CHAPTER 13

Post-COVID Economic Revival: Financial Aspects of Reform

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Introduction

Governments have implemented fiscal and monetary measures in response to the adverse effects on the real economy and financial system; such packages are necessary for overcoming the effects of the shock from the COVID-19 pandemic. The situation is aggravated by the growing trend in the dynamics of morbidity and the deterioration of the public health situation. Extending financial support for too long will distort resource allocation and asset prices, increase risks, delay structural change, and drain public finances. The longer it takes for a government support measure for the economy, the more worries will arise about the escalating debt, which stifles investment and economic growth. Governments have a dilemma to keep market imbalances at work. The main objectives of the application of policy measures are to avoid a significant drop in production and employment, bankruptcy, and inflation, among other problems

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in the banking sector. This paper analyzes the combination of financial instruments to overcome the post-pandemic economic crisis.

The market also reacted to the pandemic with an accelerated transition to digitalization. This has impacted merchants and consumers, as well as the methods of distribution, from digital trade processing to the accelerated genesis of digital currencies.

Methodology

The financial aspects of reforming national economies in the aftermath of the pandemic and lockdowns are assessed in this essay based on the example of countries with advanced economies (some focus is given to EU countries). A financial sector shows the greatest globalization and interpenetration, the general trends in the development of financial systems coincide. The article analyzes the reports of central banks in developed economies, considers the analytics of the International Monetary Fund, and assesses the impact of supporting measures of the economy. Modeling of economic processes and factors of financial regulation is considered through the works of Alfonso and Paolo, who look at data about the EU in variants of scenario calculations in the SPSS (Alfonso & Paolo, 2021). Another article, by Bańkowski, Ferdinandusse, Hauptmeier, Jacquinot, and Valenta, also shows the model of the economy under the influence of monetary support measures (Bańkowski et al., 2021). Other authors, including Glazyev (2020), Lenchuk (2019), Yankovskaya et al. (2021), Stepnoff and Kovalchuk (2020), Osipov et al. (2021), and Yukhno and Osipov (2021) discussed the general economic patterns of changes in the financial sector. Bernanke (2020) examines the use of financial instruments in a new environment based on a new monetary theory.

Results

State governments supported aggregate demand and aggregate supply by financial instruments during the pandemic period in 2020. Many countries had to change their financial policies to address the COVID-19 problem. This goal was achieved by fiscal and monetary instruments, for which targeted mechanisms were developed to help private households and corporations. A decrease in the labor market and in incomes, with any future development being extremely uncertain, leads to a significant

reduction in consumer spending and investment. There were some signs of an improvement in the economic situation when the national government began to relax distancing rules and partially lift the restrictions imposed earlier.

Everything went through the short-term economic cycle during the pandemic. The development of such a cycle during a pandemic begins with a sharp increase in uncertainty and an increased demand for liquidity. This leads to a drop in economic activity. The main goal in these conditions was the need to stabilize financial markets and restore investor confidence. Additional liquidity is introduced to the financial market.

The next stage manifested itself in an initial decline in economic activity. It is necessary to stabilize the real economy and minimize the costs associated with the pandemic and lockdown at this stage of the process. Governments expand access to liquidity and use the ability to maintain solvency for supporting the real market. The authorities are trying to mitigate problems from temporary non-payments in the financial market at this stage.

The pandemic has lasted longer than originally expected, and there is uncertainty about the trajectory of the evolution of the pandemic. Therefore, states are taking measures of targeted support in the market of the real economy. Lending took place even with high credit risks in the financial market.

Economic activity will increase, and a transition to a post-pandemic economy will take place at the last stage. State governments will phase out measures to support the real sector. The regulator is aimed at difficult cases of debt restructuring and an orderly exit from the market through bankruptcy mechanisms in the financial market. The use of non-payments is excluded, so as to manage overdue loans in these market conditions.

Thus, the first stage of the state regulation of the economy is usually aimed at stabilizing markets and restoring confidence in the financial system. The second and third stages of reducing losses incurred due to the recession in economic activity are aimed at the stabilization of the real economy (Osipov et al., 2020).

The fourth stage is aimed at restoring the balance in the real economy as it moves to normal.

Mechanisms to support the economy during the COVID-19 pandemic:

1. Monetary policy: increasing liquidity and minimizing volatility in the financial system; the availability of financing and refinancing. Monetary policy has an indirect effect on the real economy.
2. Fiscal policy: direct subsidies to households and firms, tax deferrals, official guarantees, moratoriums on mandatory payments. Fiscal policy measures are of a direct nature to the real economy.

Key direct support measures and their cancellation during the COVID-19 pandemic:

– Deferral of loan payments or tax payments.
  This insurance helps maintain the liquidity level of the household, allowing for a certain period to service debt or deferred payment of taxes or social contributions.
  In the long term, the measure will backfire on the profitability of banks, as when the debt service is resumed in full, it is possible to increase bad or problem loans, which can lead to a decrease in profitability.
– Measures of state guarantee service for a company or a self-employed economic agent. Eliminating low-cost financing options for goals can increase insolvency. The state provides guarantees for insuring trade operations for cooperative carriers; eliminating this opportunity increases the buyer's risk with potentially negative consequences for importers.
– Prohibition of layoffs and bankruptcy procedures. The abolition of this measure will produce free movement in the labor market, increase unemployment, and increase the growth of household incomes, which will affect the level of consumption and aggregate demand.
– Measures to support financial capital markets (for example, as temporary restrictions on trade) have allowed corporations to raise finance through debt increases and additional share issues, as well as initial public offerings.

Many of the support measures were canceled after the release of quarantine.

The use of financial support measures carries risks of market differentiation.

Digitalization of the financial sector as a factor of accelerated change after the COVID-19 pandemic.

Financial market changes related to automation and digitalization have 2 directions:

– making new financial products based on a distributed data system with many issuers—various cryptocurrencies;
– making a digital currencies system with a single issuer; digital currencies could be used with any equivalent (stablecoins), or they cannot have such a connection in this case.

The success of the implementation of blockchain technology in the financial sector is debatable. The increasingly popular blockchain technology is used in various fields of activity, but this technology is the most demanded and massively implemented in the financial sector. It represents information blocks connected by chains. Distinctive features of this technology for maintaining distributed databases are a decentralized procedure for ensuring the interests of all participants in the process and cryptographic data protection.

The most famous cryptocurrencies are currently Bitcoin and Ethereum. Ethereum is not merely a cryptocurrency, but a platform where cryptocurrencies can be created; Hyperlerder fabric, Masterchain, C-RDA, Exonum, and others are analogs of the Ethereum platform.

The rapid development of technology in the IT industry has contributed to the attraction of a large number of participants in economic relations using cryptocurrency, both electronic platforms inside and going beyond them (Inozemtsev,). Some of the biggest players of the personal data market have launched their cryptocurrencies in the recent past. Facebook is a social network which is the world's largest operator of network user data; it released the Libra cryptocurrency in June 2019. Libra was renamed Diem in 2020. It was born for exchange into the Facebook system. The Telegram network and a number of others have followed this path. The emergence of a big quantity of cryptocurrencies, and their ability to perform the same functions as money and increase wealth due to price increases, contributed to the making of the cryptocurrency stock market. The digitalization of the economy and monetary relations has led to the transformation of regulatory measures on the part of Central Banks.

The national digital currency in a system of monetary policy can be implemented on the basis of well-known regulatory mechanisms. The management of the economy system can be carried out by changing the interest rate paid to the electronic balances of the Central Bank's national digital currency and regulating the total amount of this money.

It is important to define a number of parameters when configuring the use of a national digital currency. One of the key parameters is access to the national digital currency of economic agents. It can be publicly available—in other words, it can be used by anyone for any purpose—or access can be limited to a set of economic agents or for a certain range of purposes.

Monetary theory defines universal access as a fundamental characteristic of any national digital currency. It seems possible that Central Banks could issue a national digital currency that is only available to a subsector of the economy, such as "retail" for households and non-financial enterprises, or "wholesale", which can be used as a settlement asset in financial markets by firms, who currently do not have access to the reserves of the central bank. The ECB has decided to use the broader term "digital base money".

The second key parameter relates to whether the national digital currency is an interest-bearing asset. The national digital currency can be paid positive, zero, or even negative rates at different points in the economic cycle. The interest rate can be used to stabilize inflation and output as the main instrument of monetary policy, or to regulate the demand for a national digital currency.

A national digital currency's important parameter is the ability to participate in trading on an equal basis with the Central Bank's other obligations. Different types of Central Bank liabilities can be exchanged with each other 1:1 in most existing monetary frameworks. For example, one unit of Central Bank notes can be exchanged for one unit of reserves. A flexible exchange rate between cash and Central Bank electronic money can be used to simplify the negative interest rate on cash and overcome the effective floor. This system would mean that the economy would operate with two different specified currencies simultaneously with a controlled exchange rate. These two currencies have a significant risk to monetary stability at the same time poses.

A national digital currency's most important making parameter is the choice of technology. Cryptocurrencies (Bitcoin, Litecoin, or Ethereum) use distributed ledger technology based on cryptographic techniques.

Making a national digital currency can be based on technology that supports the existing real-time currency settlement systems of the Central Bank. This technology does not create cryptocurrency but the digital currency of the Central Bank. The optimal setting for each of these parameters will depend on the reason for the introduction of the national digital currency.

The role of digital currencies is great during a pandemic period, because it is a means of tying free liquidity to the market from measures to increase liquidity. The Bitcoin rate from mid-2020 to mid-2021 has grown from 10,000 USD to 60,000 USD and has fluctuations around the point of 50,000 USD.

Financial policy and reforms focus on three critical areas:

1. increasing the participation of retail customers in the capital market, where digital technology plays an important role,
2. improving the opportunities for access to the capital market for small and medium-sized enterprises,
3. the formation of an integrated market architecture for retail clients, small and medium-sized businesses, and large corporations.

Interest in the financial market during a pandemic is demonstrated by the growing difference between the return on risky assets and the return on safe assets. The risk premium is the most important factor behind this trend. The role of institutional investors is increasing, including insurance companies providing large capital operators as long-term investors due to the high volatility in the financial market.

Governments and institutional investors define long-term investment goals in line with the UN's sustainable development goals, such as innovation in the fight against climate change.

The main focus of financial support during the pandemic was directed at small and medium-sized enterprises, since it is more difficult for them to survive the blow of a lockdown compared to large corporations that have large financial reserves and the ability to reallocate resources between divisions.

Removing support mechanisms could increase the likelihood of market volatility similar to March 2020. In the face of such a risk, some states maintain a policy of maintaining liquidity in the market. In particular, the euro area adheres to this policy. “The Recovery and Resilience Facility

(RRF) will make €672.5 billion in grants and loans, financed by EU borrowing, available to support reforms and investments undertaken by Member States until 2026", according to the ECB's spring forecast (ECB, 2021).

For reforming the banking sector, the main direction was through the use of "too-big-to-fail" reform (TBTF).

The formation of the principles for the implementation of reforms began with the Basel III standards. The standards have made changes to the indicators:

- leverage ratio;
- Net Stable Funding Ratio (NSFR);
- supervisory framework for measuring;
- controlling large exposures (LEX).

The implementation of the reforms will take full effect in January 2023, but it was agreed in December 2017. These were standards for the capital of insurance companies, based on the risk assessment of large international insurance companies.

It is assumed that if it is impossible to provide liquidity by banks, government agencies will help them in some cases with compensation.

Principles on Loss-absorbing and Recapitalization were developed by international banking organizations of strategic importance as a part of the new rules. They are designated by the abbreviation "G-SIB"—from "global systemically important banks" for brevity. The new standard was developed in collaboration with the Basel Committee on Banking Supervision and at the request of the G20 members. It was an implementation of the Total Loss-Absorbing Capacity (TLAC) standard. The G-SIB rules meet the TLAC minimum external requirements for 2022.

Plans are being implemented to reorganize systemically important banks and the introduction of effective reorganization regimes for insurance companies within the framework of these rules.

Discussion

There is plainly a great difference between the implemented financial reforms of the current pandemic situation and the 2008 crisis. Central Bank financial reforms focus on the implications of such reforms. The

agreed indicators of the level of stability of the financial system are the main guidelines.

This can be seen in the policies of the G20 countries. The advanced economies have become more stable due to the separation of financial reforms aimed at the real sector of the economy and the financial system as a result of the reforms. The COVID-19 pandemic was a shock around the world in 2020 and 2021. Governments of all countries implemented administrative, direct, and prudential measures to contain the spread of the pandemic, and this led to a sudden sharp decline in economic activity. This has caused tension in the financial system. The presence of high capital and liquidity reserves in the banks that are part of the core of the financial system made it possible to continue lending to business entities in connection with the introduction of new stability rules. The big banks absorbed the macroeconomic shock, rather than amplified it. This supported the recovery of the advanced economies of the G20 countries.

The stock market was also under great stress. The value of all assets fell sharply on the second half of March 2020, after the announcement of the lockdown and the closure of borders. Demand for cash and assets with high liquidity increased sharply. The system banks were able to respond to this situation with financial resources.

It is necessary to coordinate all types of economic policies and bring financial reforms in line with development programs during such a situation.

The investment policy is an element of state economic policy and must be consistent with its other components. The basic requirements for the volume and structure of fixed assets investments should be formed in the process of developing industrial policy. It is necessary to determine which sectoral group companies and enterprises can become competitive in the domestic and foreign markets at the same time, which company can only operate within the country, or which one will not be able to become competitive in the foreseeable future with any terms. The revision of investment policy is associated not only with the restrictions associated with the pandemic, but also with the aggravated sanctions effects on the movement of capital. Forms of support for these sectors and industries should also be determined, including in the area of investment policy.

The European Union has adopted the InvestEU Program (2021–2027) with an additional investment of € 650 billion (EC, 2020).

Foreign economic policy should ensure the protection of those producers who are defined as competitive in specific conditions in industrial policy, primarily related to sanctions, customs duties, and quotas, as well as restrictions on logistics with lockdown's terms. Customs protection indicates that the relevant industry needs investment and tax incentives.

Social policy largely determines the volume of investments in the domestic demand sectors. Maintaining domestic demand like a direct grant, tax relief, and equity injections, and a direct payment to households, supports the huge markets of advanced countries and allows the bulk of the population to remain at an average level of security during such conditions as low income or forced unemployment during a global crisis. With a significant decrease in the incomes of the overwhelming majority of the population in the era of the pandemic, the domestic market is significantly narrowing, which affects investment in domestic demand sectors.

Support measures for households and firms ensured a continuous flow of credit that supported effective demand and provided financial stability.

Monetary policy complemented these measures to ensure adequate liquidity and favorable financing conditions, while prudential authorities have taken measures to facilitate supervision to keep the flow lending. Together, these measures helped to prevent a sharp credit crunch and a wave of corporate defaults, as well as to protect the profitability and balance sheets of banks.

Conclusion

The main condition for the transition of the post-COVID global economy to sustainable economic growth is the financial mechanism for stimulating economic activity. Depending on the stage of the pandemic that the country's economy is going through, different support mechanisms are required. The first stage is to stabilize markets and restore confidence in the financial system. The second and third stages are the reduction of losses incurred due to the recession in economic activity and the stabilization of the real economy.

The fourth stage is aimed at economic recovery.

Carrying out a systematic policy presupposes: (1) ensuring the accelerated growth of private and public investment; (2) the implementation of

a financial maneuver in favor of sectors capable of ensuring the competitiveness of the economy in the new economic conditions of the changed production and consumption of goods; (3) ensuring the attention of states in matters of financial support for sectors that do not have sufficient investment potential, but are promising from the point of view of new markets; (4) ensuring the innovative content of investments in the dramatically changed conditions of the pandemic.

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