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IS CRUCIAL TO NEW ZEALAND'S ECONOMIC
RECOVERY IN THE WAKE OF COVID-19**

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Johns Hopkins Institute for Applied Economics,
Global Health, and the Study of Business Enterprise



In a New World, New Thinking is Required

Why the Prioritization of Resources is Crucial to New Zealand's Economic Recovery in the Wake of Covid-19

By Hon. Sir Roger Douglas KB and Prof. Robert MacCulloch

About the Series

The *Studies in Applied Economics* series is under the general direction of Prof. Steve H. Hanke, Founder and Co-Director of The Johns Hopkins Institute for Applied Economics, Global Health, and the Study of Business Enterprise (hanke@jhu.edu).

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Sir Roger entered Parliament in 1969. He first became a Cabinet Minister in 1973, in the term of the Third Labour Government 1972-1975. He held the portfolios of Broadcasting and Post Office and later Housing.

In 1982, Sir Roger was Shadow Minister of Trade and Industry and associate Shadow Minister of Overseas Trade. He became Shadow Minister of Finance in 1983, and Minister of Finance from July 1984 when the Fourth Labour Government was voted into office.

His period as Finance Minister saw major deregulation of New Zealand finance markets, the floating of the New Zealand dollar, the corporatisation of State trading departments and the adoption of privatisation policies, and dramatic reforms of the taxation system.

In 1985 he was awarded the Euromoney Magazine Award for Finance Minister of the Year; in 1996 he was awarded the Max Schmidheiny freedom prize in Switzerland for his contribution to the preservation and development of a free social and economic order; in 1997 he was awarded the Ludwig Erhard Prize of Economic Journalism; in 2002 he was awarded the Friedrich von Hayek medal given to outstanding politicians, entrepreneurs and scholars who stand for the aims and values of a free society; in 2008, in Paris, he was awarded the Turgot Freedom Prize awarded to an international Statesman for a major contribution to the advancement of freedom.

After leaving Parliament in 1990, Roger Douglas was the Managing Director of Roger Douglas Associates, an international consulting firm, specialising in advice on economic restructuring and structural adjustment. He is a founder member of ACT NZ. Director of Brierley Investments Ltd 1990 - 1999 (Chairman 1998), Director John Fairfax Holdings Ltd 1997-1998, Director Aetna Health NZ Ltd 1995 - 1999. He returned to Parliament in 2008 as an ACT List Member of Parliament.

He has done a considerable amount of work internationally, for The World Bank and private clients and countries visited include Brazil, Hungary, Canada, United States of America, Russia, Pakistan, Mexico, Austria, Fiji, the Philippines, Vietnam, Australia, China, South Africa, Hong Kong, Singapore, The Netherlands, England, Sweden, Japan, Thailand, Peru and India.

His publications include:

"There's Got to be a Better Way" (1981)

"Toward Prosperity" (1987)

"Unfinished Business" (1993)

"Completing the Circle" (1996)

"No Second Class Citizens" (2009)

and various articles.

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Executive Summary

The Covid-19 outbreak has not only precipitated a health emergency, but also an economic crisis, unparalleled in modern history. For New Zealand to emerge from that crisis in a relatively healthy state, the Labour government will need to provide a clear framework for recovery, implementing policies which clearly prioritize those most affected by the societal and economic lockdown necessitated by the outbreak. To date, such prioritization has been lacking, with the Wage Subsidy Scheme unfairly advantaging big business and the professional elite, at the cost of money and resources which could have been better directed towards assisting the newly unemployed – namely workers, their families, and small business owners.

Ultimately, poorly targeted support in the form of helicopter payments, wage subsidies, or broad-based tax cuts (such as a moratorium on GST) is wasteful, and will only serve to entrench inequalities that existed prior to the pandemic. Equally, the time and costs inherent in planning large-scale new infrastructure projects – and the fact that they offer little practical help to the majority of workers who require help now – means that they should not be regarded as a panacea, aiding economic recovery.

Instead, clear, innovative policies, which not only prioritize those most in need, but which also lay the groundwork for further social and economic reform in the medium to long term, are required. For workers and their families, support can be offered via the mechanism of special risk accounts, tailored to meet their individual needs. For small business, help can be provided by facilitating conversations between businesses, landlords, and banks, as well as providing – upon the provision of an approved business plan – forgivable government loans.

Finally, to help manage the recovery, and ensure our younger generations are not saddled with debt, the government must also identify, and eliminate, unnecessary spending, privilege, and waste. It can find an extra \$15 billion per annum by doing so, contributing to the recovery in the short term, and – more generally – to implementing wider scale reform once the immediate crisis has been put behind it.

The Economic, Social and Political Impact of Covid-19

Across the globe, Covid-19 has shattered our sense of entitlement and made it clear exactly how vulnerable we are: it has targeted those amongst us who are predisposed, either because of age or an underlying medical condition, to experience the worst ravages of the disease; it has exposed the vulnerabilities in our health systems; it has put a spotlight on the inherent weaknesses in our economies; and – in the case of Western societies – it has shaken the very foundations of our system of government.

In a few short weeks, countries with seemingly strong economies have ground to a halt, leaving leaders everywhere to confront a series of economic and social challenges unprecedented in the modern era. How they respond to these challenges, across a wide range of policy areas, will decide the type of world we live in, not only in the immediate aftermath of Covid-19, but for decades to come.

Of primary importance will be how governments respond to the exponential growth in the numbers of workers and small businesses seeking assistance. Even by the most conservative estimates, unemployment rates in developed countries are expected to reach double digits, with experts in many countries forecasting that more than one quarter of their entire workforce can expect to find itself without a job. Similarly, the projected hit to global GDP in the short to medium term is likely to be significant, with the percentage decline in the June quarter expected to be in the region of 20-25%, the largest on record.

New Zealand has been far from immune to the effects of the global crisis, and the Labour Government's implementation of a four-week lockdown, whilst successfully limiting the growth in the number of cases of Covid-19, has had a profound effect on the economy. Already, a company like Air New Zealand has required assistance to the tune of nearly \$1 billion, Bauer Media has shut its doors, NZME has laid off 200 workers, 2 Degrees has cut 10% of its workforce, and the group that owns the franchise operator of New Zealand's Burger King restaurants has been placed in receivership. Worse, hundreds of thousands of workers have essentially been rendered unemployed, forced to rely on the government's wage subsidy scheme to make ends meet.

Whilst upheaval on this scale might be deemed acceptable should the New Zealand economy quickly recover once the lockdown is fully lifted, such an outcome is improbable. Instead, both workers and the government will need to come to terms with a new reality, one in which even previously buoyant industries (and none will be hit harder than tourism), will not only take years to find their feet, but – in all likelihood – will find themselves operating under the parameters of different rules and expectations.

In such a world, coherent, innovative, clearly signaled, and – most important of all – prioritized, decision-making is going to be vital. If the government wants New Zealand to emerge from this crisis in a stronger place, then it needs a roadmap for how to get there, beginning with short-term strategies that support workers and small businesses, offering them hope and a sense that there is a way forward (so important to restoring confidence). Building on this, a trailblazing series of

medium to long-term policies will also be required to deliver the kind of robust, healthy, and equitable society all Kiwis want, immune to future crises.

To date, the government's policy response, whilst well meaning, has been inadequate.

The Problem with the Response to Date

The government's response to date has failed to take into account an issue of paramount importance: *the resources available to us are not simply finite, they are scarce, and therefore need to be prioritized effectively.*

This can be seen most obviously in the implementation of the Wage Subsidy Bill. Whilst the scheme, which already comes at a cost of \$10 billion, has undoubtedly provided short term support to those who needed it – workers and small businesses – it has also been used to prop up corporate monoliths and institutions who should have been left to fend for themselves or – at the very least – should have received assistance in the form of a loan, instead of a handout.

In 2019, the Warehouse Group made an after-tax profit of \$74 million dollars. Even allowing for some inevitable pain, good corporate management suggests that it should have been able to look after itself during the lockdown, or, failing that, should have been capable of paying back a loan once its stores reopened. Similarly, the partners in wealthy law firms like Simpson Grierson, Bell Gully and MinterEllison have enjoyed years of high six (and sometimes even seven) figure salaries. Why haven't they been required to fend for themselves and their businesses? Why, when the good times suddenly come to an end, have they gone cap in hand to the government? And why has the government responded by treating them the same as workers and small businesses who have never enjoyed an equivalent level of wealth and who do not enjoy access to the resources they do? It is the old maxim rendered true – there is never someone more socialist than a wealthy capitalist in a time of crisis.

By favouring big business and the professional elite, to the tune of \$3 billion in the last few weeks, the government has manifestly failed to prioritize resources. As a consequence, money that should have been put aside for the 'little guys', to give them extra time to get back on their feet, has been squandered.

Sadly, we are likely to see this wastefulness manifest itself not only in extremely low levels of business and consumer confidence going forward, but in the shape of long unemployment queues.

The Labour government – and its National counterpart – has also been playing at politics in recent weeks, at a time when we simply can't afford it. National has been remiss in pushing for the wage subsidy scheme to encompass its traditional supporters, big business, whilst the government has courted a variety of groups by offering them extra money. At a time when the allocation of resources is so crucial, and when there was no pressing economic need for these handouts, these steps make no sense, except – in this election year – at a political level. If we are

to get through this crisis, and find the quickest road to recovery, then all parties need to show the maturity to step above such empty politicking.

In the end, we only have finite resources at our disposal, to help us on the road to recovery. We need to spend those resources effectively, without recourse to politicking, and in a fair and targeted way that ensures those who are most in need are benefited.

Equally important, any short term spending undertaken – especially on the scale required to boost the economy – should, as much as possible, also make sense in the longer term, as an integral component of a wider program of economic and social reform which addresses institutional frailties that were inherent in New Zealand prior to Covid-19, and which delivers lasting benefits for every New Zealander, not simply a privileged few.

Building for the Future

Any builder knows that you can't simply cobble materials together and expect a building to stand, strong and true. If you don't first have a plan to work from, and if you fail to follow that plan, including setting solid foundations first, then whatever you construct will collapse, sooner, rather than later.

To date, there has been little sense that the government has a cohesive economic plan to take us forward, either in terms of building the solid foundations required to help navigate our way out of the crisis (the short term response), or in terms of preparing the policies that will help New Zealand not simply recover, but stand stronger than ever (the medium to long term response).

A blueprint is required, and it begins with a clear understanding of the kind of New Zealand we all want in the future.

For the purposes of this paper, the authors have set forth a list of objectives for reform. Ultimately, every policy instituted in the wake of Covid-19 should have at least one of these objectives at its heart. They include a New Zealand where:

- Everyone is treated fairly.
- Privilege no longer exists.
- Inequality is ended.
- Everyone enjoys a reasonable standard of living.
- Quality, timely healthcare is available to all.
- Every child has access to a first-rate education.
- A job exists for everyone who wants to work.
- Our social welfare system protects and assists those who require support.
- Every New Zealander has the opportunity to enjoy a comfortable retirement, with sufficient capital to earn a substantial income, no matter what their jobs have been in their working lives
- All Kiwis have the ability to own a home, if they want one.

- Everyone not only enjoys wide-ranging opportunities for self-fulfillment, they are part of a caring society that neither judges nor denies on the basis of gender, race, religion, or sexual orientation.

These may seem lofty goals, but they are achievable. The remainder of this paper examines how we can lay the foundations for a stronger New Zealand - by prioritizing resources and eliminating waste – and navigate a way out of the crisis together.

What Needs to be Done Now

It is no exaggeration to say that the decisions the government takes in the next 2 to 3 months will have a profound impact on New Zealand's future. If it spends the money available to it wisely, if it allocates resources with a clear sense of prioritization and within an appropriate framework, and if it invests properly in New Zealand's greatest asset – its people - then our younger generations can still enjoy the kind of prosperity that many Kiwis – until so recently – have taken for granted.

On the other hand, if, as seems likely, it reverts to instinct, and implements inward-looking statist policies which have rarely worked historically and which have no place in a modern economy (and which will be of little to no assistance to the people who most need our help now), then we will find ourselves saddled not only with a moribund economy, but a society where the lines dividing the privileged few and the put-upon majority are more entrenched than ever. Just as bad, younger generations will be left to navigate what will be, at best, a slow and painful path to recovery.

What, then, needs to be done now? In the opinion of the authors, the government should prioritize its strategy in the following areas:

- Workers and families
- Small business
- Infrastructure (which includes resisting a traditional statist response, whereby large new infrastructure projects become the cornerstone of government and economic policy)

1. Workers and Families

Right now, the protection of individual New Zealanders and their families must be the government's number one priority. Through no fault of their own – and as a direct consequence of the pandemic - hundreds of thousands of Kiwis have suddenly found themselves without work, including those who have previously enjoyed stable employment in industries as diverse as processing, packaging, construction and retail. Others have been hit even harder, with some industries threatened with extinction almost overnight, including sectors of the all-important tourism industry. A lot of money will be required to help these workers get back on their feet and restore confidence.

Whilst the government's Wage Subsidy Scheme has been of some assistance, the criticisms levelled against it remain – namely that it has been overly generous towards big business and the

professional elite, and that significant resources have been wasted as a result. Further, the way the scheme has been constructed, with money going to employers, rather than directly into the hands of workers, has left it open to abuse, raising questions about how much money, either directly or indirectly, has found its way into the back pocket of big business.

It is also a matter of conjecture as to how many of those currently on the wage subsidy will still have a job, once the scheme runs its course. We can only hope that the number of newly unemployed will be few, but hope is a tenuous commodity and – sadly – it rarely gets the better of actuality. Already, the number of those requesting the job seeker benefit has risen alarmingly and we can expect these numbers to increase in the coming months. Whether that number hits 25% or more of the workforce, as some models indicate, or whether – optimistically - the number settles in the low teens, one thing is certain: a large number of Kiwis are going to find themselves unemployed.

If that is not distressing enough in itself, it comes with the corollary that for many, the current job seeker benefit is likely to prove insufficient. This is especially true, of course, for those with families, who will need to cover their day to day living expenses as well as try to meet mortgage or rent payments, school and family expenses, and other, unexpected costs, including sickness.

For those who find themselves in such a position, it is suggested that the best way forward is for the government to assist them directly, rather than second-hand, through their employers.

The mechanism for such support would be a special risk account, tailored to meet the specific needs of individuals and their families (if they have one). It would operate as follows:

- Step One: A company or employer makes it clear in writing that they cannot support an employee during the crisis or in its immediate aftermath.
- Step Two: The employee is either made redundant, or temporarily under-employed/unemployed, with the expectation that they will be re-employed once the crisis has passed and the business – inasmuch as it is possible - resumes its normal footing.
- Step Three: A special risk account is set up and documentation downloaded into that account for the employee to fill out. This documentation will help him/her identify any special support they require, including meeting mortgage or rent payments, as well as family, sickness, or any other (pre-qualified) payments.
- Step Four: Government provides payment (for a prescribed term and up to a specified limit) directly into the special risk account. If the account holder is already receiving unemployment support, which will be the case in many instances, then this payment will top up that support.

By tailoring assistance to individual workers, the government can ensure that the support it provides meets specific needs, in a way that poorly targeted helicopter payments, subsidies provided to businesses, or even broad based tax cuts (such as a moratorium on GST) cannot. Not only that, such support also provides workers with a measure of respect, as well as a sense of autonomy and self-responsibility, that can only help to engender confidence, both at an individual and societal level.

2. Small Business

Small businesses are the lifeblood of New Zealand's economy. Sadly, not all of them are going to survive the health imperatives of the Covid-19 outbreak, which saw their closure. It is important, however, that as much as can be done, is done, to help viable businesses recover. In the short term at least, this will require other interested parties to step up, including banks and landlords, proffering help to small business owners by sharing their burden.

It will also require clear strategies on the part of the government, including a firm commitment to financially support small business, as well as providing expert advice where it is needed. Above all else, the government needs to demonstrate that it both understands the situation small business owners find themselves in and that it has their back. To date, largely the opposite has been the case. MP Deborah Russell's declaration that small businesses should be considered at fault if they lacked the resources to negotiate the lockdown, and the assertion of the Minister of Employment - Willy Jackson - that an extra week of lockdown would make no difference to businesses, indicates that many inside government are out of touch with reality. Unless the Labour caucus quickly emerges from its ivory tower, and get to grips with the crisis facing small business, this vital segment of New Zealand's economy and society faces years of pain.

What then, can be done to help small business? It begins, first and foremost, with the support of landlords and banks. For many small businesses, a sizeable percentage of their fixed costs comes in the form of items like rent. If consideration is not given to these costs, and how they can be reduced or allayed in the short term, then many businesses simply will not survive.

In such an environment, the hard-nosed approach adopted by some landlords is short-sighted. If a small business owner cannot meet the costs of a lease, and is forced to relinquish his/her business, then the property is likely to sit empty, with little prospect that it will be leased again in the short term. Much better – and more realistic - is the approach taken by groups like Westfield, who have signaled their intent to drop rents in their malls.

This is not to overlook the commitments many landlords have themselves, particularly in terms of mortgage payments. Here, the banks have an important role to play, coming to the party by negotiating adjustments to mortgage payments that reflect the new economic realities of life, post-Covid.

If small businesses, landlords and banks work together, rather than stubbornly holding to their own piece of turf, then the final outcome will be better for them, and for the New Zealand economy overall.

Of course, simply reducing rents, or even imposing a 'rent holiday' for a couple of months, will not be enough to save many businesses. It is here that the government has a role to play, supporting viable businesses in the form of forgivable loans.

The following, four-step strategy, is suggested as a way of supporting small businesses in trouble:

- If a business is unable to meet the costs required to open its doors again, or faces short-term difficulties, it will be required to meet with a business consultant, accountant, or government appointed consultant.
- As part of the consultation, it will be determined whether or not the business has a viable future. If a path forward can be found, then a business plan will be created.
- In the first instance, this plan will form part of any conversation that takes place between the business owner and his landlord, as a means of setting new, realistic rent payments that will help keep the business afloat. If necessary (and in the manner outlined above), the landlord's bank should also be party to this conversation.
- Should rent mitigation not be enough, the business owner can also approach the government for a forgivable loan. An assessment will be made at this point about the viability of the business plan, and – if successful – a tailored loan will be provided to help the business recover.

It should be noted that the intent of this plan is not to provide loans to companies that have access to plenty of liquidity and other sources of capital. Rather, given the large sums that will inevitably be involved, the plan is for the benefit of those businesses that have been unduly affected by the lockdown and which need our support in the short-term.

With proper focus and prioritization, the necessary funds can be made available to save many small businesses and hasten the recovery of the New Zealand economy.

3. Infrastructure

For a number of reasons, extensive new infrastructure projects are not the panacea members of the government, and some economists, believe them to be. Whilst this does not mean that projects already in the pipeline should immediately be put on hold, the government needs to ensure that it does not waste finite resources on big projects, at a time when those resources must be prioritized elsewhere.

Put simply, large scale infrastructure projects are not only expensive, they take a long time to plan and implement; time we simply don't have right now.

Furthermore, there is the not inconsiderable matter of where we will find the workers for such projects. Even before Covid-19 hit, New Zealand was short of the labor required to undertake large scale construction. Unemployment was at a low 4% and migrant workers were being increasingly relied upon to fill the gap. However, in the foreseeable future, immigration will drop to a trickle. The government might expect the newly unemployed to take up the reins, but if it does, then it has fundamentally misunderstood the nature of the crisis we all face.

This is not a crisis affecting unskilled workers who are often the first to be laid off during a downturn and who can be offered jobs in new construction projects. Rather, this is a crisis which

afflicts the shopkeepers, the florists, and the chefs – skilled workers who wish simply to be afforded the chance to return to what they once did. Quite understandably, they will have little inclination to retool and build a highway, and they should not be expected to.

If the government is to institute a big infrastructure push, then housing is perhaps the one area where this makes sense. It is an industry that employs a large number of people, and new housing stock can help resolve a long-standing social and economic problem confronted by many New Zealanders – the inability to afford their own home.

To repeat (and putting housing to one side), now is not the time for new infrastructure projects. A new, improved highway between Christchurch and Dunedin, or a fast-train link between Hamilton and Auckland, is of no immediate benefit to the café owner in Whangarei, the florist in Kerikeri, or the pet shop owner in Blenheim, whose very livelihoods are threatened. They – and the people they employ – instead need real, generous, and targeted government assistance to help them get back on their feet and keep them in work.

Where Will the Money Come From?

It goes without saying that recovering from Covid-19 will be expensive. Even with the savings identified below, we will need to borrow extensively.

What we want to avoid, though, is saddling our younger generations with a debt so large, that it impinges upon their prosperity, and quality of life, for decades to come. That is why we require a clear framework for recovery, and why we must both prioritize and target spending, so that it reaches those most in need, rather than being spread more generally (à la helicopter payments), and falling into the pockets of those who are able to care for themselves.

It is also why we must look to eliminate privilege and waste, both of which have been part of New Zealand's economy for too long. In total, there are \$15-16 billion dollars of savings we might make per annum, simply by removing unnecessary government spending:

1. **Ending Waste:** By removing Kiwi Saver tax breaks and subsidies, by ending future government contributions to the New Zealand Super Fund, by retargeting income derived from those funds, and by reducing the excessive Votes available to government departments, we can quickly access approximately \$9 billion per annum (n.b. in their next paper, the authors will discuss how government contributions to the Super Fund can be replaced by individual savings accounts which will provide working New Zealanders with \$1 million plus - in today's dollars - upon retirement).
2. **Eliminating Privilege:** Unnecessary privilege is entrenched in New Zealand society. By ending corporate grants and tax breaks, by stopping the Provincial Fund, by removing high income families (approximately 15% of the population) from access to Working for Families and Winter Energy subsidies, and by ending tertiary education grants for students other than those from low capital and low income families, we can make further savings around \$7 billion per annum.

In the end, these annual savings will not be enough to cover the cost of revitalizing New Zealand's economy, post-Covid. In the short term, however, they can make a significant contribution towards managing the recovery, ensuring that money is available for those who most need it, and mitigating – at least to a degree – the debt we impose upon our younger generations. In the medium to long term, they can be used to fulfill the objectives outlined earlier in the paper, helping to not only create a fair and prosperous New Zealand, but one much better placed to handle a crisis like Covid-19 in the future.

Building a Better Future

For now, our focus must be on finding a way out of the devastation caused by Covid-19, minimizing its social and economic impact. With a clear policy framework in place, and with resources properly allocated to those who most need them, this can be successfully managed.

However, putting Covid-19 behind us does not guarantee future prosperity. For most of this century - and despite the protestations of successive Prime Ministers - the New Zealand economy has been going backwards, the gap between it and the rest of the advanced world widening in the three major cornerstones of social wellbeing: health, education, and welfare.

Shockingly, across these areas, we are spending, in real terms, roughly three times more per person than we did in 1972, to the point where 71 cents in every dollar spent directly by the government in 2019 was required to fund them. Despite this, we have not experienced any improvements in productivity; in fact, we have experienced a decline.

In addition, we have an aging population (which, going forward, will place a massive burden on our health and benefits systems); house prices that are amongst the highest in the world (especially when measured against income); and labour productivity that is 40% below the top half of the OECD.

By virtually every measure, we lag behind the rest of the developed world, badly placed to confront the challenges of maintaining a stable, prosperous society in a challenging new global environment.

To meet this challenge, we must be brave. We must, first and foremost, accept that the old way of doing things no longer makes sense in a modern economy. In New Zealand, the government has traditionally been, and remains, by far the dominant supplier of social welfare services, including health and education. Contestability is minimal. This needs to change.

In an upcoming paper, the authors will examine in more detail what has gone wrong, why we should immediately set up working committees (SOE style) to make recommendations for the future, how we can free up an extra \$20 billion via vastly improved productivity outcomes thanks to structural social welfare reform, and how we can use that money (along with the \$15 billion previously freed up thanks to the elimination of waste and privilege) to institute innovative policies in areas as diverse as health, housing, education, welfare, personal tax, company tax, and superannuation.

Ultimately, we have a choice. We can either muddle through as we are - relying on policies that haven't worked since the 1950s and which are ill-suited to our quickly changing world – or we can opt for a reset, introducing social and economic policies that will make New Zealand not only a richer but more equitable place to live; a country where every New Zealander has the chance to take control of their lives and secure a better future for themselves and their families.