Who wants to be an economic policymaker in a crisis?

By **Dr Alan Bollard**
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As we all sit in home lockdown, spare a thought for Grant Robertson, Minister of Finance; Caralee McLiesh, secretary of Treasury; Adrian Orr, Reserve Bank governor; and their teams. They are very busy and very worried, though they cannot let this show. That is because the Covid-19 crisis is so severe, and it is so different from previous events.

Speaking personally, I thought I knew something about crisis management; when I was running NZ Treasury we endured the East Asian financial crisis and the 9/11 disasters. While I was Reserve Bank governor we had to cope with the global financial crisis and the Christchurch earthquake. But this crisis is bigger and this time it's different.

Ernest Hemingway memorably wrote that a financial disaster has two speeds: first, slow and then fast. This crisis started with a news report of a local epidemic in a distant Chinese city – but we had been through SARS, avian bird flu and swine flu in the region, and felt we knew something about containment and recovery. Now we realise Covid-19 is bigger, faster and we are still ignorant about how it will evolve. Making assumptions about socialisation rates, contagion rates, symptom timings, infection intensity, treatment rates and death rates has allowed us to simulate many scenarios. But the outcomes are hugely variable and they cannot be incorporated into normal economic forecasts. In fact, the Reserve Bank and Treasury forecasting models and forecasters' experiences are of limited use at the moment, and some official data becomes unreliable.

And that causes an unusual problem for knowing when and how to intervene. We are groping our way through Clausewitz's "fog of war." We want to keep our intervention options wide and open for long enough to get necessary information, but not too long to miss their impact. Some big decisions are having to be made before we have the evidence we would like to support them.

What sorts of policy tools are appropriate for Covid-19? We should know the answer to this in a year, or maybe longer, but we cannot wait. I recall the 1970s' OPEC crises, a supply-side shock that caused wide disruption; the 2001 9/11 terrorist events, a demand-side shock that devastated international travel; and the 2008 global financial crisis, a financial shock that paralysed northern hemisphere banking. But Covid-19 looks to be much more complex: a closedown of population movement, the end of demand for many services, most places of employment closed and the inevitability of financial contraction – that adds up to a simultaneous demand/supply/financial shock. We have not dealt with such a scenario since the 1930s depression and World War II.

So, this time, the economic approach is different and will need to focus on four stages:

- urgent maximum support for medical interventions;
- minimising the effects of the necessary economic contraction;
- supporting the recovery when the time comes; and
- dealing with the long-term consequences of the distortions.

Normally in a recession, cheap money is used to keep investment going and fiscal stimulus to keep demand flowing. Not this time. The Reserve Bank monetary interventions will be important for recovery but not for current investment. The government's social support may sustain households but cannot stimulate extra spending.

I am on several discussion chains of economists, and there is an intense focus on this crisis. Some are now looking for policies that could put the economy into hibernation, but hibernations have to be planned ahead. A better analogy might be "short-term induced coma" so that when the economy awakes, the minimum damage has been done with employee layoffs and firm bankruptcies, and it is ready to pick up activity. This relies on banks readily advancing commercial credit and governments readily providing employment support, but we have no prior experience of doing this.

And then there is the problem of recovery: how to stimulate new growth but somehow (maybe in two months but maybe in two years) turn off the support and avoid over-stimulation and bubbles? Then the sobering job far ahead will be how to deal with the world suffering economic distortions, interest rate rises and a huge increase in public sector debt from providing stimulus.

This is going to change the world's political economy; the US and Japan already suffer very high public debt. China is reassessing its problematic stock of US Treasury Bills. Private sector balance sheets are suffering asset deterioration and debt build-up. There will need to be exchange rate realignment. The US and others will reassess their supply chain exposures in China. Massive interventions such as the $US2 trillion US stimulus are going to cause massive hangovers.

In the meantime, Grant and Caralee and Adrian will be finding out who among their teams they can rely on during a crisis, and which ideas that are circulating to ignore. We are in an early stage of fear, but anger, criticism and accusations will soon follow, just as after the GFC. As then, many irritating pundits will claim they forecast the pandemic. For those directly involved, this will only add to the stress and worry they are already suffering; living off adrenaline soon hits your health.

Spare them a thought.