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

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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:
  - Firms need to believe that they can financially ride out the disruptions without voluntary liquidation or bankruptcy;
  - Households 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 each sector relies on the other’s viability, neither firms nor households can sustain such beliefs unless the other does so too:
  - Nobody can expect to be OK unless they believe everyone else 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

- Typical 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) risk 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 everyone else 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 – see later.
- 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/ATO already run such a scheme (student loans), and already know your pre-COVID revenue.

My Proposed Solution (cont'd)

- Ideally such loans would have been committed to before any lockdowns:
  - They will be much more effective as a *preventative* than as a *palliative*, 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
  - Usual income insurance can be meagre even for low-income applicants, and wholly inadequate for anyone vaguely skilled.

Making it Work

- The rationale for requiring businesses to continue to paying [50%] of employees' wages is subtle.
- The issue is that firms, if left to their own devices, might choose to insure their hard-to-replace workers and let the others go (banking on being able to rehire the easier-to-replace workers when things pick up again):
  - This could likely hit lower-income workers hardest, requiring them to disproportionately borrow against their own future income to make up shortfalls, and hence creating equity issues;
  - But if all firms do this, then everyone suffers a possible reduction in demand from these workers – a form of "prisoner's dilemma".
- Requiring businesses to at least partially insure all their workers incomes is intended to overcome the prisoner's dilemma, and make all firms and workers better off at the same time:
  - It should simultaneously relieve any equity issues.

Making it Work (cont'd)

- Implementing the scheme for <u>individual/household</u> loans should be relatively easy for IRD/ATO to administer:
  - Probably loans should be made available one month at a time and require proof of income shortfall (in real time or via audits) – that would limit the risk of individuals becoming overly indebted without cause.
- To make the scheme work for <u>firms</u>, existing technologies could be co-opted:
  - Ordinary shares could be deemed to be partly paid, with the unpaid portion being a pro rata share of the firm's borrowings;
  - Special resolutions (75% votes) should be used to ensure shareholders buy in to ultimately being on the hook for repayments;
  - Existing resident and non-resident withholding tax mechanisms could be implemented to clip repayments at the company level, rather than relying on personal declarations (addressing shareholder non-residency/emigration);
  - Unit trust-type models could be used to allow shareholders to repay debts at different rates;
  - Etc – we have a lot of existing legal technologies to draw on.

Supposing We Don’t Do Something Like This …

- Hard to find alternatives in place – let alone on the horizon – that adequately preserve whatever economic confidence remains, so there is a risk of confidence continuing to haemorrhage:
  - E.g. wage subsidies face being wound back and running out of road, so they may have only delayed the inevitable for many businesses (at high cost) – cf Fabling et al. (2016) re Earthquake Support Subsidy …;
  - Beware – once lost, confidence will be very hard to restore.
- This means business failures and redundancies could continue to spread exponentially – “like a virus” – greatly reducing future tax revenues (especially if borders remain closed and the global economy stalls):
  - This could require cutbacks in future health and other social services (e.g. “Austerity [New Zealand]”?, ≈10,000 premature deaths?);
  - *By fighting COVID we are saving lives <u>now</u> but losing lives <u>later</u>, and placing costs on future generations* – it is essential that we acknowledge the trade-off, <u>minimise it</u>, and ensure we have the right balance.