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Financial Literacy and Household Access to Emergency Funds at the Beginning of the COVID-19 Pandemic and the Implications for the Financial Resilience of Israeli Households

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Abstract

Background

This report is the third in a series reviewing the economic effects on Israeli households of the COVID-19 pandemic and the social distancing requirements imposed by the government to slow the spread of the virus. An earlier report in the series found that by August 2020, nearly half of all households had drawn down their savings, and one-sixth had borrowed money in order to cope with the pandemic. The financial response of households to the pandemic raises important questions about their level of financial literacy (i.e., financial knowledge) and the financial resources that households brought to these decisions.

The academic literature has found that financial literacy is an important factor in a household's ability to make sound financial decisions. The pandemic offers a rare opportunity to study the effect of a high level of financial literacy and adherence to recommended financial principles (such as maintaining access to emergency funds) on household welfare in times of widespread economic stress. A finding that many households either lacked emergency savings or drew them down significantly could indicate that they are likely to emerge from the economic slowdown in a particularly fragile financial situation, suggesting the need for continued government support. A finding that low financial literacy was associated with having less savings going into the pandemic and/or higher rates of borrowing during the pandemic would suggest that strong financial literacy is particularly important for weathering periods of economic stress. Insights into these questions can provide important background information when the government considers future policies with regard to financial education and technologies designed to help families manage their finances.

Goals

The overarching goal of this research is to expand the existing knowledge on the financial resilience of households in Israel, in light of the ongoing economic slowdown. Specific objectives include determining the extent to which the level of financial knowledge influenced financial decisions at the beginning of the pandemic and examining households' access to emergency funds.

Methods

Data were collected by means of an online survey conducted among a representative sample of 1,501 respondents, aged 25-70, from among the Jewish population in Israel. The survey was conducted during August 16-18, 2020, between the first and second closures imposed by the government to deal with the pandemic in Israel. All the results indicating differences between groups are statistically significant at p=0.05 unless otherwise indicated.

Findings

Financial literacy: The survey found that individuals with low levels of financial literacy had less savings than others going into the pandemic and were also more affected financially by the slowing economy (even after accounting for differences in income and education). The study also found that those with lower financial literacy were more likely to deal with the situation by borrowing money. Among the respondents who reported a decrease in income as a result of the pandemic, 16% of those with low financial literacy borrowed money as compared to only 10% of those with high financial literacy. At the same time, respondents who reported high confidence in their financial knowledge were more likely to borrow than those with low confidence (15% versus 8%) (Differences between the groups were little changed after controlling for income and education).

Household access to emergency funds: After the first closure, one in eight households reported that they could not afford an unexpected expense of NIS 2,000; in other words, they did not have access to emergency funds. An additional 33% indicated that they would be able to afford such an expense only with difficulty. This proportion was higher among respondents with less education and lower income. Similarly, among employees who were not working in August during the crisis (because they had been fired or furloughed), 21% reported that they would not be able to afford an unexpected expense of NIS 2,000, compared to 10% of those who were still working. Among respondents who could cover such an expense, over 70% indicated that they would do so by drawing on savings. Households with access to emergency funds coped better with the crisis than those without and they were less likely to reduce spending in a way that impacted their standard of living.

Insights and Policy Recommendations

These findings can provide policy makers with guidance as they consider how to best support households during the economic recovery.

1. The correlation between borrowing and financial literacy suggests that many households made decisions that may harm their long-term financial situation. As the crisis continues, **it remains important to monitor the financial status of households** whose decisions during the crisis may have long-term negative consequences and may adversely affect their ability to recover from the crisis. In addition, the relationship between a respondent's confidence in their financial knowledge and their propensity to borrow suggests that **simply giving households access to credit may not be sufficiently helpful for those who do not have enough confidence to take advantage of those borrowing opportunities without additional assistance in navigating the borrowing process.**
2. **Policymakers should consider continuing government support** to households that are likely to emerge from the economic slowdown in a fragile financial condition and with limited access to the emergency funds they would need to confront additional economic challenges.
3. Policy makers should **promote sound financial decision making** (such as setting aside emergency savings) **through educational campaigns and should provide convenient infrastructure that will encourage household saving, such as, for example, digital solutions that can help households manage their finances.** It is important that these solutions increase households' self-confidence in their financial knowledge rather than just providing information. In this context, these findings reinforce the case for **advancing the "open banking" project**, which would allow third parties to access information at financial institutions in order to streamline processes, receive financial services, and analyze financial information. These measures will put Israeli households in a better position if and when another crisis arrives, whatever form it takes. **The immediate aftermath of the pandemic would be an auspicious time for launching such interventions**, with the memory of the pandemic's financial impact still fresh in people's minds.

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1. Background

In Israel, as in other countries, the public health crisis caused by the COVID-19 pandemic was accompanied by an economic crisis, due to the social distancing and other measures imposed by the government to slow the spread of the virus, which adversely affected the economic situation of many Israeli households.

This report is the third in a series studying the economic impact on households following the first closure. The two previous reports focused on the effect on income, expenditure and standard of living, as well as households' use of financial resources to deal with the lost income (Laufer et al., 2020, 2021). The second of these reports found that nearly half of all households reduced their savings, that one-sixth of households borrowed money to weather the crisis, and that low-income households were more likely to adopt these strategies (Laufer et al., 2021).

Building on this previous research, the current report focuses on two characteristics of households that affected their decision making and their financial resilience during this period: their financial literacy and their access to emergency funds. Both of these factors are recognized in the scientific literature as variables that significantly affect the financial resilience of households (Lusardi & Mitchell, 2014; Lusardi & Mitchell, 2015; Lusardi et al., 2011; Demertizis et al., 2020). However, the relationship between these variables and households' ability to cope with the COVID-19 pandemic are only beginning to be explored.

The current report uses "financial literacy" to refer to knowledge about financial concepts, though there are other definitions also used in the literature. This concept of financial literacy is sometimes referred to as "objective financial literacy" because it can be measured objectively using questions that measure respondents' understanding of basic financial concepts. In the research world, it has become standard practice to measure financial literacy by asking a series of three basic financial questions on interest, inflation, and risk diversification (see, for example, Lusardi & Mitchell, 2015a, 2015b). The literature has documented the relationship between financial literacy, as measured by the ability to answer these questions, and the ability to make good financial decisions. For example, researchers have identified connections between financial literacy and decisions in the areas of savings, personal debt management, and payment of management fees (Lusardi & Mitchell, 2015a, 2015b). Nonetheless, a 2014 study found that only one-third of the world's population had enough financial knowledge to answer all three questions (Klapper et al., 2015). It has also been found that more vulnerable populations, whether defined by education, income, age, or gender, have lower financial literacy than others (Lusardi & Mitchell, 2015a).

In 2012, the Central Bureau of Statistics published a survey of financial literacy (CBS, 2012), which found that the proportion of the population in Israel that could answer each of the three aforementioned questions was lower than the OECD average (59% versus 82% for the question on interest, 65% versus 80% for the question on inflation, and 48% versus 71% for the question on risk diversification). Recent online surveys (for example: Haran Rosen & Sade, 2019; Bank of Israel, 2019) have found that the proportion of the population in Israel who knew how to answer all three questions was 31% in 2015 and 37% in 2018, which is similar to the aforementioned global figure. These surveys also found that financial literacy in Israel is correlated with socio-demographic characteristics in a manner similar to that in other countries (Lusardi & Mitchell, 2015a).

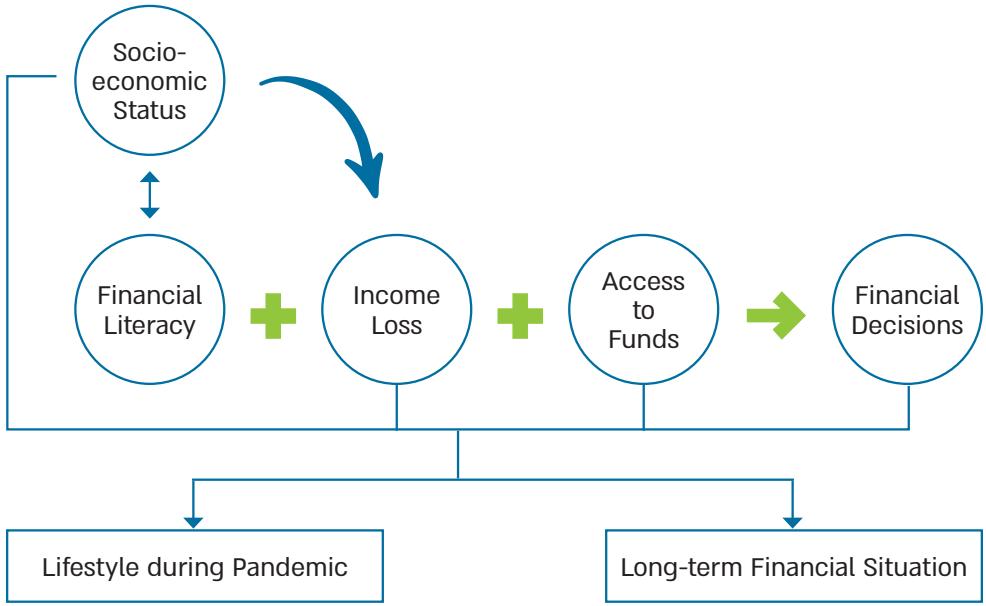
The literature also shows that in addition to objective financial literacy (the objective level of an individual's financial knowledge), subjective financial literacy (the level of an individual's confidence in his or her knowledge of financial issues) also affects financial behavior (Lusardi & Mitchell, 2015a; Allgood & Walstad, 2016). Haran Rosen & Sade (2019) and the Bank of Israel (2019) found that the impact of subjective financial literacy on financial choices was actually greater than that of objective financial literacy following a series of consumer financial regulation campaigns. The most recent survey of this kind, conducted in 2018 (Bank of Israel, 2019), found that approximately 22% of respondents reported having high confidence in their financial knowledge and that subjective financial literacy was correlated with socio-demographic characteristics in a manner similar to objective financial literacy.

Because all the aforementioned research was conducted prior to the COVID-19 outbreak, little is known about financial literacy in Israel since the start of the pandemic. The significant financial decisions that households had to make in the wake of the pandemic once again raises the importance of understanding whether a household's level of financial knowledge, or alternatively their confidence in that knowledge, affected how they coped with the economic slowdown. In the US, researchers have found that households with higher financial literacy coped better with the economic fallout from the pandemic (Lusardi et al., 2020), but similar studies have not yet been conducted in Israel.

The literature has also found that access to emergency funds, in addition to financial literacy, is an important indicator of a household's financial stability and their ability to deal with personal crises (Lusardi et al., 2011, 2020; Schneider et al., 2020). However, in January 2020, it was found that 27% of Americans did not have immediate access to $400 in emergency funds (though this proportion was significantly lower than prior to the 2007-2008 financial crisis when the rate was 50%). The proportion was particularly high among the unemployed, low-income households, the less educated, and women. Furthermore, these gaps appear to have widened in the wake of the pandemic (Schneider et al., 2020). Also, in Europe, approximately one-third of households reported not having access to emergency funds in 2018 (Demertzis et al., 2020).

Combining these findings paints a complex picture of how we might expect financial literacy and access to emergency funds to affect households' experiences during the pandemic. First, those with low financial literacy are more likely to belong to socio-economic groups that experienced larger income losses during the pandemic. Second, those with lower financial literacy could make different financial decisions than others in response to a loss of income, for example, by taking on more debt. Such decisions could affect households' lifestyle during the pandemic, as well as magnify the negative effects of the economic slowdown on households' long-term financial situation. Meanwhile, households without emergency funds to draw on could experience a larger impact on their lifestyle in response to similar economic shocks and, similarly, may be forced to make financial decisions that impact their long-term welfare. **Figure 1** provides a graphic representation of these possible associations and effects.

Figure 1: A model of the impact of financial literacy and access to emergency funds on households



Finally, and importantly for public policy, the pandemic offers a rare opportunity to understand how strong financial literacy and adherence to recommended financial behaviors (such as maintaining emergency savings) affect household welfare in times of widespread economic stress. A finding that many households lacked emergency savings or drew them down significantly could raise concerns that they are likely to emerge from the economic

slowdown in a particularly fragile financial situation and as a result will need continued government support. A finding that low financial literacy was associated with entering the pandemic with less savings and/or with higher rates of borrowing money during the pandemic would suggest that strong financial literacy is of particular importance in periods of economic stress. Insights on these questions can provide important background as the government considers future policies with respect to financial education and technologies designed to help families manage their finances.

2. The Study

2.1 Research Questions

The overarching goal of the study presented in this report is to expand existing knowledge about the financial resilience of households in Israel, against the background of the ongoing economic slowdown, and to identify areas of particular concern.

Against the background of the slowdown, the report examines the importance of financial literacy in making informed financial decisions and of access to emergency funds as a tool to weather financial shocks, while focusing on the period between the first and second closures. The report attempts to answer the following questions:

- What is the relationship between the level of financial literacy among Israeli households and the effect of the pandemic on their income and standard of living?
- Is financial literacy related to the financial decisions made by households in response to the pandemic?
- What proportion of households were able to access the funds necessary to afford an unexpected expense of NIS 2,000 and from where did households expect to obtain those emergency funds?

The economic effects of the additional closures in September 2020 and January 2021 and the continuation of the economic slowdown further emphasizes the importance of understanding the level of economic resilience among households and their sources of emergency funds, particularly among vulnerable populations.

2.2 Research Methodology

Data collection method: To address these questions, an online survey was conducted between August 16th and 18th, 2020, several months after the first closure and the accompanying restrictions imposed in March-April 2020, and approximately one month before the second round of restrictions imposed in September 2020. The survey was conducted among a sample of 1,501 respondents, aged 25-70, from among the Jewish population in Israel, and was constructed to match the distribution of respondents in the 2019 CBS Social Survey according to age, gender, and religiosity. Data collection was conducted using an online, self-administered survey. Respondents were compensated for completing the questionnaire.

Sample limitations. The sample does not include respondents from the Arab population in Israel since this group was not adequately represented in the online sample. Furthermore, the fact that this was an online survey

means that the sample likely over-represents segments of the population with higher levels of digital literacy. In particular, respondents in the sample appear to be slightly more educated but to have lower incomes than in the 2018 CBS Expenditure Survey (CBS, 2020).

Survey topics. Survey participants were asked standard questions designed to measure their financial literacy as well as their confidence in their financial knowledge and their ability to cover an unexpected expense of NIS 2,000. The survey also included questions on issues reviewed in previous reports in this series, including questions about demographic characteristics, employment and income history during the pandemic, changes in household spending, and changes in financial behavior during the period between the first closure and August 2020.

All the reported differences between groups are statistically significant at p=0.05 unless otherwise indicated.

3. Findings

3.1 General findings regarding financial literacy and access to emergency funds

The findings regarding objective financial literacy are similar to those of previous research. The survey asked three standard questions about basic financial concepts that are in standard use to measure financial literacy. The first question asks about interest: "If you have NIS 100 in a savings account that provides a return (profit) of 2% per year, and assuming that you do not make any withdrawals, how much money do you think you will have after 5 years?" The answers to choose from are "more than NIS 102", "exactly NIS 102", "less than NIS 102" or "do not know." Seventy-nine percent of respondents correctly answered that they would have more than NIS 102, while 9% gave an incorrect response and 12% said they did not know.

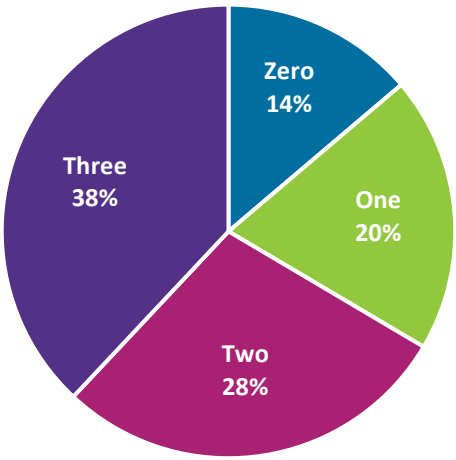
The second question asks about inflation: "From what you know, if you have savings that give you a 1% return (profit) per year and inflation is 2%, after a year can you buy more, exactly the same, or less than what you could buy with the money today?" Sixty-two percent of respondents correctly answered that they would have less spending power at the end of the year, while 10% gave an incorrect response and 28% said they did not know.

The third question asks about the benefits of diversifying investments: "From what you know, do you think the following sentence is correct or incorrect: 'Buying a share of one company provides a safer return (profit) than buying a mutual fund that invests in the shares of several companies.'" Fifty-one percent of respondents correctly identified that this was a false statement, while 5% incorrectly thought that it was true and 44% said they did not know.

A total of 38% of the respondents answered all three questions correctly, which is similar to the previous finding from a 2018 online survey conducted in Israel, in which the proportion was 37%. Meanwhile, 29% answered two questions correctly, 20% answered only one correctly, and 14% did not answer any correctly (**see Figure 2 below**). The proportion of respondents who correctly answered all three questions was slightly higher than the proportion globally, as well as the proportion in the US, which are both approximately one-third (GFLEC 2020).

In the following analysis, respondents who correctly answered only one question or none are defined as having "low objective financial literacy," while respondents who correctly answered two or three questions are defined as having "high objective financial literacy."

Figure 2: Number of correct answers given by respondents to the three financial literacy questions (percent)



Thirty percent of respondents reported a high level of subjective financial literacy (i.e., a high level of confidence in their financial knowledge), which is slightly higher than in previous studies. Meanwhile, 18% described their level of knowledge as low, 48% as medium, and 5% said they did not know their level of financial knowledge.[1] (Haran Rosen & Sade (2019) reported that only 22% of respondents described themselves as having a high level of financial knowledge. The higher level of self-reported financial knowledge found here likely reflects the composition of the sample, namely that it does not include representatives of the Arab population, which has been found to have somewhat lower levels of subjective financial literacy.) Answers to this question were positively but weakly correlated with respondents' ability to correctly answer the questions measuring objective financial literacy. Those who reported that they did not know their level of financial knowledge correctly answered the fewest number of the objective financial literacy questions.

Measures of financial literacy were found to be correlated with several demographic variables, consistent with findings from previous research (such as Lusardi & Mitchell, 2015a). Those with more education demonstrated greater financial literacy: survey respondents with a high school diploma or less correctly answered 1.5 of the 3 questions on average, while those with at least a bachelor's degree correctly answered 2.2 questions on average. Similarly, respondents from households with higher income correctly answered more financial literacy questions on average: respondents with above-average income correctly answered 2.3 questions on average, compared

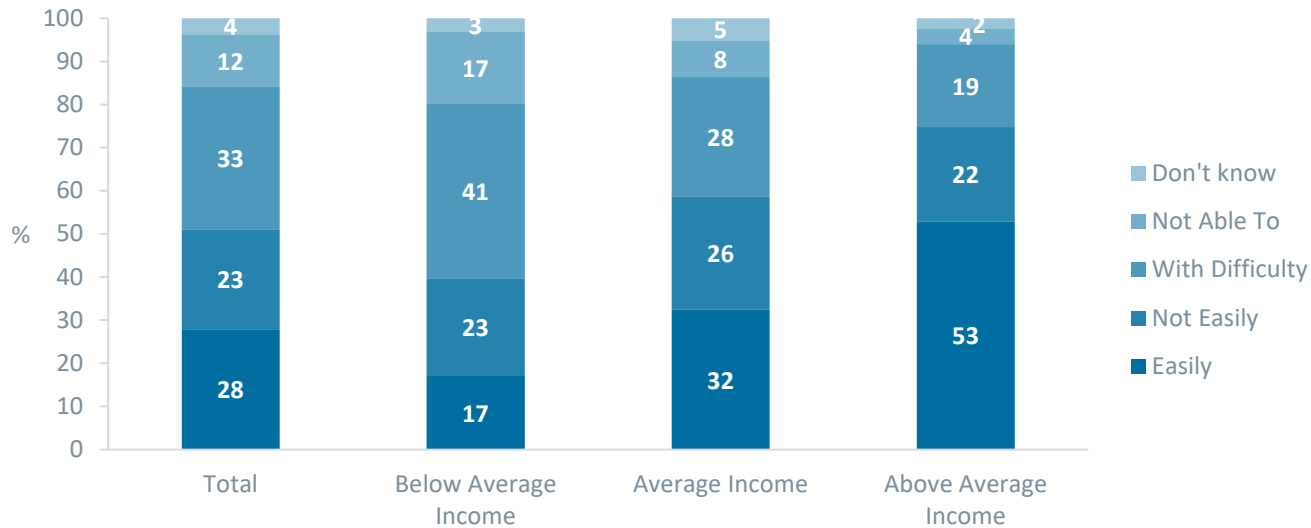
[1] The percentages total more than 100% due to rounding.

to 2.0 questions for those with average income and 1.7 questions for those with below-average income. Male respondents correctly answered more questions on average than female respondents (2.2 versus 1.6). There was no difference in the number of correct responses between ultra-Orthodox and non-ultra-Orthodox respondents. Similar patterns were found for subjective financial literacy, but unlike in the case of objective literacy and findings from an earlier survey (Bank of Israel, 2019), ultra-Orthodox respondents reported lower levels of subjective financial literacy relative to other respondents.

Respondents with high financial literacy were more likely to report that they had savings going into the pandemic. Seventy-two percent of those with high objective financial literacy had savings before the pandemic, compared to 55% of those with low objective financial literacy (and only 41% of those who did not know how to answer any of the financial literacy questions). A similar correlation was found for subjective financial literacy, with 77% of respondents who rated their financial understanding as high having saved money before the pandemic, compared to 52% of respondents who rated their financial understanding as low. These differences are little changed after controlling for income and education.

In August 2020, after the first closure, one in eight households replied that they could not afford an unexpected expense of NIS 2,000. Though only 12% of the respondents answered that they would be unable to afford an unexpected expense of NIS 2,000, another 33% answered that they would be able to but only with difficulty. Overall, 84% of respondents answered that they could afford such an expense (whether easily, not easily, or with difficulty). By comparison, 73% of respondents in the United States reported that prior to the crisis they could afford a one-time expense of $400 (approximately NIS 1400) (Lusardi et al., 2020). Respondents with less education and from low-income households were more likely to report that they were unable to afford the expense (**see Figure 3 below**). In addition, it appears that the pandemic had a significant economic impact on families' financial health: 21 percent of employees who did not work in August (because they had been either furloughed or fired) answered that they would not be able to afford the NIS 2,000 expense, compared to 10% of those who were still working.

Figure 3: Reported ability to afford an unexpected expense of NIS 2,000, by income (percent)



Most households would cover an unexpected expense by drawing on savings. Of the respondents who answered that they would be able to afford an expense of NIS 2,000, 71% indicated that they would do so by withdrawing from savings or from a checking account. Six percent answered that they would take a loan, and 10% answered that they would obtain assistance from a family member or friend. Thirteen percent reported that they would use some other source or that they did not know where they would get the funds. These patterns are consistent with the actual behavior reported by survey respondents in response to the financial difficulties caused by the pandemic. When asked what financial resources they had used during this period, the most common answer was a reduction in savings (45%) with smaller proportions reporting that they had taken out loans (17%) or received help from family and friends (14%) (Laufer et al., 2021).

3.2 Findings regarding financial literacy and economic outcomes during the pandemic

People with low financial literacy were more adversely affected by the pandemic. Previous studies in Israel (Laufer et al., 2020) as well as in other countries (such as Lusardi et al., 2020; Clark et al., 2020) have found that the economic effects of the pandemic were more severe for low-income and less-educated workers. Because these segments of the population tend to have lower financial literacy, as described above, one would expect

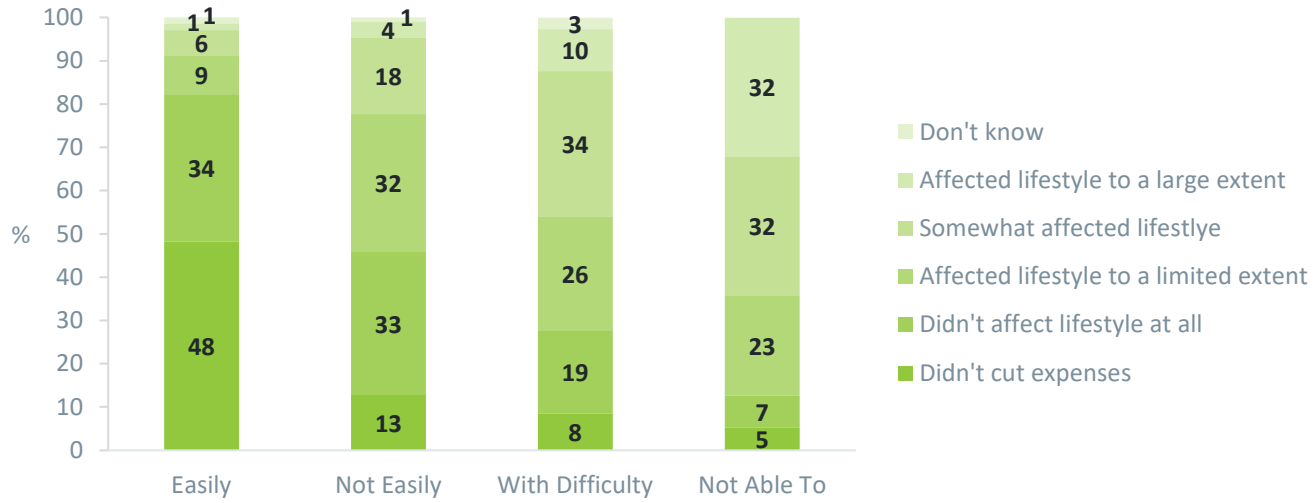
that individuals with low financial literacy would have been more adversely affected by the pandemic. Indeed, among those with low objective financial literacy, 63% reported a decrease in income during the sample period as compared to 53% of those with high objective financial literacy. Also, in the case of subjective financial literacy, 64% of respondents who described their level of financial knowledge as low reported a decrease in income, as compared to 50% who described their level of financial knowledge as high.

Respondents with low subjective or objective financial literacy were more adversely affected even after adjusting for differences in income and education. In multivariate regressions that included controls for income and education, it was found that: 1) Respondents with low objective financial literacy were 6% more likely to report a decrease in income relative to those with high objective financial literacy; and 2) respondents with low subjective financial literacy were 9% more likely to report a decrease in income relative to those with high subjective financial literacy.

Respondents with low objective financial literacy and those with high subjective financial literacy were more likely to respond to the pandemic by borrowing money. Among respondents who reported a decrease in income due to the pandemic, those with low objective financial literacy were more likely to borrow compared to those with high objective financial literacy – 16% versus 10% (after controlling for income and education, the difference between the two groups was reduced to 5 percentage points and is only statistically significant at $p = 0.06$). In contrast, respondents with high subjective financial literacy (i.e., those identifying themselves as having high financial understanding) were more likely to borrow to cope with the pandemic as compared to those with low subjective financial literacy (15% versus 8%, and the difference remains statistically significant at $p < 0.05$ even after controlling for income and education). Of the respondents who reported a decrease in income due to the pandemic, those with low objective financial literacy were also more likely to withdraw pension savings than those with high objective financial literacy – 8% versus 4%. (No correlation was found between withdrawal of pension savings and subjective financial literacy.)

Among families that reported a decrease in income, households with fewer financial resources were more likely to reduce their spending in a way that harmed their lifestyle. Overall, 54% of respondents reported a decline in income due to the pandemic. Among those families, only 1% of those who could easily afford an unexpected expense of NIS 2,000 reported that they had to reduce their expenses in a way that greatly affected their lifestyle. Among respondents who reported a decrease in income and answered that it would be difficult for them to afford a NIS 2,000 expense, 10% said they had to reduce their expenses in a way that greatly affected their lifestyle, a proportion that rises to 32% for families who could not afford the expense at all (**see Figure 4**). (See Laufer et al., 2020 for a discussion of the impact of the pandemic on household expenditure and income.)

Figure 4: Respondents' reports on the extent to which their reduction in spending adversely affected their lifestyle, according to their ability to afford an unexpected expense of NIS 2,000 (percent)



Respondents who answered that they would have more difficulty affording an expense of NIS 2,000 were also more likely to reduce savings and to borrow money during the pandemic. (For a broader discussion of savings and borrowing in response to the pandemic, see Laufer et al., 2021.) Among the respondents who reported that they could easily afford an unexpected expense of NIS 2,000, 27% reduced their savings and 2% borrowed money, as compared to 57% and 13% respectively among respondents who reported that it would be difficult for them to afford such an expense. Respondents who reported that it would be more difficult for them to cover a NIS 2,000 expense were also more likely to report that they spent government grant money distributed in response to the pandemic (such as grants for families with children and for those over retirement age), as opposed to saving the money or donating it to others (74% versus 37%). In addition, respondents with low objective financial literacy were slightly more likely to spend the money they received from government grants than those with high objective financial literacy (All of the findings remain statistically significant after controlling for income and education).

4. Conclusion, Discussion and Policy Recommendations

Numerous studies have documented the important role of financial literacy and access to emergency funds in determining the economic well-being of households. The present study examines these issues in the context of Israeli households attempting to cope with the economic fallout from the COVID-19 pandemic.

An earlier report based on the same survey (Laufer et al., 2021) found that in the early months of the pandemic (i.e., up until August 2020), households reduced their spending and borrowed from a variety of sources in order to deal with the pandemic's economic consequences. That report also noted that although the decision to draw on financial resources may have helped families maintain their economic well-being in the short run, these decisions may have been detrimental to the households' longer-term financial situations.

Balancing near-term and long-term considerations in such situations requires a certain level of financial sophistication. While borrowing money can be a good decision in many circumstances, the connection between borrowing and financial literacy during this period raises concerns. Among the households affected by the economic slowdown, it was found that those with low objective financial literacy (i.e., low financial knowledge) and those with high subjective financial literacy (i.e., high confidence in their financial knowledge) were more likely to cope with the slowdown by borrowing money, relative to otherwise similar households. The greater propensity for borrowing among those with low financial literacy raises concerns that the debt incurred by many households during this period could put them into financially fragile situations in the future. **As the Israeli economy begins to recover, it is important to reexamine the financial situation of households.** If many households are indeed in a more economically fragile situation, then **a future economic slowdown or a slower-than-expected recovery may require more aggressive government intervention.**

In addition, the relationship between respondents' confidence in their financial knowledge and their propensity to borrow suggests that **simply giving households access to credit may not be sufficiently helpful for those who do not have enough confidence to take advantage of those borrowing opportunities without additional help navigating the borrowing process.**

The experience of Israeli households during the pandemic also underscores the importance of proper household financial management, such as maintaining access to emergency savings. The current survey finds that, as a whole, households with access to emergency funds coped better with the economic slowdown and were less

likely to reduce spending in ways that significantly affected their lifestyle. **These findings reinforce the need for policy makers to encourage household savings through educational campaigns and by promoting user-friendly savings infrastructures, such as digital solutions that help households manage their funds.**

These findings also reinforce the case for **advancing the "open banking" project**, which would allow third parties to access information at financial institutions for the purpose of streamlining processes, receiving financial services, and analyzing financial information (Bank of Israel, 2021). Such measures could increase the likelihood that households will be in a better financial situation if and when another crisis arrives, no matter what form it takes. **The immediate aftermath of the pandemic would be an auspicious time for launching such interventions** since the memory of the pandemic's financial impact is still fresh in peoples' minds.

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