

Assessment of the Economic Impact of Covid19

August 28, 2020

This assessment is intended to assist members in their short and long-term planning by providing the outcome of discussions among board members. The board has been holding regular assessment sessions to share and discuss the impact within their industry and among their clients, customers and partners. These exchanges have been informed by research and input from our committees. This document is a working document which will be updated regularly, and all comments and suggestions are welcome. The document is divided into five sections: 1) duration of the crisis, 2) economic impact, 3) transformative effect, 4) effectiveness of government measures, and 5) business priorities.

Duration of Covid19 crisis

The duration of the pandemic depends on the development and global distribution of a vaccine, or a dissipation in the potency or infectiousness of the virus. The duration of economic crisis caused by the pandemic will extend, with varying degrees of severity, at least six months after the virus is suppressed globally.

Duration of the pandemic. Any permanent weakening the virus cannot be predicted based on current knowledge. The timeline for comprehensive distribution of a vaccine remains unknown, and is estimated at 10-16 months or more. The usual development of a vaccine takes approximately four years. Governments, however, have streamlined testing processes and provided funding for production and distribution facilities, which could shorten the timeline significantly. Dr. Anthony Fauci, the director of the US National Institute of Infectious Diseases has suggested that his institute is "optimistic" that a vaccine would be ready for distribution in the first quarter of 2021. The World Health Organization has registered 31 candidate vaccines; six of these are in the third and last phase of testing.¹ In the third phase, thousands of human volunteers are treated with the vaccine over several months. Oxford University's candidate vaccine² is among those six, and is considered by many experts as the most promising. Much about the virus remains unknown, and a King's College experiment raised questions about acquiring permanent immunity or achieving herd immunity.

A vaccine may not be discovered, and this would lengthen the period, and likely the severity, of the health and economic impact of COVID19. The H1N1 flu of 1918-1919 spread in three waves over two years before mutating into a less severe, endemic strain that was finally eradicated by the 1957 pandemic. The 2003 SARS epidemic was contained through strict measures of isolation infected people and quarantining their contacts; COVID19 differs from SARS in its longer asymptomatic, highly infectious incubation period and the lower percentage of patients with serious and notable symptoms, which may make such measures less effective.

¹ https://www.who.int/docs/default-source/coronaviruse/novel-coronavirus-landscape-covid-19-2.pdf?sfvrsn=9c18d69c_6&download=true

² <https://www.ox.ac.uk/news/2020-05-22-oxford-covid-19-vaccine-begin-phase-iiii-human-trials#>

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Duration of the economic crisis. Until more is known about the virus and a vaccine is approved for mass distribution, society must balance restrictions of human interaction and open economic activity. A sufficient, affordable supply of quality personal protective equipment combined with individual responsibility can reduce the chance of outbreaks; the voluntary use of personal protective equipment such as masks or disinfectants will help contain infectiousness, and lower the risk and level of the economic impact. Testing can narrow the geographic scope of restrictions required to quell any outbreak. This will lessen the severity of the economic impact. Nevertheless, outbreaks are probable.

Greater experience with the virus, and global networks for sharing that experience, have and will continue to improve treatment and lower fatality rates. This should allow governments to utilize more targeted and lighter restrictions, and diminish the economic harm caused by the pandemic.

Companies with large offices have implemented social distancing rules and some require the wearing of masks and regular disinfection of hands. Most companies have restricted or banned business travel by airplane. A minority of companies have banned outside meetings. A larger minority have banned employees from attending meetings with ten or more people. A large majority of companies have adopted some form of “home office”, and some companies have either shifted all workers to home office or have plans to do so if a second wave of mass infection occurs.

Once the vaccine is distributed globally, concerns about being infected will continue to damage businesses dependent on close interaction or indoor congregation for several months.

Companies should expect the direct Covid19 impact to last until the end of 2021. Having an action plan ready for an early discovery and distribution of an effective vaccine will not only create a competitive advantage for a company, but also the country.

Depth of Covid19 economic impact

The depth of the economic impact will be determined by the duration and effectiveness of government's attempts to stretch the cost over several years using taxpayer revenue. The recently approved EU recovery plan and adjusted multi-year budget provides an opportunity for the government to create a national recovery and resilience plan that combines targeted support for severely impacted industries and regions with infrastructure investments that could reshape the economy to generate more value-added products and services. The government also faces key decisions in the next few months on whether to extend employment support or moratoria on bankruptcy and loan services.

The Czech Republic's dependence on car export and Prague's dependence on tourism complicate an immediate and strong recovery. Automotive purchases and air travel require consumer confidence in both finance and health safety, and these may be slower to return in the wake of the crisis.

Without further government intervention or a vaccine, the Czech GDP probably will retract by 5-8% in 2020. The deepest decline could occur in September or October. Growth in 2021 will require the EU Recovery Plan to be effectively spent. If the vaccine is distributed, the economy should stabilize or begin a period of uneven, slow growth sometime in the second half of 2021 or first half of 2022.

EU Summer 2020 interim forecast for Czech Republic and its top ten trading partners

real GDP increase/decrease <i>Projection</i>	2020	2021
Czech Republic	-7.8	4.5
Germany	-6.3	5.3
Slovakia	-9	7.5
Poland	-4.6	4.3
France	-10.6	7.6
UK	-9.7	6
Austria	-7.1	5.6
Netherlands	-6.8	4.6
Italy	-11.2	6.1
Hungary	-7	6
Spain	-10.9	6.1

IMF World Economic Outlook, June 2020

real GDP increase/decrease <i>Projection</i>	2020	2021
China	1	8.2
India	-4.5	6
Japan	-5.8	2.4
Russia	-6.6	4.1
United States	-8	4.5

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IMF World Economic Outlook, June 2020

general government fiscal balance as % gdp <i>Projection</i>	2020	2021
World	-13.9	-8.2
G20	-15.4	-9.1
Euro area	-11.7	-5.3
United States	-23.8	-12.4
UK	-12.7	-6.7
China	-12.1	-10.7
India	-12.1	-9.4
Japan	-14.7	-6.1

IMF World Economic Outlook, June 2020

general government gross debt as % gdp <i>Projection</i>	2020	2021
World	101.5	103.5
G20	111.2	113.2
Euro area	105.1	103
United States	141.4	146.1
UK	101.6	100.5
China	64.1	70.7
India	84	85.7
Japan	268	265.4

Transformative effect on the economy

The virus has mostly served to accelerate already existing trends. This can be seen in industries such as automotive sector, and also in the workplace with such trends as working from home.

Reliance on global supply chains probably will continue, but efforts to regionalize supply chains and reduce dependence on specific regions or counties will increase.

International travel probably will be severely curtailed until a vaccine is globally distributed. When it does return, economy travel may lag behind high-end travel due to the lasting impact of joblessness or reduced income.

The shift to working outside of the office (mainly from home) will reduce the need for office space, and change how office space is utilized. It may also lead to a workforce more evenly distributed along major highways and railines within 60 kilometers of major urban areas.

The EU Council passed an adjusted budget which prioritizes digitization and climate change. If this priority is maintained in reality, the structure of the economy could undergo significant changes.

Impact of government measures

In terms of total amount of government intervention programs to date, the country compares favorably to other Central European countries.

The use of EU funds meant some business rescue programs initially excluded Prague. Establishing a national cap for the Anti-Virus employment support program meant that regions with higher wage levels (and higher costs-of-living) received less benefit from the program even though those regions were among those hit hardest by the virus and government restrictions.

Leveraging commercial banks and their risk-management systems through government guarantees meant that some companies most impacted by government restrictions could not be financed by the COVID programs due to little or no revenue.

The administration of some programs needs to be less procedural, and more focused on providing immediate relief to companies and citizens.

The key to the future effectiveness of government intervention now centers on the quality of the national recovery and resilience program, and its effective implementation.

Business priorities

The key to stabilizing the economy and shifting business decisions back into investment and job creation is a higher degree of predictability in the economy, greater efficiency in government processes that support investment, and countercyclical impulse that would reverse the negative ripple effect of the virus.

Predictability could be achieved by setting clear plans for employment support until December 31, 2020 and by establishing clear rules for imposing movement and gathering restrictions.

Greater efficiency in government processes could start with the comprehensive reform of the construction approval and permit process, and continue with rules for research investment that focus on outcomes generated and not excessive regulation of spending.

The most significant countercyclical impulse is the EU Recovery Program. How the Czech government accesses and utilizes this money will likely determine how successfully the country emerges from the COVID19 crisis and how competitive the economy will be for the next decade.

National Recovery and Resilience Program. This program is necessary to access the funds available in the EU Recovery Program. The national program will be assessed by the EU Commission, and the Commission's assessment approved by the EU Council. The EU Council determined the criteria for assessing National Recovery Programs at its July 21 meeting:

“The recovery and resilience plans shall be assessed by the Commission within two months of the submission. The criteria of consistency with the country-specific recommendations, as well as strengthening the growth potential, job creation and economic and social resilience of the Member State shall need the highest score of the assessment. Effective contribution to the green and digital transition shall also be a prerequisite for a positive assessment.”

An earlier EU Commission assessment of the EU area's investment identified 17 sectors and determined how capital would be needed to revitalize each.

EU Commission Assessment of basic investment needs

Tourism	161
Mobility-Transport-Automotive	64
Aerospace & Defence	4
Construction	54
Agri-food	32
Energy Intensive Industries	88
Textile	6
Creative & Cultural Industries	6
Digital	66
Renewable Energy	100
Electronics	18
Retail	115
Proximity & Social Economy	N/A
Health	32
Total	€748bn

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When devising the national recovery plan, the government should prefer green and digital investments into these 17 sectors and weigh projects by industrial sector as a means of maximizing access to funds.

To maintain the prosperity generated since 1989, the focus of this program should achieve four outcomes:

1) to maintain household consumption without significant increase in household debt through employment support and loan guarantees.³ This can be achieved through two policies.

a) targeted employment support programs for industries with substantial revenue decline due to the direct effects of the coronavirus, such as hotels with 60% or more revenue loss due to a substantiated drop in international guests. The support program would run for six months. Applicants would need to show that their business was competitive within their industry (for instance, in the hotel industry, achieving a competitive revenue per available room night that was in the 40th percentile of higher of similar accommodations).

b) loans, loan guarantees or support programs for businesses experiencing continuing revenue loss as a direct effect of the coronavirus. An example of the support program are temporary programs for cultural performers to create free performances or exhibitions of works throughout the country that could be used to raise the awareness of Czech culture and promote cultural tourism.

2) to increase the value-added in the manufacturing industry (energy intensive, automotive, aviation) and help prepare for major technological change, including

a) a package of investment incentives aimed at attracting the development and production of climate change-related technologies in the aviation and automotive industry.

b) a time-limited package of accelerated tax depreciation and subsidies for manufacturing companies to introduce waste and energy reducing technologies on production lines.

c) a time-limited package of accelerated tax depreciation and subsidies for manufacturing to digitize their products and production lines.

3) to increase the commercial capacity of public research infrastructure (such as university labs) through joint investments to develop key technologies contributing to the EU's digital and climate goals,

³ The government has proposed eliminating the supergross calculation of the personal income tax base, which includes the employer portion of social taxes. This would stimulate household consumption, particularly in high value good obtained with credit lines, such as automobiles, home appliances, and computers.

a) an investment incentive scheme targeted at domestic and foreign companies with global sales (defined by Euro 10 million revenues in at least 10 countries) for projects to develop existing or new products that include

1) private investment to develop university or public research capacity either through improved research technology or increased knowledge, with the private investment amounting to 40% or more of total investment into the public research infrastructure,

2) production in the Czech Republic for export or significant licensing revenue for Czech entities, and

3) the potential to develop clusters around the product, including spin-offs and start-ups. We recommend focusing this program on companies already with significant global sales because this increases the chances for the research to generate sales, and shortens the period between the government's investment and the return on this investment through tax revenue. Furthermore, we believe this program would serve as the most effective way to generate a strong start-up industry, as it would create a strong customer base to provide a feedback mechanism for product development.

4) to invest in tourism infrastructure that will increase the revenue per tourist and turn the Prague Airport into the main hub for tourism travel into Europe from Asia and into central and eastern Europe from North America.

a) We propose creating three world-class events that would be attached to existing or newly created festivals, and which would be subsidized by state and city revenues.

a) an annual performance of Ma Vlast on Strelecky Ostrav featuring a globally recognized soloist or conductor. This could be connected with the Prague Spring or other classical music event.

b) an annual Independent Voices event featuring unique vocal and instrumental performers that would be held during the week marking the Velvet Revolution. The opening performance for the event could occur at Mustek.

c) A summer outdoor theater festival for political plays and featuring adaptations of Kafka, Capek, Hrabal and with a featured performance of Havel. The main performances would be set in major historical venues such as the Castle, Old Town Square, and Letna.

b) To take advantage of the fame of Czech beer and the growing cycling and running communities, the country could organize a cycling and running tour of the country that would start in Prague (at Staropramen) travel to the Sumava (Budvar), Brno (Staro Brno), Hradec Kralova and end at the Plzensky Prazdroj breweries. Although the major breweries would be the pivot points, the tour would also promote smaller

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and microbreweries located along the path. Over time a dedicated path could be built on the route to avoid traffic.

c) The development plans for the Prague Congress Center, and, if necessary, upgraded to make the center a state-of-the-art MICE venue that is carbon neutral and fully digitalized.

d) As a way to pay for infrastructure improvements, provide long-term financing of the Prague Convention Bureau and subsidize world-class cultural performances, we suggest increasing the tax on room nights to 5 euros per room.

Construction Policy. Too many problems not associated with law are trying to be fixed by the Construction Act. Cities and towns need clear zoning rules that are based on an economic development plan (for instance, Prague wants to be a start-up hub, but lacks industrial space around its technological university). Permit offices need to be staffed by a sufficient number of competent people paid at market rates with incentives to approve projects quickly. The process of registering a complaint or appeal against a decision should carry some accountability, such as reimbursement of the cost of delays if the complaint is rejected.

Employment Support. AntiVirus Regime B may need to be extended and altered if the crisis continues in September. The program should take into account differences in overall employment and income in the regions. A supplemental short-term works program to support cultural workers, especially in major urban areas, could be considered.

Digital Economy. By moving first in the implementation of new digital technology, the country could gain a competitive edge that would benefit start-ups, improve quality of life, and make businesses and government operate with greater efficiency. The need to separate coronavirus patients from other patients, and to rapidly identify individuals with possible infection could trigger improvements to an undeveloped e-health system.

Another area of government that could use the opportunity provided by the EU Recovery funds and adjusted budget is the immigration process. The immigration system could be integrated with labor offices to track demand for workforce, and a points-based system could be created to prioritize jobs that increase the value-added economy. A fully digitized immigration process would also reduce the time needed on each application while increasing the national security.

Creating a two-year tax break to help small business invest into remote office technology will help them adjust to possible government restrictions and help society lower the risks of further outbreaks. Accelerated depreciation on manufacturing investments into waste and energy reduction, combined with grants through the new EU budget framework, will increase the country's overall competitive position.