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"Lessons from the pandemic: Fairer financial assistance for business"

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Bruce Chapman Let me begin by acknowledging the Ngunnawal and Ngambri people, the traditional custodians of the land of which this conference is being held. I acknowledge the elders past, present and emerging.

I also share in the sadness, I think the profound sadness which will eventually have the melancholy associated with what happened on October the 14th.

I'm going to talk something quite different, which is that I want to take it back to the pandemic and a particular program that was kind through the pandemic. I think it was a program that in some respects was extremely important. And I doubt whether there's anybody who knows much about macroeconomics, who did not believe that the government needed to spend a lot of money at that time in ways that we had never thought of before.

We never had a recession which was caused by legislation. This is a legislation recession because of health reasons. And so in some respects, the outlays is not my issue. It is the fact that we used job keeping, which was a huge program, the biggest wage subsidy scheme in the entire history of the world that came about. And I've got no problems with that motivation for doing something about what could have been a tragic result in recessionary terms.

What I do have problems with is that it could have been turned into something that would have had the same effects, basically in terms of the mitigating the prospects of a recession that cost so much money and I think costs the money and the sums of money were extraordinary. And I'll share them with you in a moment.

We're talking $89 billion. And at the time, I was disappointed with the nature of the debate. Several of us in the academic community have been talking about outlays in different areas of what I'll call contingent debt. And I'll talk a little bit about that. We could have had this contingent debt approach to job keeper, which would have made the current budget circumstances roughly in the order of $80 billion more healthy than they currently are. So. Oh, I do want to acknowledge my day, my dear friend and colleague Richard Dennis, for asking me to turn up. Richard knows his stuff real well. In fact, he could give this talk because he's been involved with me and many and I've been involved in such a lucky research.

Really. I've been involved with some of the best people. In the country, in the world on the contingent issues. And I feel very blessed and grateful that I can share some of this research experience with you today. What was job keeper? Job Keeper was the government outlay response delivered to business in response to the lockdowns of 2020 2021. There were direct payments to firms.

They started on the 30th of March 2020. The 30th of March is a very important date in the discussion of this debate because it was actually introduced after there was information available about the prospects of turning this from a grant into a revenue contingent loan. And I'll explain more about that in a little while. So the direct payments to firms that started at the end of March. Quite a large sum of money. We're talking here $71 billion, not as big as the stage three tax cuts, but certainly extremely substantial. As I say, the biggest wage subsidy scheme that ever been seen anywhere. It was originally due to end on the 27th of September on 2020, but job cover 2.0 was introduced, which is an extension. It was much more parsimonious. And wage subsidy scheme. The amounts of money were much smaller. It went for a much shorter period of time. There were the total grants 89 billion. That was about a third or more of the increase in the total Commonwealth Government debt at that period, 2020-22.

And to give you a longer term context, that 89 billion, if you took that off the current total government debt of the Commonwealth, it would be about 10% and so we're talking the total government debt to the Commonwealth is around 900 billion. It would have been closer to 800 billion if the system in my view had been designed differently. These are some of the beneficiaries of the job creator grants. The biggest beneficiary was a company which quite recently had some attention, not necessarily attention of massive affection. And Qantas gave aid and gave were given 856 million. I've also put in parentheses the amount that they gave back and you'll see in this top ten, they're not too many notes. This I don't blame these companies particularly.

I mean, I wish they were nice people, but it's not their job to redistribute. They follow the rules. And the rules were designed by government. If there had been a requirement to repay and that's essentially what my talk is about, all of those notes would not have been notes. Next to Qantas, we would not have an figure nought next to 856 million. We would have the number 856 million now. So we go down.

You may know some of these companies, you may or may not know some of these companies. There's a sums of money. I want you, there is an organisation that you might know that you might have heard about. It's called the Australia Institute, and I asked Richard Dennis about his views about job keep and he simply Australia Institute did get a job. CAPA And then he volunteered extremely quickly that the instead of the number not being next to what they got, which was 440,000, there is a number 440,000. This organisation was one of the six that paid back in full. You might be.

You might be intrigued as to why the font size of the Australian Institute is so low, and it's really a reflection of my view of Richard. He's he's he's such a wilting wallflower. You know, when I think of Richard, I think of the word understated. And so it would have been inappropriate to share the font with Qantas, not just because of the Australia Institute's modesty, but because they operated so completely differently to about 98% of the other organisations that benefit from John Oliver. I now want to talk about loans. This is the way I think it could have gone. And there will be one type of loan you'll be familiar with because it's time based and it's the kind of loan that if you've got a mortgage, you will have a loan just like this. It's a loan which the repayments are set in nominal terms for a mortgage every month for, say, 30 years. It doesn't matter what your financial circumstances are, you have to pay. If you're unemployed, you have to pay, and that's a problem.

These are loans for borrowers which are associated with quite important risks. And there is an alternative type of loan called an income contingent loan. And it's based not on repayment, depending on time, but depending on financial capacity in the future to repay. The most obvious example of an income contingent line is Hicks. And Hicks started in 1989. It was the only student loan at the time that was capacity based on financial capacity to pay.

That is income contingent, but other countries have since adopted that. I think that sometimes people can pay Hicks inadvertently, I hope, but without enough information with other student loan systems around the world. Income contingent loans. The most important single word associated with an income contingent loan is the word insurance. It's insurance for borrowers. If you've got a debt and you don't have a job or even part time work, you're looking after an infant and not working in the paid labour market. When you're looking after an aged care period, it does not matter. Your repayment obligation is zero. So the comparison with the United States, for example, which has roughly 13 or 14 million people who defaulted on their student loan because they did not have the capacity to pay. You cannot default on an income contingent loan because nobody actually cares about you not repaying the financial institution, in our case, the government, because they can get the money back when you can afford it.

So unlike a mortgage based loan, there is an insurance and it's against two particular potentials in borrowers life. One is repayment hardship. If you've got a debt and you've lost your job, you've got repayment hardship. In some cases, that repayment hardship can go on for a while. You might be lucky. It might have friends who can help you. Generally, banks would help you with that, but in the end you can default. And defaulting on a loan is one of the most serious things that you can ever happen in your life in financial terms. And that's why when the government introduced Job keeper, they also introduced a loan system. But it was one through the banks. The banks weren't all that keyed actually in providing the money, but the businesses weren't all that keen either in taking up the offer. 4.5%, only of the potential borrowing that was available was taken up.

And why is that? I think it's fairly obvious that we were in the most uncertain environment in living history with respect to business associated with a pandemic which we did not know anything about in terms of its financial longevity or what it means for business. The prospects for business, particularly small business of taking a loan, which meant foreclosure and bankruptcy was so big that even though there was an interest rate subsidy associated with those loans, just about nobody was interested. So let me tell you about. Whether or not a revenue contingent loan could have worked for job creator.

This idea of a revenue contingent loan while almost nobody apart from Richard and John Quiggin in the room probably understand it completely is is not pie in the sky. It wasn't airy fairy. I met Linda Bottle in 2001 and we were both complaining. Whinging is the right word and neither of us are English about the fact that the government at the time and for many, many years had been giving hundreds of millions of dollars to farmers when they were in drought and the Australian population kind of loved it. And when we have major droughts in this country, you'll have little boxes in the supermarket where I go save money for the farmers, for drought. This is a really unreasonable thing to do so long as you've got a financial bridge to protect farmers in a drought. Farmers over their lifetime are not poor people, the extremely asset rich in general.

But if you've got a problem, why would you give it in terms of a grant that doesn't get repaid when you could? With a bit of thought about the institutional arrangements and a bit of understanding about how accounting works designed what we thought originally would be a profit contingent loan. You're in drought, we'll give you the money, but when you profits recover, we want it back. That's fair. It's being funded, after all, by taxpayers, and the vast majority of taxpayers over their lifetime will be less advantaged financially than the recipients of those drought benefits. Profit won't work. And the reason we know this is, as other people have said today, you got to talk to people, particularly if you an academic, you don't really understand what the real world is at all. I mean, someone has an economic theory friend of mine, what's what is the real world? And he said, Oh, I don't know. I guess it's the of nominal world divided by the price level. And that's kind of what I'm like. So what am I going to do?

I say to Linda, How are you going to collect it? She said, You can't use HECS because it's designed for graduates. So the bottom threshold repayment of $50,000 is irrelevant. So we talk to Michael Egan and we talk to many other people who are rural accounts. Here's the trick Use revenue. Revenue is absolutely simple to collect. Every company in Australia, every quarter has to declare their revenue through the business activity statement. No depreciation, no shifting around various savings, no potential for gaming without breaking the law. And we talked also to Michael Egan about how farmers might be able to avoid this. There's all kinds of ways of avoiding this, he said.

Oh, that's easy. I spent my entire life showing farmers how to avoid paying tax. This will be easy. And he came up with 18 different ways and it was all covered basically in a promotion, a revenue contingent loan instead of drought relief. When when COVID turned up and the pandemic arrived on our door and the lockdowns and there was discussion about large government outlays, it did occur to several of us, and I'll name some of them Linda Botterill, Glenn Withers, Warwick McKibbin and and myself, Linda said, Somebody said, But we've never really done this for business. And to which Linda said, Yes, we have. That's what farmers are farmers.

But apart from the big corporates, farmers were essentially small business. So we had done it, we designed it for business, We never thought about it for business, but I needed help because the thing about a farm is that it's very hard to hide a farm. It's there, you can't bury it, you can't bottom of the harbour farm, basically. So I was blessed with friendship with John Niven, who's not here, but his mate, his colleague Paul Appleby from a CPA, is a registered tax agent. You might not think this is interesting, but Paul and I spent hours and hours on the phone talking about risk management and adverse selection and moral hazard, all to do with accounting principles. Now cancel, you know, my next dinner party. If you if people think that okay they don't coming because they don't want to hear about this. Paul basically explained how you can minimise the risks associated with a revenue contingent like the first and general concepts about repayment of contingent debt.

There are three things you've got to look after. Adverse selection. Do not give this to fly by night businesses. So make sure that if around for a while the moral hazard comes through bankruptcy. It used to be called bottom of the harbour. It's now called Phoenix. Make sure that if in the event of bankruptcy there are some mechanisms whereby you can get the money back. And Paul came up with things that already existed. For example, make sure that the debt is secured with collateral, with the government being a secured lender. And he suggested some personal liability which can be linked to the unique director identification number or the tax phone number. So it was going to be costly for a manager or somebody taking out these debts personally. Now, when it comes to the design issues, we wanted to make it as simple as possible.

And so the first simple thing was let's make eligibility exactly the same as shopkeeper, which we did. Let's talk about bankruptcy contingencies, which we did through Paul. And we got those three aspects which I think would his view would have decreased to a very, very tiny number, the extent to which bankruptcies would have been promoted through this system. You've got to limit the size of the debt.

So really small institutions like the Australia Institute would not get higher than 56 million, although you would have paid it back. It would have would have taking a little while, I guess. So we had to make a decision about the rate of interest and then we had to have it as a collection. What was the collection? All the time. We'd modelled drought relief in other areas. We used between two and 8%, we just put in five. And this is the illustration. This is modelling I did with John Piggott, who was also involved in all this, and I just wanted to use this a very simple example. Would you get the money back? How long would it take when we've designed the extension? It was too late then to not to have job creation, but we knew the extension was coming up.

Let's have an extension, which was the revenue contingent loan, which could have saved another -$20 billion or so. And so we cut the amount of money there to a thousand per fortnight. True, 1500 was only three months and we had a really low rate of repayment of 5% in our modelling for drought. You could get away with ten or 15 with that because. Any problems at all in our view. And these are the data that resulted from this. We had an forgiveness period for six months. Then we had the 5% rate. We put these companies, these institutions, through bad times. It was going to take at least one year to get back to 50% of pre-COVID revenue and then another six months to get back to three quarters. That's the data to share with you. The illustrative only his sorry.

Here's the basic point that with all of these just the low revenue firms, meaning that they only getting low debts and the median revenue and the high relief and the biggest point of all is the cumulative repayment, even at 5% of revenue, would get the total debt repaid by by two and a half years. If you doubled the rate, you could double the period, you could double the amounts and double the rate of repayment.

You're talking about maybe six years total to get all this money back. Let me ask you this question. Do people know about this? And the basic point is. A lot of people have been working on this publicly. And the most important bit of information here is not all the names and the dates, all of those publications which are all beds in the conversation, etc., that were all that in 2002 and well before extension two. And the paper with Warwick McKibbin came out before before job paper was announced.

If you read Michelle Grattan in the In The Age, she commented on a conversation that went on between Warwick McKibbin and the Prime Minister at the time at a private dinner on the 14th of March, of which Warwick is quoted as saying What you need are revenue contingent loans, so you don't ruin the budget for a very long period of time. That's not what we got. And I. I'm very sad about that. Concluding thoughts. I've got no doubt this would work. This is not boffins hanging around, you know, having a few drinks and saying what I think is a good idea here. This has worked out. We've done all the work with the small business associations. I talk to hundreds of small business people, a lot of tax people, a lot of tax agents. The revenue contingency came from a lot of work from my colleague and in the rural sector.

Then for a bit of fun, it's not that much fun because we can't get a lot of this now. $89 billion. What would you spend it on? I talked to the people that I spent a lot of time working with lately. David Lindenmayer I'm doing work with financing projects to help with the potential extinction recovery threatened species. He says 1.94 billion a year to get to remove all the potential for the ensuing extinction problems. I've been talking to and I've been working with his summers on domestic violence recently to restore the income. Support for single supporting parents would cost maximum 2 billion a year. Well, we've got 40 years of that 40 years of that restoration.

That's they go on with respect to with respect to job keeper Richard Denis told me, look at the household expenditure. I did. It's $9,600 per Australian household. You can do it. Awful lot of electrification for the soul. So Griffith and Senator Pocock's goals about rewiring Australia, it costs about $4,000 per household. You could have done half of that just with that. And while this is I don't want to be totally negative, I'm an economist, I'm supposed to be miserable and that horse has bolted. But there'll be our horses, there'll be other crises, and I'll be very, very pleased if governments might put this concept and these modelling into their back pocket for some other kind of similar crisis, because the costs of not doing so are massive. Thank you.