous and the largest local economy in Vietnam). The Labor Force Survey in Q3 of 2021 (General Statistics Office(GSO), 2021a) started to highlight the negative signals in the labor market. In that quarter, Vietnam saw more than 28.2 million people aged 15 years and older negatively affected by the pandemic, including those who had lost their jobs, taken time

off work or taken temporary leave, reduced their working hours, or were forced to accept reduced incomes. Thus, compared with Q2 of 2021, the pandemic negatively impacted an additional 15.4 million workers. The most badly affected group was those aged 25–54, accounting for 73.3 percent of the affected workers. Out of a total of more than 28.2 million people negatively impacted: 4.7 million people lost their jobs (equivalent to 16.5 percent); 14.7 million people had to temporarily stop/suspend production and business (equivalent to 51.1 percent); 12.0 million people had their working hours cut or were forced to take time off or to take temporary leave (equivalent to 42.7 percent); and 18.9 million workers faced decreased income (equivalent to 67.2 percent). The number of workers in the Southeast and the Mekong Delta regions who said that their work had been negatively impacted by the pandemic accounted for the highest proportion, at 59.1 and 44.7 percent, respectively. Meanwhile, workers in the Northern Midlands and Mountains and the Central Highlands regions reported suffering less negative impact, at 17.4 and 19.7 percent, respectively.

Labor in urban areas also suffered more, with 46.2 percent being negatively affected (24.3 percentage points higher than in Q2 of 2021), while this figure in rural areas was 32.4 percent (18.1 percentage points higher than the previous quarter). Nearly half of all employed people (48.7 percent) said that their jobs had been made more difficult due to the pandemic (26.1 percentage points higher than the previous quarter). More than four-fifths of the unemployed (80.9 percent) said that their work had been adversely affected by the pandemic (up 32.8 percentage points from the previous quarter). Finally, of the 23.7 million people aged 15 years and over who were not engaged in economic activities, 14.5 percent reported having been negatively impacted by the pandemic (up 10.7 percentage points from the previous quarter).

A report by GSO (2021b) showed that, in the first 11 months of 2021: 52,100 enterprises temporarily ceased operations for a certain period (an increase of 17.3 percent compared with the same period last year); nearly 39,500 enterprises temporarily ceased and awaited dissolution procedures (an increase of 17.4 percent compared with the same period last year); 14,900 enterprises completed dissolution procedures (a decrease of 3.7 percent compared with the same period in 2020). On average, nearly 9,700 enterprises closed their operations every month. Evaluations from field surveys by UN Vietnam (2020a, 2020b), UNDP (2021), and World Bank (2021) showed similar critical issues in the labor market in Vietnam, particularly since late 2020.

6. **The pandemic also seriously affected various groups of vulnerable people, especially those who had migrated to large cities/provinces to work without contracts or social insurance (namely, informal workers), as well as poor and low-income people.** Estimates by Giang et al. (2021a, 2021b) indicate that older persons (those aged 60 and over), ethnic minorities, and those living in rural areas were more significantly affected by income reductions. The World Bank (2021) also emphasized the role of social protection in shocks such as the COVID-19 pandemic, given that the coverage of the social protection system in Vietnam is limited, particularly for more than 50 percent of the labor force who are informal workers.

3. Policy measures in response to COVID-19

7. **The Government of Vietnam (GoV) implemented a variety of fiscal stimulus/ support packages in 2020 and 2021 to support affected individuals and businesses, particularly those in vulnerable situations.** Among these were two major fiscal packages: (i) Government Resolution 42/NQ-CP issued on 9 April 2020 (R42); (ii) Government Resolution 68/NQ-CP dated 1 July 2021 (R68).

8. The 2020 package included the following categories:

- Deferred payments of value-added tax (VAT) and corporate income tax (CIT), delayed payments of land rent for a period of five months, delayed payments of personal income tax (PIT) until the end of the year (the value of the deferred payment is estimated at VND 180,000 billion, or 2.4 percent of GDP). By the end of 2020, more than VND 66 trillion (accounting for about 37 percent of the tax revenue) had been disbursed to the targeted populations.

- Reduced registration fees by 50 percent and postponed payment of excise tax on domestically-produced cars, reduced land rent by 15 percent, and reduced environmental protection tax by 30 percent on jet fuel during August–December 2020, reduced or waived fees and charges, reduced CIT for small and medium enterprises (SMEs) by 30 percent.

- Applied tax exemptions on medical equipment.

- Business registration fee reductions applied from 25 December 2020 (one-year license tax exemption for the newly-established business households).

- SMEs changing from household business status were exempt from licensing tax for three years from being granted a Certificate of Business Registration for the first time.

- Businesses and employees were allowed to postpone for up to three months' payments to the Retirement and Survivorship Fund without requiring interest payments (total amount of delayed payments was about VND 9.5 trillion).

- Cash support of VND 36 trillion for affected workers and households from April to June 2020. It was estimated that more than 13 percent of the population benefited from the program. The Ministry of Finance (MoF) estimated that about VND 12,800 billion had been disbursed by the end of 2020.

- Set a target of disbursing 100 percent of public investment capital in 2020 with a total value of VND 686 trillion (equivalent to 9 percent of GDP), of which VND 225 trillion was transferred from 2019. The actual disbursement of public investment in 2020 was estimated at 83 percent of the total planned, the highest disbursement rate in the past five years.

9. **Resolution 42 provided cash transfers to various groups.** Cash transfers were provided once for three months (April, May, and June 2020) to people with war merits; the poor and near-poor households; formal workers who had lost jobs but were ineligible for social insurance; informal sector workers who had lost jobs (of several types of non-agricultural employment); household businesses with an annual revenue of less than VND 100 million.

10. **Along with Resolution 42, other regulations to amend and supplement included:** (i) Decision 15/2020/QD-TTg dated 24/4/2020 of the Prime Minister on regulating the implementation of policies to support people facing difficulties caused by the pandemic; (ii) Government Resolution 154/NQ-CP dated 19/10/2020 on amending and supplementing Government Resolution 42/NQ-CP dated 9/4/2020 on measures to support people facing difficulties caused by the COVID-19 pandemic; (iii) Decision 32/2020/NQ-CP of the Prime Minister on amending and supplementing a number of articles of the Decision 15/2020/QD-TTg dated 24/4/2020 of the Prime Minister on regulating the implementation of policies to support people facing difficulties caused by the COVID-19 pandemic. The implementation of Resolution 42 as mentioned above is presented in Table 1.

11. **The 2021 package included the following categories:**

- Continued postponement of tax payments and land rent with a value of VND 115,000 billion, of which corporate VAT was postponed for five months with a total value of VND 68,800 billion, CIT was postponed for three months in Q1 and Q2 of 2021 with a total value of VND 40,500 billion, VAT and PIT of business households was postponed with a total value of VND 1,300 billion, and land rent payments were postponed with a total value of VND 4,400 billion.

- The reduction of the environmental protection tax on jet fuel by 30 percent continued until the end of 2021. About 30 types of fees and charges (mainly in the transport and infrastructure development sector) were cut from 10 to 50 percent until the end of 2021, with an estimated value of VND 1,000 billion.

- Electricity tariff discounted by 10 percent (before VAT) for factories and production facilities in provinces and centrally run cities for three months from September to November 2021 in the fields of processing and preserving seafood and other seafood products, processing and preserving vegetables and fruits, and producing export products with an export value of over US$1 billion (by 2020). Reductions of telecommunications charges are valued at about VND 4,000 billion.

- Continued implementation of various measures to support employees and employers: reduction of social insurance premiums for occupational accidents and diseases applied until September 2022; support for the temporary suspension of contributions to the retirement and survivorship fund; support for employers in training, retraining, and improving vocational skills to maintain jobs for employees; support for employees to postpone the performance of labor contracts, take unpaid leave until the end of

2021; support for employees to stop working; support for employees to terminate labor contracts where they are ineligible for unemployment benefits; support for children and people being treated for the COVID-19 virus and medical isolation; support for staff in artistic activities and employees working as tour guides; support for business households; support for employers to borrow funds to pay wages for work stoppages and also to restart production.

- The government used a part of the unemployment insurance fund balance in 2020 to support employees who are paying unemployment insurance (about VND 38,000 billion) with an expectation of nearly 13 million employees and about 386,000 employers benefiting from this support policy. Employers were entitled to reduce the contribution rate to the Unemployment Insurance Fund from 1 to 0 percent for 12 months (with a total amount of about VND 8,000 billion).

- In September 2021, the MoF submitted a package of policies to the government: CIT reduction in 2021; VAT reduction for some groups of goods and services; tax exemptions for business households and individuals; exemptions from late payment interest; reductions of land rent for those facing difficulties; reductions of import tax rates for many groups of goods (with a total amount of more than VND 22,000 billion).

- An 80 percent reduction of deposits for travel service businesses until the end of 2023, and a reduction in the time for settlement of deposit refunds for travel service businesses from 60 days to 30 days.

- Established the COVID-19 Vaccine Fund at the end of May 2021 as a non-profit and non-budget fund to mobilize contributions from domestic and foreign individuals and organizations to help with vaccine purchases, vaccine research, and production. The government estimated the fund was worth VND 25.2 trillion (about US$1.1 billion) and sufficient to buy 150 million doses of vaccine to serve 75 percent of the population in 2021. As of September 2021, this fund had mobilized funds worth VND 8.6 trillion.

12. **For the second package (Resolution 68), Decision No. 23/2021/QD-TTg dated 7 July 2021 started the implementation.** This covered 12 policies to support employees and employers facing difficulties due to the pandemic. In particular, Resolution 68 was designed with the dual goal of focusing on supporting economic development under the new normal, as well as ensuring social protection for disadvantaged groups (such as those in Resolution 42). The content of the support package was aimed at recovering production and businesses, minimizing the negative impacts of the pandemic, and stabilizing production and business (such as reducing insurance premiums for occupational accidents and diseases; temporarily suspending contributions to the retirement and survivorship fund; training and job maintenance for employees; making loans to businesses to pay wages for job cessation and compensate for production recovery). A report on the socioeconomic situation for the first nine months of 2021 by the General Statistics Office (2021a) showed that, as of 21 September 2021, the total funding under Resolution 68 was spent with nearly VND 13,800 billion going to almost 17.6 million beneficiaries, of which VND 11,400 billion was spent on 23 provinces/cities

that had been most heavily affected by the pandemic (including Hanoi, Da Nang, Khanh Hoa, Phu Yen, and 19 provinces/cities in the Southeast and Mekong River Delta regions). Table 2 provides statistics of the implementation of the Resolution 68/NQ-CP in 2021.

13. **The state budget generally achieved its planned targets, but various challenges were revealed due to the more severe impact of the fourth COVID-19 wave.** On the revenue side, as of 15 September 2021, budget revenue reached VND 1,034.2 trillion (or 77 percent of the estimate for the year). Also at this time, the budget expenditure reached VND 975.6 trillion (or 57.8 percent of the estimate for the year). Thus, despite facing difficulties due to stagnant economic activities as a result of social-distancing measures in response to the pandemic in major economic centers, the 2021 budget balance in general was still guaranteed.

    However, since the outbreak of the fourth wave starting in late April 2021, domestic revenue from taxes and fees decreased in June 2021 (compared with the same period in 2020) by 9.1 percent; in July it decreased by 10.8 percent; in August it decreased by 21 percent; in September it decreased by 26.5 percent. Revenue from import and export activities in August and September 2021 also dropped sharply. In addition, the National Assembly's Standing Committee decided to supplement the central budget reserve in 2021 with VND 14.6 trillion by cutting spending in the 2021 budget to spend on COVID-19 pandemic prevention and control measures. In addition to the central budget reserve in 2021, there was also a reduction of interest payments compared with the estimate in the central budget, by VND 4,200 billion. Funding for the implementation of policies to support people affected by the COVID-19 pandemic according to Resolution No. 42/NQ-CP dated 9 April 2020 of the Government (GoV, 2020b) was transferred to 2021 (about VND 4,540 billion), of which VND 1,540 billion was used to continue supporting localities to implement the policy, with VND 3,000 billion going to the remaining budget.

14. **On the spending side, one remarkable feature in 2021 was that the development investment spending until 15 September 2021 only reached VND 202.2 trillion (or 42.4 percent of the annual plan).** In the context of the pandemic, while private and foreign investments had decreased, the slow disbursement of public investment was a drag on the economy's resilience. By the end of 2020, Vietnam's public debt was at 55.3 percent of GDP, which was lower than the public debt ceiling approved by the National Assembly (at 60 percent of GDP). Vietnam's budget deficit in recent years has also been well controlled, at an average of 3.45 percent of GDP in 2016–20. These figures showed a significant improvement in Vietnam's fiscal space in recent years. In the context of the pandemic, many countries implemented large-scale fiscal stimulus packages to support people and businesses, and accepted high budget deficits compared with those in normal economic conditions (according to the IMF data, in 2020, the budget deficit in the United States was 18.73 percent; in China: 11.88 percent; in Japan: 10.77 percent; in Australia: 10.06 percent).

15. **Table 3 presents the fiscal balances (all in VND billion) for 2020 and 2021 in Vietnam.** Many studies by international organizations show that the COVID-19 pandemic had the

greatest impact on the most disadvantaged groups in society, increasing income and property inequality, so the fiscal support packages are often aimed at mitigating this negative impact. Resolution 23/2021/QH15 of the National Assembly on the National Financial Plan for the 2021–25 period sets the target of controlling the budget deficit at 3.7 percent of GDP. In the context that the Delta variant spread quickly, and the production and consumption activities were very badly affected by the pandemic, it raises questions about the need for flexibility in controlling the budget deficit.

4. Assessment of policy responses and future challenges

16. **The stimulus packages were issued in good time, but their implementation ran into a number of challenges.** Fiscal policies responding to the COVID-19 pandemic supported people, workers, and businesses across the board, and in a timely manner, as the goals were set out clearly and appropriately. The policy packages implemented in 2020 and 2021 in Vietnam were similar to those in other countries, based on the description by International Labour Organization (2021). The implementation of these packages, however, revealed various limitations, as follows:

- Most policies were designed and implemented along similar lines across different provinces/cities with different population sizes and industries, failing to take into consideration the level of impact of the pandemic, as well as their different resilience capacities.

- The amount of support was still limited due to budget constraints and such a wide range of beneficiaries. According to the World Bank (2021), the levels of social assistance for unemployed workers and wage subsidies were only 17 and 30 percent of the average monthly income in Q2 of 2020, respectively.

- Procedures to receive policy support were cumbersome, not really creating favorable conditions for people and businesses to access. The guiding documents were relatively complicated and lacked feasibility. The policy implementation process placed a heavy emphasis on screening policy beneficiaries from the very beginning, so it took a long time to implement the policy.

- The level of technology application in policy implementation was low. Implementation was mostly manual, so it took a long time for the policies to reach those people and businesses in need.

- The dissemination of information regarding the policies and their beneficiaries, as well as the steps that were required to receive the benefits for targeted beneficiaries, was limited.

- The current fiscal policies to support businesses mainly focus on tax exemptions, and reductions and postponements of tax payments, as well as exemptions or reductions in fees, charges, and land rental costs. These policy packages had the effect of reducing costs and thus reducing short-term financial pressures for businesses. However, when the level of demand in the economy is still weak, along with the fact that businesses had to spend significant sums to ensure pandemic prevention and control, the impact of these policies on the recovery of the economy was also limited.

- The progress of disbursement of public investment was slow despite the considerable efforts made by the government, ministries, and localities.

17. Recommendations. The fiscal stimulus policies should: (i) be designed and implemented in line with the government's new strategy, i.e., safely adapting, flexibly and effectively controlling the COVID-19 pandemic, instead of a zero-COVID strategy, as in Resolution 128/NQ-CP; (ii) ensure the principle of income redistribution, i.e., increase income for the more disadvantaged groups; (iii) ensure the principle of redistribution of productive resources towards businesses that operate effectively for society, having positive spillover effects on the business community and the economy as a whole.

18. In particular, the policies should be as follows:

First, for the recovery of production and businesses:

- Shift the focus of support policies from the priority target of pandemic prevention to the goal of restoring production and business activities, and ensuring social security.

- Expand the beneficiaries, the amount of support, and the duration of that support for current policy packages on late payments, exemptions, and reductions in CIT, land rent, electricity bills, social insurance, etc.

- Promulgate and implement policies to stabilize the price of input materials for production and the cost of circulation and transportation of goods.

- Promulgate and urgently implement policies to support the costs of pandemic prevention and the costs of reorganizing production activities for enterprises to safely adapt, and flexibly and effectively control the epidemic. Issue guidelines for enterprises to account for the cost of pandemic prevention and control, and to reorganize production into the costs of production and business activities.

- During the recovery period, support policies need to be more selective, focusing more on large enterprises with important spillover effects to other areas of the economy.

- Coordinate with monetary policies to ensure cash flow and liquidity of the business sector, especially large and leading enterprises.

- Accelerate the implementation and disbursement of public investment projects, especially key national projects. Focus on removing bottlenecks in terms of institutions and site clearance/preparation in the implementation of these projects. The allocation of capital needs to ensure concentration to completely implement each project.

Second, to support vulnerable groups of people and workers:

- Timely implementation of policies to support migrant workers who have to rent houses to avoid disruption of labor supply when returning to the new normal.

- More supportive policies for unregistered migrant workers and freelance workers in the informal sector and additional forms of direct support with budgetary resources for vulnerable groups (such as the elderly, children, and disadvantaged people) are needed.

- Consider revising the current laws and regulations related to participation in social insurance, particularly voluntary social insurance for informal workers, so as to provide financial and health protection to this "missing-middle" of the social protection system, as well as to prepare to cope with future shocks similar to the COVID-19 pandemic. In other words, there remains a significant need to develop an integrated and inclusive social protection system, in which social insurance and social assistance are integrated and supplementary to protect all people from catastrophic shocks such as a COVID-19 pandemic crisis.

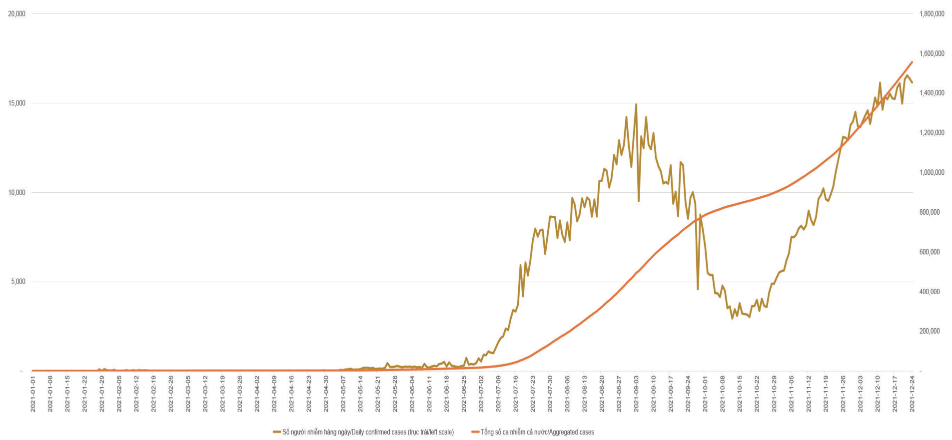
Third, systematically transform the management of the social protection system:

- Accelerate the application and urgently improve the information technology infrastructure in the implementation of social protection programs in general, and the support packages in particular.

- Promote e-registration for beneficiaries, as well as e-payment of benefits to them. This will help deliver benefit packages in a timely manner to the proper beneficiaries in a transparent way, both in terms of identification of the proper beneficiaries and the timely delivery of benefits to them.

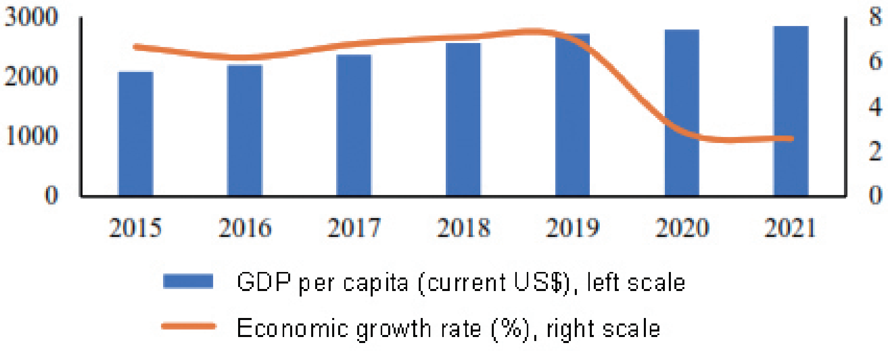
Appendix 1. Selected Figures

Figure 1 The daily and accumulated number of infected cases, 1 January – 24 December 2021



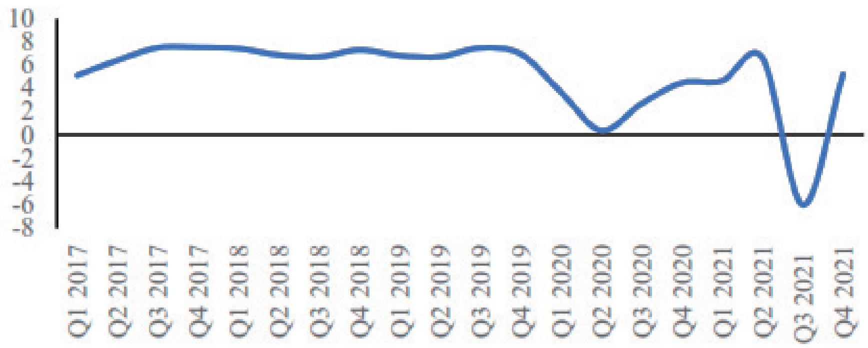
Source: Author's compilation from the MoH's nCovi website.

Figure 2 Vietnam's GDP per capita (current US$) and economic growth rate (%), 2015-21



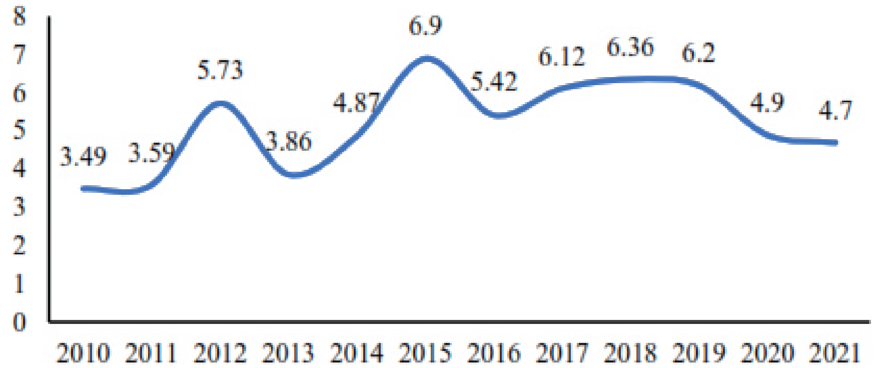
Source: GSO (various years), as cited by Pham, To, et al., (2021).

Figure 3 Vietnam's quarterly economic growth rate (%), Q1/2017 – Q4/2021



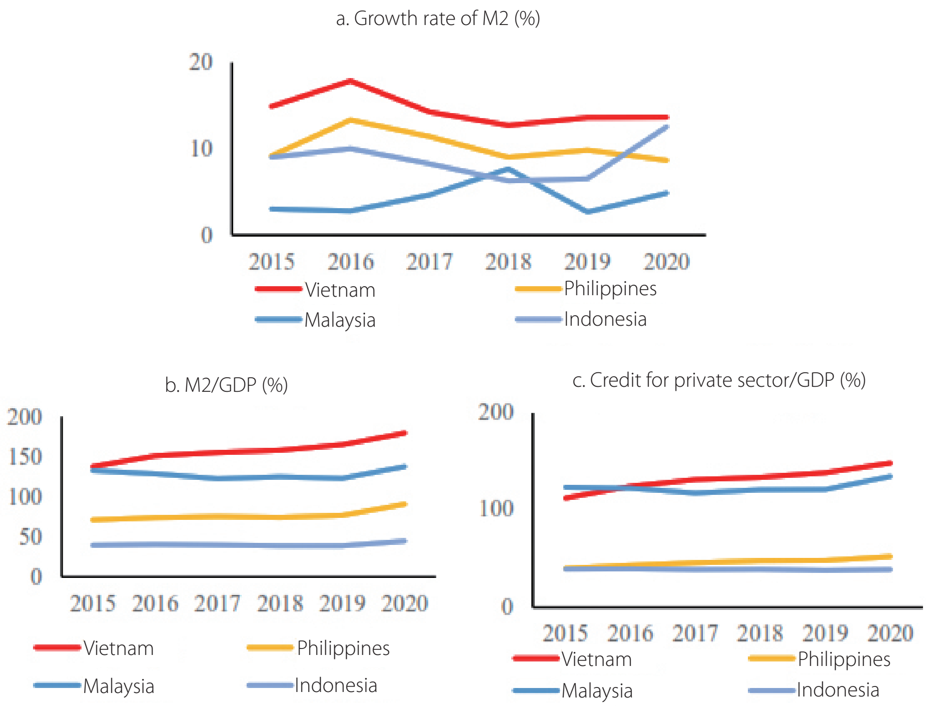
Source: GSO (various years), as cited by Pham, To, et al., (2021).

Figure 4 Productivity growth rate (%): Vietnam and other Asian countries



Source: GSO (various years), as cited by Pham, To, et al., (2021).

Figure 5 Growth rates of M2, M2/GDP and credit for private sector/GDP: Vietnam and some ASEAN countries



Source: Pham, To, et al., (2021).

Appendix 2. Selected Tables

Table 1 Implementation of the Resolution No. 42/2020

No.	Objects	Number of recipients (persons)	Expense (VND million)
1	Employees working under the labor contract regime must agree to suspend the performance of the labor contract and take unpaid leave	54,028	71,864
2	Individual business households with tax declaration revenue of less than VND 100 million/year temporarily suspend business	30,271	30,489
3	Employees whose labor contracts or work contracts are terminated but are not eligible for unemployment benefits	117,007	124
4	Employees who do not have a labor contract lose their jobs	869,032	823,373
5	People with meritorious services to the revolution are enjoying a monthly preferential allowance	1,031,519	1,528
6	Subjects of social protection who are receiving monthly social allowance	2,885,938	4,290,074
7	Poor households, near-poor households according to the national poverty line	7953,06	5,948
	Total	**12,940,855**	**12,814,884**

Source: Report by Ministry of Labour, Invalids, and Social Affairs (MOLISA) as of 21 December 2020.

Table 2 Implementation of the Resolution 68/2021

TT	Policies	Number of employers (persons)	Number of employees (persons)	Amount supported (VND million)
	General policies	**39,000**	**25,021,399**	**26,635,976**
1	Policy to reduce insurance premiums for occupational accidents and diseases		11,000,000	3,696,000
2	Policy on temporary suspension of contributions to retirement and survivorship funds	39,000	11,500,000	8,450,000
3	Policies to support training and job maintenance for employees		1,000,000	4,500,000
	Social insurance-related policies	**39,000**	**23,500,000**	**16,646,000**
4	Policies to support employees to suspend labor contracts and take unpaid leave		200,000	742,000
5	Policies to support employees who stop working		60,000	111,300
6	Policies to support employees to terminate labor contracts		100,000	371,000
7.1	Policies to support pregnant employees		3,759	3,759
7.2	Policy to support children under 6 years old who are children of employees		16,940	16,940
7.3	Additional support policy for children who are F0, F1		42,000	42,000
8	Food support for people who have to be treated for COVID-19 infection (F0) and people who have to undergo medical isolation (F1)		100,000	240,000
9.1	Support art directors, actors, painters holding career titles IV		2,000	7,420
9.2	Support tour guide		26,700	99,057
10	Policies to support business households		300,000	900,000
11	Policies to support workers without labor contracts (freelance workers) and some other specific subjects		Assigned the localities to self-determine the recipients	
	Cash transfer policies		**851,399**	**2,533,476**
12.1	Loan to pay salary stop working		220,000	2,448,000
12.2	Loan to pay wages to restore production		450,000	5,008,500
12.3	Loans to pay wages to restore production to transport and tourism enterprises, and to send workers to work abroad under contracts			
	Lending policies	**0**	**670,000**	**7,456,500**

Source: Report by MOLISA as of 31 August 2021, cited by United Nations Development Programme Vietnam (2021)

Table 3 Revenue and expenditure sources and fiscal balances in Vietnam, 2020 and 2021

	2020		2021	
	Budget	**Realized**	**Budget**	**Realized**
1. Revenue	**1,539,053**	**1,507,846**	**1,343,330**	**1,365,530**
1.1. Taxes	529,219	568,979	489,243	529,600
1.2. Social contributions	181,820	185,359	144,834	104,692
1.3. Grants	5,076	4,825	8,130	8,130
1.4. Other revenue	822,938	748,683	701,123	723,108
2. Expenditure	**1,773,766**	**1,787,950**	**1,687,000**	**1,709,200**
2.1. Current expenditure	1,056,492	1,072,068	1,036,730	1,059,197
2.2. Interest payment	118,192	107,297	110,065	105,865
2.3. Capital expenditure	599,082	608,585	540,205	544,138
3. Fiscal Balance	**-234,713**	**-280,104**	**-343,670**	**-343,670**

Source: Author's compilation and calculations from the MoF's annual budget reports

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