# A FAIR ECONOMIC FUTURE?

## IMPACTS OF COVID-19

Alan Bollard

Expert commentary

**TE TAPEKE**

FAIR FUTURES IN AOTEAROA

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**TE TAPEKE** FAIR FUTURES

Royal Society Te Apārangi has convened a multidisciplinary panel of leading experts* to examine issues of equality, equity, and fairness in Aotearoa.

The panel's name, **Te Tapeke**, comes from 'ka tapeke katoa te iwi'† and conveys valuing and including all people. This expert commentary expresses the view of the author.


## Dr Alan Bollard

**Te Tapeke Fair Futures Panel**


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* royalsociety.org.nz/fair-futures † Joshua 4:11–13. 'Including all people, without exception'.



# A FAIR ECONOMIC FUTURE?

## IMPACTS OF COVID-19


Alan Bollard


The Covid-19 pandemic currently sweeping the world is, in some ways, the biggest shock of a generation in New Zealand. It has been unexpected, severe, and globally synchronised. This highly contagious virus is affecting most countries, and has resulted in lockdowns and government stimulus of economies.

After a year, it is still not possible to be definitive about the epidemiological future of the virus, and the eventual impact of improved tracking, diagnosis, treatment, and vaccination. For the purpose of this analysis, it is assumed that the pandemic will continue for several years, gradually being contained though not eradicated. On that assumption, it is hard not to foresee an economic future, for the world and New Zealand, in which people are significantly worse off.

In addition, this big shock is having severe distributional effects – separate groups in the population are being affected differently, sometimes in complex ways, raising issues of equity and fairness. Some of these effects now seem inevitable, while others depend on future New Zealand and international policy choices. This paper describes these possible effects.

### CURRENT ECONOMIC IMPACT

There is not yet agreement about how to analyse the economic effects of the pandemic. The Spanish flu pandemic (1918–20) might be the most obvious comparator, but economic policy today operates very differently. So far, there has been a huge, synchronised decline in economic output: the Organisation for Economic Co-operation and Development (OECD) has forecast an average 4.2% reduction in 2020 world Gross Domestic Product (GDP)[1]. This is the first time most countries in the world have been in recession at the same time, and economists have been comparing this with the first year of the Great Depression (1929–39). In any event, 2020 was not a good time for a pandemic crisis, with a build-up of debt in some countries, declining trade-driven growth, rising economic tensions between the United States and China, and urgent demands for climate-change mitigation.

New Zealand responded to the pandemic with urgent lockdowns – stringent by OECD standards – and was subsequently rewarded with very low levels of infection, though not complete eradication. The tight lockdown has caused significant economic damage, though this has been cushioned by the fast delivery of job and business support by the government. The 2020 budget provided for a $50 billion fund for spending on Covid-19 relief, including job support, business continuity, and infrastructure investment.

By historical standards, this is a huge intervention, representing a 30% increase in government spending and an 8% stimulus to the economy, with the government budget surplus forecast to move towards a significant deficit. Monetary policy has been very accommodating, with near-zero interest rates, a bold programme to increase money supply in the economy, funds for bank lending, and a commitment to keep the banking system financially sound and operating. The extra government spending has meant that public debt will more than double in two years, and there will need to be significant borrowing in what will be a pressured international funding market.

## FORECASTING THE ECONOMIC FUTURE

The size of the Covid-19 shock has been so large it has made some economic data difficult to interpret. Second- and third-quarter data for 2020 have been too extreme to fit conventional forecasting models, unemployed numbers have been cushioned by temporary government policies, and real-time data have often been unreliable. While the New Zealand economy appears to have recovered from lockdown faster than expected, the median forecasts for the New Zealand economy show a very difficult 2021 starting point, and a forward path that loses several years of expected growth. Such unappealing forecasts are now typical among many OECD countries.

It is also unclear how policy will revert to normality, as current settings are unsustainable. There is already managed termination of some government support programmes, such as wage subsidies. Apart from the social and political challenges involved, the government will need to find ways to reduce its debt in future years, especially if interest rates and debt-servicing costs increase. The Reserve Bank will also need to return to more normal monetary policy settings and reduce its very large balance sheet. The Covid-19 stimulus has been huge and unprecedented. The return to more normal conditions will be difficult, and it will hurt.

## MAPPING THE DISTRIBUTIONAL EFFECTS

Covid-19 is having broad (mainly negative) economic and social effects: it worsens health outcomes, is hugely costly, and reduces economic activity, which is bad news for many in New Zealand. However, these burdens are being felt in complex ways – some of them are unavoidable, while others can be mitigated by policy decisions.

### 1. Health impacts

The health burden is falling on two groups. The first is those who are health-compromised or elderly; they are suffering most risk of contracting the disease. These people are reducing the probability of becoming infected by taking precautions, but this has limited their mobility and opportunities to socialise. The long-term physical and mental health effects of contracting Covid-19 are still being assessed and could be very significant.

The second group is health professionals, quarantine staff, and other essential service workers, who face difficult working conditions and increased risks of infection. As a result of New Zealanders' 2020 experiences, public health and border protection budgets will be increasing, and taxpayers will have to absorb that extra burden.

There has been significant research on the trade-off between economic costs and health benefits. A common finding (eg, Lally) is that governments are spending significantly more on Covid-19 than on other urgent health risks that could achieve a similar level of quality-adjusted life-years saved. Given the population's feelings of high uncertainty and worry, this may not be the wrong approach, but it does mean that Covid-19 policies are potentially crowding out higher-priority health spending.

### 2. Government financial impacts

To date, the extra government costs of Covid-19 are about $50 billion. The indirect impacts on health, households, and social cohesion could be very much higher, but these costs are difficult to estimate. This huge public bill has come at a time when tax revenue looks fragile because of reduced spending by households and businesses, falling government revenue owing to lower economic activity, and calls from local government and not-for-profit organisations for the government to take on extra liabilities.

[1] GDP is the monetary value of the goods and services produced within a country during a specific period of time, normally a year.

The government needs to borrow some of the difference between its extra spending and reduced revenue, resulting in a big increase in public debt for New Zealand taxpayers. New Zealand's public debt as a percentage of GDP is forecast to grow to over 50%. When interest rates rise, significantly higher debt-servicing costs will add further to the overall debt burden. Due to the low public-debt levels prior to the crisis, this looks to be fundable in global financial markets, provided the latter are not too badly squeezed by the bigger funding demands of other countries.

Following the global financial crisis of 2007 to 2008, there was little public support for austerity policies, such as increasing taxes and reducing benefits. However, countries will be forced to address their Covid-19 debt and rebalance their accounts, and the options are limited. Previous debt shocks like World War II (1939–45), the OPEC[2] crises of 1973 and 1979, and the more-recent global financial crisis have been rebalanced in a number of unappealing ways: governments cut services, tax rates were increased, special charges were levied, and/or inflation reduced the real debt at the cost of private savings (see Bollard, 2019). Economists have learned from these experiences that the choices made by governments about spending and tax in response to crises can make a big difference to how effective and relatively painless rebalancing the government's finances can be. The most optimistic approach is to reduce the debt burden by growing GDP. This is also the approach most likely to minimise unintended impacts on fairness and equity that might arise from the government's policy choices. However, this will only be possible if growth rates are higher than real interest rates (ie, the extra tax revenue outweighs the extra debt servicing, given certain assumptions).

The government's choices about rebalancing its accounts will therefore mostly affect people who receive social services (primarily the vulnerable, the young, and the elderly), the payers of tax (primarily middle-income earners), and savers (primarily older groups). Provided financial markets remain functional, there is some choice as to whether rebalancing should be done faster, at the risk of upsetting economic recovery, or slower, meaning that future generations will end up paying for this generation's pandemic. The experience of the global financial crisis shows that this trade-off may generate intense debate.

## 3. Broader economic impacts

The full costs of Covid-19 are much broader than the government financial costs. Based on an assessment of future economic growth lost as a result of Covid-19, the full economic costs from disrupted activity and lower growth could be a multiple higher. These costs fall unequally across age groups, employment status, and business sectors, and highlight and exacerbate existing issues of fairness and inequality.

[2] Organization of the Petroleum Exporting Countries.

### Age groups

Young people have been particularly affected by Covid-19 because of disruptions to school and tertiary education and training. The 2020 to 2021 cohort of new jobseekers has been especially hard hit, and already some are having to divert to further education or training because of a lack of job opportunities. Overseas work and travel prospects have evaporated.

Middle-aged people may have been hit by pandemic-related risks to their jobs and their businesses, although much of this is yet to play out. Surprisingly, some people's financial situations have not been impacted because house values have remained high or risen, while mortgage repayments have stayed low.

Older people have been affected by pressures on health and mobility. Some have also been hit by reduced returns from fixed-income savings, though for that relatively limited proportion with share investments, values have stayed surprisingly high. The prospect of a vaccine will bring new tensions if, for example, older people (who are more at risk from the virus) are prioritised for vaccination and consequently able to travel internationally, while younger people have to wait.

These added intergenerational tensions are coming at a time when climate change and ageing population pressures are creating a significant age-related divide in New Zealand (see Workman, 2020).

### Employment status

The most direct impact on welfare and equity is via the job market. Within households, the economic impact of Covid-19 has mainly depended on employment status – some marginalised, low skill, and casual jobs have been affected and that could worsen. That means impacts are more likely to be felt by Māori and Pacific peoples in the labour force, and also by some migrant groups. This may accelerate the labour-market divide between low-skilled workers and those with sought-after skills such as information technology and advanced construction, which have traditionally been supplied by skilled migrants.

Recent labour-market data point to a reduction in the proportion of the working age population employed or actively seeking employment, and an increase in discouraged jobseekers. This impact has so far mainly been borne by women and those nearer retirement age. In the past, recessions have hit manufacturing and therefore male workers more heavily. This time is different – it is a service-industry recession (eg, hospitality and travel) and that affects female workers more acutely. (This gender effect is slightly offset by the concentration of women in the public sector where job losses have so far been much less.)

### House-owning status

As lockdown restrictions have eased, New Zealanders have responded by spending significantly more on homes and personal services, partly paid for by savings on planned international travel. Together with very low mortgage rates, and demand for homes from returning New Zealanders, this has led to much activity in the housing market and big increases in (already high) house prices. Houses and property are by far New Zealanders' dominant form of savings and wealth, and this price surge is consequently increasing the wealth gap between home owners and renters.

### Business sectors

Covid-19 has affected different business sectors in quite different ways. Many personal services, such as hairdressing, lost several months' revenue during lockdown, but their future has not been threatened. By contrast, the hospitality and travel industries have been badly hit. Other conventional activities which have for some time been at risk of digital disruption are now closing. Examples are some traditional retail activities in malls and high streets (eg, clothing shops). Long-term patterns of change are still unclear but there will likely be an ongoing contraction in traditional retailing, in some office activities, and in commercial property – in some cases a slow burn because of long-term leases. Other businesses, such as those in the construction sector, have become more expensive to run or less productive because of Covid-19 restrictions. Businesses have been less inclined to borrow money for investment and expansion. An important question will be whether the financial sector rides out the recession, or whether the level of non-performing loans to businesses and consumers becomes problematic and leads to more severe disruption to the economy.

It has not all been bad news for business; there are some major expansions underway in technology sectors, and due to strong commodity prices, eg, in dairy, meat, forestry, and horticulture, the natural resources sector has remained reasonably buoyant (though affected by a shortage of seasonal labour), while some domestic tourism has boomed.

Reduced overall employment opportunities in the future mean there will likely be an increase in self-employment and new start-ups aided by new technology (albeit sometimes earning low returns).

## 4. Some broader social and political impacts

Of course, the effects of Covid-19 will run widely through the community in ways that cannot be measured in GDP; many other aspects of wellbeing are at risk (eg, see Prickett et al, 2020). Many households are bearing more social costs, such as childcare and education (although there have been some savings from reduced commuting). The corollary of this is that opportunities to travel and socialise have diminished, which has consequences for wellbeing.

Covid-19 has focused attention on border control. There has been a flood of overseas New Zealanders returning to a safe haven, and this has prompted some challenging questions about what is fair. Many of these returnees have been raised at New Zealand taxpayer expense, yet have not themselves been taxpayers in this country, while their relocation is mainly being funded by New Zealand-resident taxpayers. This is leading to tensions between onshore and offshore citizens, and there will be political consequences.

Finally, Covid-19 has also focused attention on the increasing problems of climate change. The lockdown experience has demonstrated the temporary benefits of reduced economic activity on carbon emissions and other pollution – eg, from less travel and reduced manufacturing output. Arguably, this has increased concerns about climate change. However, Covid-19 has left the country poorer and therefore less able to afford the cost of mitigation strategies, and this will have environmental consequences.

[3] **Comparative static** is the comparison of different economic outcomes before and after an externally imposed change, such as Covid-19. It does not account for the process of adjustment.

## CONCLUSION

It is apparent that the distributional consequences of Covid-19 will be major, complicated, not always clearly determined, and often unfair. As a generalisation, those with compromised health are most affected by the disease, and those with compromised employment positions are most affected by the 'cure' – the measures taken to address the pandemic's economic impacts. But there are many complex impacts within different groups defined by age, household, labour force, ethnicity, gender, and business sector.

Some qualifications should be made: this analysis has focused on the incremental effects of Covid-19, not on underlying issues of equality or fairness. The framework used is comparative static[3], but there are also complex dynamic effects arising from distortions in the economy (eg, the inability to travel has impacts on business efficiency and consumer welfare). There will be longer-term behavioural adjustments, such as working from home, the effects of which we cannot yet gauge. And finally, some of the economic impacts may unleash other intergenerational, social, cultural, political, or environmental stresses that may further affect New Zealanders.

There will be some trade-offs and tensions ahead.

Alan Bollard

## SUMMARY OF COVID-19 IMPACTS

| Health impacts | Fiscal impacts | Impact by age | Impact by employment |
|---|---|---|---|
| Elderly & health-compromised | Increased public spending | **Young** – education, jobs, & housing pressures | Marginalised workers |
| Health workers & essential services | Big increase in debt | **Middle aged** – jobs and businesses risks | Māori and Pacific peoples |
| Crowding-out of other health priorities | Potential reduction in social services | **Older** – health, savings, and mobility | Women in the service industry |
| | Tax pressures ahead | | Discouraged jobseekers |
| | | | Divided labour market |
| | | | Failing businesses |

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