Limiting COVID's Economic Fallout – "Student Loans" for both Businesses and Households to Insure Revenues and Sustain Economic Confidence

LEANZ Webinar (Slides on Cognitus Website)

Dr Richard Meade, richard.meade@cognitus.co.nz

Cognitus Economic Insight, www.cognitus.co.nz

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The Problem

- Firms and households around the world have been hit by an "unprecedented" correlated economic shock:
  - Through no fault of their own, and regardless of their pre-COVID financial health, they are all now looking financially sick.
- Lockdown measures (however necessary), and uncertainties about future COVID responses, amplify this.
- Even with effective countervailing measures, this will surely lead to cascading and widespread business failures and redundancies, significant declines in GDP and wellbeing, and reduced future tax takes (affecting future wellbeing):
  - We are currently in the eye of the storm – COVID's full impacts are yet to unfold, but we still face choices about how best to minimise them (how deep/steep is the "V", "U", "Bathtub") …

Key Feature of an Effective Economic Response

- The urgent challenge, first and foremost, is to limit any (unwanted) permanent impacts of the pandemic:
  - <u>Firms</u> need to believe that they can financially ride out the disruptions without voluntary liquidation or bankruptcy;
  - <u>Households</u> need to believe that they can keep their heads above water (e.g. keep their jobs and homes) long enough for “normal” to resume.
- Since <u>each sector relies on the other’s viability</u>, neither firms nor households can sustain such beliefs unless the other does so too:
  - Nobody can expect to be OK unless they believe <u>everyone else</u> will be (which is why it is hard for anyone to claim solvency or bankability).
- This means we need to sustain economic confidence and hence revenues, jobs and purchasing power – as much and as widely as we can – i.e. in both firms and households.

Why Existing Economic Support Measures Don’t Achieve This

- Existing support measures are <u>too selective</u> to *widely* sustain confidence:
  - Wage subsidies will not protect jobs unless employing firms can also continue to pay their other bills, which they can’t when expected revenues have collapsed and liquidity cannot be secured to replace them;
  - Mortgage holidays are viable precisely because banks offer them expecting repayment with interest later – but holidays for rents, utilities, insurance, etc (if they can even be secured) imply an economic hit on those making them;
  - Business lending schemes with BAU lending criteria, tight lending caps or short repayment horizons deny otherwise-viable businesses needed liquidity;
  - Tax refunds for loss-making businesses do nothing to help businesses whose profits have simply collapsed to low levels:

<u>Nobody can assume these measures are keeping others afloat!</u>

- Worse still, due to deficit funding these measures might not just be <u>ineffective</u>, but costly charges against future generations (so they may also be <u>inequitable</u>).

My Proposed Solution

- Without delay, government should COMMIT to making "low-cost" loans available to all (non-major) businesses and households that don't already enjoy "insured" incomes:
  - For as long and as often as needed due to the pandemic;
  - Proportional to COVID-related revenue shortfalls – i.e. providing ex post "income insurance";
  - Interest-free until the economy "recovers sufficiently";
  - Repaid through higher tax rates for those taking out the loans (akin to "equity");
  - Tied to shareholders rather than firms so they can't just liquidate to avoid repayments, and a charge against estates in case borrowers die before repaying; and
  - Requiring businesses to continue to pay [50%] of employees' wages.
- Such loans would be more cost-effective, affordable and inter-generationally equitable than $-for-$ support measures like wage subsidies (government is only subsidising interest) – so they can be offered more widely and for longer.
- They are also administratively "simple", since IRD already runs such a scheme (student loans), and already knows your pre-COVID revenue.

My Proposed Solution (cont'd)

- Ideally such loans would have been committed to <u>before</u> any lockdowns:
  - They will be <u>much more effective as a *preventative* than as a *palliative*</u>, and cheaper too in that case (since if they sustain confidence, then revenue shortfalls will be lower)!
- Importantly, they replace government-imposed qualifying criteria and favoured cost lines with "self-selection criteria" and "self-prioritised cost lines":
  - They are "incentive compatible" in that taking out loans is a choice to personally pay higher taxes, which protects against over-borrowing (likely a lesser evil anyway);
  - They otherwise rely on households using their private information to determine how much "income insurance" they need to remain able to pay their priority bills, keep their house (etc), and obviate the need for bluntly targeted subsidies.
- They fill important gaps, enabling all households (not just low-income ones) to smooth lifetime consumption in the face of the COVID shock:
  - Anti-slavery laws mean banks are reluctant to let us borrow against our own future incomes, so there is an exceptional role for government in this case; and
  - New Zealand's usual income insurance is meagre even for low-income applicants, and wholly inadequate for anyone vaguely skilled ($490/week, after recent increase).

Supposing We Don't Do This …

- There is nothing else already in place – let alone on the horizon – that adequately preserves whatever economic confidence remains, so confidence will continue to haemorrhage:
  - E.g. the wage subsidy has already been wound back and will soon run out of road, so it has really only delayed the inevitable for many (at high cost);
  - Beware – once lost, confidence will be very hard to restore.
- This means business failures and redundancies will continue to spread exponentially – "like a virus" – leading to significantly reduced future tax revenues:
  - This could require cutbacks in future health and other social services ("austerity New Zealand" anyone?, ≈10,000 premature deaths?);
  - *By fighting COVID we are saving lives now but losing lives later, and placing costs on future generations* – it is essential that we acknowledge the trade-off, minimise it, and ensure we have the right balance.