The Treasury

COVID-19 Information Release

April 2020

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[25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[29] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

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[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;

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MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

TE TAI ŌHANGA
THE TREASURY

Joint Report: An Intervention Strategy for Economic Policy Responses to COVID-19

Date:	Friday 6 March	**Report No:**	T2020/480
		File Number:	SH-1-6-1-3

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	**Direct** officials to prepare further detailed economic policy responses for Cabinet decisions **Refer** this report to Ministers on the CVD Cabinet committee, the Ministers of Social Development and Revenue, and any others at your discretion.	9 March 2020
Hon Phil Twyford **Minister of Economic Development**		

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Udayan Mukherjee	Senior Analyst, Transitions Regions and Economic Development, The Treasury	39 [redacted]	N/A (mob)	✓
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Bryan Chappl	Deputy Secretary, Macroeconomics & Growth, The Treasury			

Minister's Office actions (if required)

Return the signed report to Treasury.
Refer to Ministers on the CVD Cabinet committee, and others at the discretion of the Minister of Finance.

Note any feedback on the quality of the report	

Enclosure: No

Joint Report: An Intervention Strategy for Economic Policy Responses to COVID-19

Executive Summary

It is clear already that COVID-19 will have a substantial and prolonged impact on the New Zealand economy. The most up-to-date data internationally suggests that the quarantine measures taken, especially in China, are very disruptive to global economic activity, through interconnected demand and supply chain impacts and financial system channels. A more severe outbreak of COVID-19 in New Zealand (or Australia) would lead to significantly lower growth longer-term – including potentially a recession.

Officials and Ministers will not know with certainty how serious the situation will become in real-time. The Government has a range of economic policy tools available to alleviate the situation as it develops. Decisions on how to use these tools will need to balance the risks of moving too early and potentially spending or locking in money unnecessarily, or moving too late to support affected firms and individuals when they need it.

Further analysis and data will help, but there are no unambiguous 'trigger points' that would make these judgements obvious. Nevertheless, clear and frequent communication about the Government's assessments, plans and options will help maintain confidence and reduce uncertainty in the community, which will itself help to sustain economic activity more broadly.

Annex 1 provides a summary of the main economic policy options that officials recommend be further developed in preparation for Cabinet decisions, either soon or if the situation deteriorates further. This will allow further work to understand implementation requirements, so that Ministers will be able to make more informed choices as the situation develops.

The current expansionary fiscal stance, and the capital investment package announced in December are supporting the economy, as well as the automatic fiscal stabilisers – that is, a reduction in tax receipts and an increase in welfare payments. Supportive monetary policy and an exchange rate depreciation have also provided macroeconomic support.

Therefore, given current information, unless a major economic slowdown becomes more likely in New Zealand, we consider that implementing a range of targeted measures should be the priority. These should have the objective of supporting firms that face cash flow challenges and maintaining employees' attachment to the workforce.

This will involve some additional fiscal spending, that could also act to support confidence and demand more generally. The banking sector's role in supporting firms facing cash flow challenges is also critical. We understand banks have prepared hardship packages for customers and are expecting demand for these to increase.

For individuals, most support will come via the normal operation of the benefit system. At Cabinet's direction, officials are already working on options for redeploying forestry workers to other sectors. However, there is also merit in developing further options to increase training and re-deployment for affected workers particularly where an affected sector is facing other market challenges and it may be helpful to retrain workers for different sectors. It will also be important to develop options to provide support to vulnerable individuals and families through community wellbeing and income support packages.

We also recommend that officials develop options for temporary wage subsidies for workers – focusing on specifically affected regions and where loss of labour market attachment is a presenting risk. [redacted]

For businesses, there is some support currently available via Inland Revenue in of the form of relief from late filing and payment fees, and help to set up instalment plans to manage tax debt. [redacted]

It is also worth noting that Inland Revenue are due to make a significant system change over Easter and then immediately enter a peak demand period following the issuing of tax assessments to customers. Diverting administrative focus from that to setting up new interventions could have an impact on how well the changes are embedded, and the ability to manage customer demand. Because of that, and because wage support targets both firms and helps maintain workforce attachment, we recommend focussing initially on wage subsidies.

A simpler alternative, which would send a signal of support, would be to reduce the interest charged by Inland Revenue for tax debt. This rate is currently 8.35% and could be reduced. This would provide some support to struggling firms who are late with tax payments. Retaining some level of interest is useful to retain an incentive for healthy firms to make tax payments on time. This measure could be taken for all firms and would therefore not require complex eligibility calculations.

An additional way to support firms could be through a programme to provide working capital lending. The Treasury's Export Credit Office already provides services along these lines to some exporters, in partnership with banks. At the moment, it is small-scale and targeted at a very specific part of the market. As with [redacted], it would require work to develop this option for other firms, but we recommend Ministers direct us to do that.

Should the situation require a macroeconomic policy response, our advice is to calibrate the response to how the shock transmits through the economy. This will differ, depending on the extent to which further disruption is global or domestic. There is scope for a further fiscal policy response given the healthy fiscal position, but permanent policy changes in response to a severe but short-term disruption could create long-term fiscal sustainability challenges. As the situation is unfolding rapidly, the Treasury is developing macroeconomic policy options now so that an appropriate fiscal stimulus can be delivered if it is needed.

Recommended Action

We recommend that you:

a. **note** that COVID-19 will, most likely, have a substantial and prolonged impact on the New Zealand economy;

b. **note** that initial policy responses agreed by Cabinet have focussed on supporting directly affected regions and sectors of the economy, where there is clear evidence that impacts have already been felt;

c. **note** that the economic impacts will likely broaden over time and impact households and firms across the economy, and that these effects will be exacerbated if major public health measures are required in response to an escalating domestic outbreak of COVID-19;

d. **direct** officials to develop further targeted firm support options for Cabinet decisions with priority on:

- a targeted wage subsidy scheme for workers in the most adversely affected sectors;
- training and re-deployment options for affected employees; and
- targeted working capital support for firms that face temporary credit constraints;

e. 33 [redacted]

f. **note** that the Treasury and MSD are continuing to consider welfare policy options tosupport household to maintain incomes and labour market attachment, with a priority on:

- employer support with regional and national targeting options;
- income relief programmes to provide temporary financial assistance for people who have lost their job or are unable to work due to COVID-19;
- community wellbeing requirements to provide support to vulnerable individuals and families;

g. **note** that in providing further analysis for Cabinet decisions, officials will highlight the trade-offs involved in targeting or limiting the scope of these policy options, and the operational and legislative issues involved in implementing them in a timely fashion;

h. **note** the Treasury's advice that a substantial domestic recession is not the current prediction, but it is a possibility, and a large fiscal stimulus should be delivered if this scenario becomes more likely;

i. **direct** the Treasury to develop macroeconomic advice for the Minister of Finance that sets outs options for an appropriate fiscal stimulus in preparation for decisions if the economic situation deteriorates further;

j. **refer** this report to the Ministers on the CVD Cabinet committee, the Ministers of Social Development and Revenue, and any others at your discretion.

Refer/not referred.

Bryan Chapple
Deputy Secretary, Macroeconomics & Growth, The Treasury
Economic Pillar Lead, COVID-19 Response

Hon Grant Robertson
Minister of Finance

Joint Report: An Intervention Strategy for Economic Policy Responses to COVID-19

Purpose of Report

1. This report brings together a range of analysis to help Ministers understand the potential economic impacts and response options to the COVID-19 outbreak:

    a. The first section explains officials' current assessment of economic impacts on New Zealand;

    b. The next two sections set how to approach decision-making on policy given the current uncertainty, and some broad categories of economic policy responses available;

    c. The last two sections explain, the general microeconomic and macroeconomic policy options available to Ministers;

    d. Annex 1 provides a summary of the main economic policy options that officials recommend be further developed in preparation for Cabinet decisions, either soon or if the situation deteriorates further;

    e. Annex 2 provides further detail on some of the possible fiscal stimulus options that could be developed, that the Treasury is considering as part of its further macroeconomic advice.

Updated assessment of the economic impact of COVID-19

2. On 21 February, the Treasury provided three stylised macroeconomic scenarios to the Minister of Finance on the potential impacts of COVID-19 (T2020/391 refers). There were:
    a. Scenario 1: A temporary global demand shock
    b. Scenario 2: A longer lasting domestic incomes shock
    c. Scenario 3: A global recession

3. The continued spread of COVID-19 outside of mainland China and the first confirmed domestic cases suggest that the economic impacts of the outbreak on New Zealand will be larger and more sustained than was reflected in earlier forecasts. Therefore, as a working assumption, this report takes the view that New Zealand is in a version of Scenario 2 right now.

4. There remains considerable uncertainty about the breadth and depth of impact within Scenario 2. The Treasury is working on further analysis that will provide more detail on the potential demand-side and supply-side channels of impact on the New Zealand economy.

5. The Ministry of Health is leading analysis to understand epidemiological scenarios around the potential spread of COVID-19 in New Zealand, beyond the current

confirmed cases. This will inform the public health responses that would be required if there are, in order of escalation: single or multiple clusters of confirmed cases, the start of community transmission, through to sustained and intensive community transmission.

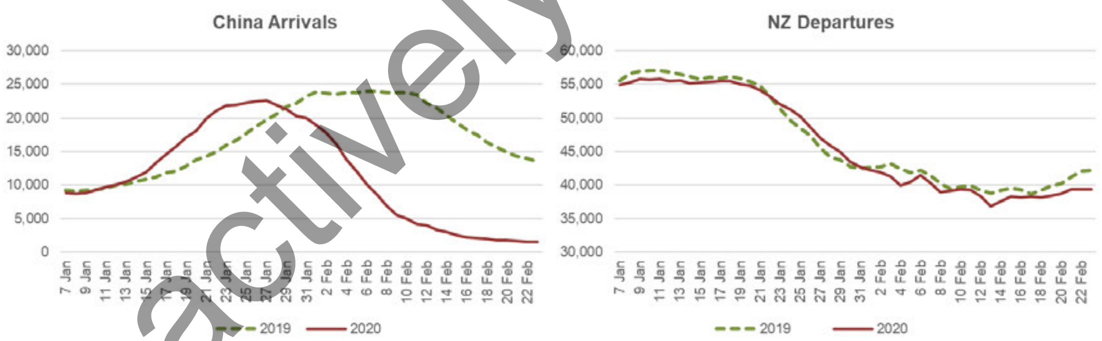
6. The necessary public health measures in any of those epidemiological scenarios would themselves have significant economic impacts. Most likely, these would be supply-side impacts, as domestic production supply chains or and labour supply is disrupted through widespread domestic self-isolation and quarantine measures and significant worker absence.

7. Understanding those economic effects will be a focus of the next stage of economic analysis. Nevertheless, at this moment, the major economic impacts that New Zealand is already facing are a result of the economic disruption and uncertainty from the global spread of COVID-19.

8. The rest of this section sets out some indicators of the current economic outlook. We first describe data on the sectors of the New Zealand economy directly affected by the global impact of COVID-19. Then we provide some indicators of more general impacts across the economy. Lastly we set out some indicators of the activity in China, where disruption has been centred to date.

Directly affected sectors of the domestic economy

9. **Tourism** - Data from customs on arriving and departing passengers shows that the 7-day moving sum of Chinese arrivals were down 89% as at 23 February compared to the same period in 2019, with total arrivals down [illegible]2% year-on-year. However, data from IATA, which gives an indication of intended travel 1-3 months from now (based on airline bookings), shows that countries excluding China are down about 12%. New Zealanders also appear to be less keen to travel, with New Zealand departures down 7% compared to 2019 as at 23 February.



Source: New Zealand Customs

10. **Merchandise trade** - Experimental data from Stats New Zealand shows that New Zealand's merchandise exports to China declined by 8% in the four weeks ending 23 February compared to 2019. It should be emphasised that before the COVID-19 outbreak, New Zealand's exports to China were growing strongly. Furthermore, this data is based on the intention to export, not actual exports, and given that Stats New Zealand has made this data available at a much shorter lag compared to their usual monthly trade data release, it could be prone to relatively larger revisions.

11. Given these factors, we think that the actual impact on trade may be larger than these figures suggest. At a sectoral level, meat exports to China are down $113m compared to 2019, forestry exports are down $61m, seafood exports are down $40m, while dairy exports are $101m higher. In volume terms, meat exports to China have halved, while

forestry volumes have fallen by 13%. Exports to countries other than China are roughly unchanged from 2019.

12. There is also increasing anecdotal evidence of supply chain disruption for New Zealand importers (including manufacturers using imported components).

13. In terms of **commodity prices**, as at 28 February, meat prices are down more than 20% compared to the start of the year, while forestry prices have fallen by 13.5%. Meanwhile, despite some weakness, dairy prices have recovered, and are up by almost 5% since the start of the year. On the import side, West Texas Intermediate oil prices have fallen by 27%.

Broader impacts on the New Zealand economy

14. **Social development** – MSD continues to respond to COVID-19. From 6 February to 2 March, MSD has received 465 calls specific to COVID-19. Most calls are from Auckland (40%), followed by Northland (15%). 31 hardship payments have been made to 26 clients that may relate to COVID-19, these have primarily been for food[1]. People who are self-isolating and unable to support themselves continue to approach MSD for support. MSD continues to monitor daily benefit numbers, but has yet to see significant changes. However, reports from industries indicate that there are already a large number of people who are out of work or are affected by reduced hours, for example, MPI have reported that as of February 24 2019 there were already 381 people without work and 876 people affected by reduced hours in the forestry industry.

15. **Labour markets -** The disruption to economic activity is having clear impacts on employment in particular sectors, and regions. The impact on contracted forestry workers is the most marked, as a result of reduced demand from China. These effects are especially pronounced in Tairawhiti. The region is expecting to lose around 1,000 jobs in the next six weeks, and Mori will be disproportionately impacted. A range of government agencies is responding to this risk in partnership with local industry. Tourism and the education sector are observing employment impacts. Should the more severe scenarios develop, we expect such adverse impacts would become more systemic, spreading to other sectors and regions

16. **Confidence** - In New Zealand, the ANew Zealand Business Outlook headline index fell by 6 points to -19 in February. However, only about a third of responses were received after COVID-19 started making headlines. The first sample group scored -14% for business confidence, while the second group reported a much worse -33%. The March index, which is due to be released on 31 March, is likely to show a notable deterioration.

17. The ANew Zealand-Roy Morgan New Zealand consumer confidence index eased by just 1 point in February to 122, following up on gains made at the end of 2019. We expect to see a weaker reading on the March index, which is due to be released on 27 March

18. **Financial markets** - Financial markets have started reacting more strongly to COVID-19. As at 28 February, the New ZealandX Total Return Index was down 2.4%, having fallen by 6.8% since its 21 February peak. The 90-day interest rate has fallen by around 40 bps since the start of the year. The New Zealand trade-weighted exchange rate has depreciated by around 5%.

19. Ultimately, the most important financial channel is likely to be the credit channel. If firms face falling sales (or an inability to operate due to import constraints or quarantine

[1] Data should be treated as indicative only

restrictions), debt repayment will become difficult and some firms may default. We understand that banks are preparing hardship packages for their customers.

20. If defaults trigger stress amongst financial institutions, then lending more broadly will be reduced. The government and the Reserve Bank have tools they could use to offset this but all involve a degree of fiscal and financial stability risk. According to information provided by the Reserve Bank, the banks generally believe they are adequately liquid in the near term.

International outlook

21. China's manufacturing PMI fell from 50.0 in January to just 35.7 in February, its lowest level on record (below 50 denotes a contraction) and below market expectations. The non-manufacturing PMI fell from 54.1 to 29.6.

22. Higher frequency data on China's activity shows that, while there has been some improvement, the economy continues to operate at a much reduced capacity level. Coal consumption is currently at 67% of 2019's level, while property sales for 30 key cities are at 61%. Congestion levels have also started picking up, but are still down by about a third compared to the end of last year (for Tier 1 cities). There are still a large number (more than 100 million) of migrant workers that are yet to return to work. This has two implications: 1) most manufacturing companies are still operating at a reduced capacity, and 2) when these people do return, there is a risk of a spike in new infections.

23. Global stock markets have also fallen. China's Shanghai-Shenzhen-300 Index is down 3.8% compared to the start of the year, the Australia All Price Index has declined by 4.3%, while the S&P 500 is down 8.6%. Volatility levels have also increased sharply: the CBOE Market Volatility Index (VIX) reached 40.1 on 28 February, compared to about 13 at the start of the year. The last time the index was this high was in August 2015.

Considering economic policy responses under uncertainty

24. The situation is developing quickly and we have incomplete information. Notwithstanding the ongoing analysis described above, there will continue to be ambiguity over coming months about which the economic impacts New Zealand is facing. There will also be uncertainty about the impact that interventions will have under any likely scenario ahead.

25. This creates two particular challenges for deciding on an appropriate response to the outbreak:

- **Information lags**: Our assessment of the economic impacts of the outbreak relies heavily on backward-looking indicators. As a result, it is unlikely that we will have a timely sense of the optimal points for implementing policy responses.

- **Implementation lags**: Any policy response will take time to design and then implement. By the time it is clear that action is desirable, it may be too late to implement a timely response.

26. Ministers will therefore need to make a series of judgements about their risk tolerances when considering the scale and type of policy response. Fast action may pose implementation risks and could end up being unnecessary. In contrast, the Government may be unable to provide a timely response if it decides to delay action until better information is available.

27. As this suggests, Ministers will need to consider a key judgement in respect of information and data: are Ministers prepared to wait to get better information before taking action, or do they judge that the risks of inaction outweigh the risks associated with a timely (but potentially unnecessary) response?

28. In light of that uncertainty, there are no clear 'trigger points' that would provide an unambiguous signal that further economic policy responses are required. Nevertheless, clear and frequent communication about the Government's assessments, plans and options will help maintain confidence and reduce uncertainty in the community, which will itself help to sustain economic activity more broadly.

How should Cabinet decide on its economic policy response?

29. Given the information emerging about the outbreak and the level of global market disruption it has already caused, it is likely New Zealand will face a longer lasting domestic shock – that is, some version of Scenario 2. Even if this is ultimately avoided, we will not be sure for some time. Therefore it is prudent, at this stage, to plan for this scenario, while also being mindful to preserve exit options from new interventions where possible.

30. Some microeconomic interventions may be 'least regrets' under most potential future paths. Policy decisions may be protective if the current economic impacts deepen or broaden. And in the event of a best case-scenario, these options may deliver some value anyway.

31. An example of this is the recent tourism package, boosting international marketing efforts. It aims to create a flow of Australian visitors through the year, and promote New Zealand as a destination through the key booking period of April to June for longer haul markets (who will arrive November 2020 to March 2021). This protects our tourism sector throughout the year, and in the event that there is only a limited outbreak, is still expected to generate a sizeable return on investment.

32. Still, there is a risk when taking precautionary policy action of this nature. Policy interventions may end up supporting sectors of the economy which only end up facing shorter disruptions, and come to rely on this support. This is a fundamental trade-off, but the risks may be able to be mitigated with detailed policy design and careful communication.

33. The time it would take to effectively implement any new interventions should also be a factor taken into account when choosing any policy responses, to ensure that economic support is timely if the situation deteriorates. This is especially true when options require long lead times for design and implementation. That is why we recommend you direct officials to work up details now of possible interventions.

34. As mentioned above, the Treasury is currently working on further analysis that will provide more detail on the potential demand-side and supply-side channels of impact on the New Zealand economy. This will assist officials to advise Ministers on which potential policy options are most likely to address the specific economic and social impacts of COVID-19.

When should Cabinet decide its economic policy response?

35. The next section of this report describes some of these potential options, which are summarised in Annex 1. This will also include initial advice on the suitability and ease of implementation of these options, and what trade-offs would need to be considered in further policy design.

36. 33 [redacted]

37. [redacted]

Categories and principles for economic policy responses to COVID-19

38. Table 1 sets out four general categories of economic policy responses that can be helpful to simplify the general options available to Ministers.

39. Annex 1 of the report summarises a range of potential policy options under each of these categories, for further development ahead of Cabinet decisions soon, or as required if the situation deteriorates.

Table 1: Four categories of economic policy responses

Categories	**Description**
1. Leveraging existing policy settings	This involves upscaling current response activity, or augmenting/adjusting current business as-usual activity to support the economic response to COVID-19 While leveraging existing policy settings, many initiatives will require additional funds and/or ministerial decisions to expand the scope of activity.
2. New targeted microeconomic interventions	Initiatives could be designed to target specific affected groups: • *sectors* of the economy that are directly impacted; • *regions* of New Zealand which are most affected; • *firm support* for business that may benefit from temporary support; • *households* that are vulnerable to labour market disruption. Some decisions have already been made by Cabinet, including: • tourism marketing package (aimed at boosting domestic visitors and keeping momentum for international visitors later in the year) • Enhanced Regional Business Partners programme (supporting firms with capability and connecting with further assistance) In the context of making decisions in uncertainty, some of these options are 'least regrets', against the downside risks. Further policy work is required to develop the specifics, and some will involve lead time.

3. A broader package of options to support economic activity	The Capital Investment Package announced in December will provide some support to the economy through 2020 and beyond. However, this was partly designed in response to the pre-existing softening of economic indicators. 33 [redacted]
4. Design and implement a large fiscal stimulus	If there is a reasonable expectation of a prolonged downturn, then a large fiscal package would likely be appropriate to provide a timely stimulus and support incomes. In this scenario an ideal response would be timely, temporary and targeted, with the overall response calibrated to the specific circumstances. We would first consider a combination of larg tax and transfer options, as these will have shorter lead times and wider coverage across the economy than options uch a a capital investment package, which would be subject to c pacity and agency constraints, and may be difficult to de iver in the presence of supply disruptions.

40. Table 2 sets out a framework that Cabinet has conside ed when making initial decisions over the past few weeks. Officials have and will continue to use these principles to guide their assessment of any recomme ded economic policy responses to Cabinet.

Table 2: Principles to guide economic policy respon es

Principles	Assessment
Balanced and proportionate	The scale and scope of the response is in proportion with the anticipated duration and scale of the economic impact.
Aligned with broader Government direction	The economic response should not be counter to broader Government policy, and ideally support Government objectives (short and/or long term).
Sustainable	The response should be able to scale with the impact (up or down), and should aim to avoid creating on-going reliance or support. Therefore there should be an exit strategy for policy interventions.
Ease of implementation	For short term responses, simple and quick implementation is desirable, which may involve trade-off with targeting and proportionality.
Best decision under uncertainty	The response is 'least regrets' – that is the risk of over-investing has been considered against the risks of under-investing.

Further targeted microeconomic policy interventions

41. The microeconomic policy interventions (Categories 1 and 2) are most appropriate for addressing a modest economic impact. Even if the macroeconomic impacts are more severe, these types of interventions can support the broader fiscal stimulus options discussed in the next section. This could support resilience in particular parts of the economy, and speed recovery in targeted regions. By providing targeted support, particularly affected groups will be able to minimise losses and be better placed to resume normal business operations and employment activity as the economy recovers.

Targeted options to support directly impacted firms, sectors, and regions

42. Under the first category of interventions – leveraging existing policy settings – options comprise greater information, advice (diversifying, resilience), and well-being support for firms and business owners. Some of these are already underway, such as through the expansion of the Regional Business Partners programme.

43. The second category of policy response – further targeted microeconomic interventions response – could include support the export-oriented sectors of the economy most affected, including targeted marketing and communications and trade events. It also could include financial support for affected firms, though given the potential scale, this should have a high threshold for activation. Also, there are some options to relax regulatory restrictions such as quotas, as has been done for lobster fisheries.

44. Regional support for affected areas could be considered where the local economy is heavily reliant on affected sectors, and therefore there are substantial spillovers. Options for regional responses include upscaling more general responses for the affected region, and regional taskforces or planning, which could include accelerating infrastructure projects to create local economic stimulus.

45. Other forms of targeted support could include firm support, such as working capital arrangements, relaxing immigration settings (in the event of workforce issues) and job loss cover for affected workers.

Using the welfare system to provide broader support to households and labour markets

46. MSD can also administer a range of microeconomic policy interventions to support people impacted by the economic consequences of COVID-19. This includes a range of options including providing support for employers to keep workers attached to their jobs, additional income support for individuals out of work, and wider social support for impacted community and families.

Employer Support

47. Employers impacted by COVID-19 could be supported with an Employer Subsidy to keep workers who have reduced hours, attached to their employers. Note that there is a risk of subsidies going to businesses who do not need them, and/or supporting businesses who are struggling for unrelated reasons. This could include funding to cover the wages of staff working reduced hours or funding for those who need training/upskilling in and alternative area of work. This could start at a regional level and be scaled up to a national level if required.

Income Support

48. The Income Support Options provide financial assistance to people who no longer have work (or need supplementary assistance while in work) as a result of COVID-19. This includes removing stand-down periods for Main Benefit assistance (so that people

can access Main Benefit assistance in a shorter timeframe[2]), increasing benefit payments (which is covered in further detail in the macroeconomic response options), and an option to establish [redacted] 33

Resourcing and Community Support

49. In order for MSD to effectively respond to increased number of people in need of financial assistance, additional staff may be required to meet increased demand pressure and to deliver the Employer and Income Support options above. This would include additional frontline, call centre and brokerage staff. Additional funding for community providers may also be required to help communities that are suffering adverse social outcomes, build resilience and maintain wellbeing though COVID 19. This would involve increasing funding for service providers to provide wrap around support services for vulnerable individuals and families impacted by COVID-19.

50. These packages should not be considered in isolation. There could be strong rationale for combining some options across various packages, to ensure there is no duplication of response. The appropriate set of options will also depend on options put forward by other agencies to provide a cohesive response. Some of these options could be further targeted (towards specific regions or sectors) or scaled up to a national level depending on need. 33 [redacted]

Targeted tax policy options to provide broader support firms facing disruption

Activities already underway

51. An economic disruption will reduce cash flow for some firms. This will affect their ability to continue operating while also meeting their tax obligations. Inland Revenue has already implemented a number of measures to assist taxpayers with paying the right amount of tax in a way that is manageable. These measures include relief from penalties for late payment and late filing, the establishment of instalment arrangements to help taxpayers pay off outstanding tax debt, and setting up tailored tax codes for individual taxpayers with multiple jobs so they do not have to pay secondary tax. These measures are sufficient to assist taxpayers through a period of moderate economic disruption.

Additional measures

52. Economic disruption may have a negative impact on business continuity for some firms. Without assistance, some otherwise profitable firms may be unable to continue to operate

53. [3] [redacted]

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[2] Further advice on options for Stand Down periods will be considered by the COVID-19 Cabinet committee on 4 March 2020.

[3] Similar to the ReStart package used in the GFC

33 [redacted]

54. Another option for assisting firms is to temporarily set the provisional tax uplift to zero, rather than the usual 5% that applies under normal conditions. This will allow businesses to pay less in provisional tax throughout the year (with a potentially higher tax bill at the end of the year). This measure recognises that businesses are unlikely to experience income growth during the period of the economic shock.

55. Officials have identified a number of other options for providing support through the tax system. These options would require a significant amount of time to develop and implement, so they may be unsuitable for providing assistance to taxpayers in a timely manner. These options include:

- Allowing companies to carry back a loss to a previous tax year and get the valu of the loss refunded.
- 33 [redacted]

56. Officials have also considered a deferral of PAYE or GST payments In our judgement, a deferral of PAYE or GST payments is unlikely to provide signif cant support to businesses in a targeted way, but would cause significant disruption to the tax system.

- A deferral of GST payments would actually provide the greatest assistance to unaffected taxpayers. It would not provide any assistance to exporters (as GST is not applied to exports), or to businesses receiv ng a GST refund (due to GST spent on businesses expenses being g eater than GST received on sales). Taxpayers affected by the economic disruptio taxpayers are more likely to see a reduction in their GST receipts (due to a decrease in sales) and are therefore more likely to receive a GST refund.

- A deferral of PAYE payments would not assist employers, as they are currently required to hold PAYE deducted from an employee's wages on trust for the Commissioner of Inland Revenue.4 The PAYE system is not only used to provide employees with a credi fo tax liabilities on their salary and wages, but is also used to collect child support, repay student loans, collect ACC levies, and provide a mechanism for contributing to KiwiSaver. Allowing employers to convert employee salary and wages into working capital of the business would set an undesirable precedent and risks the integrity and wider taxpayer confidence in the tax system. We would not recommend that businesses use tax deducted on behalf of mployees to pay for other business activities.

Options for targeting support

57. The impact of any economic disruption could affect certain sectors of the economy more than others. However, the tax system is not well suited to target particular sectors of the economy. In fact, we understand from discussions with Inland Revenue that it may not be administratively feasible to target tax support to particular sectors.

58. It is more feasible to target assistance to particular regions. In previous emergency events, such as the Canterbury earthquakes and the Hawkes Bay gastroenterology outbreak, the Government introduced tax measures to support the affected regions. However, the ability to access emergency tax measures on a regional basis generally requires self-assessment by taxpayers. This creates some integrity risk for the tax system.

[4] Tax Administration Act 1994, s 167

59. It is likely to be more effective to target tax relief at specific activities that you wish to encourage during a period of economic disruption. This could include the use of investment incentives to encourage investment and payments to cover employee sick leave costs in the event that some employees contract COVID-19. Officials can provide further advice on these options at your request.

Preparing a broader macroeconomic policy response

60. Should the economic situation deteriorate and a substantial domestic recession becomes likely, then microeconomic interventions alone won't provide a sufficient degree of support to the economy. A large fiscal stimulus should be delivered as macroeconomic response if this scenario becomes more likely.

61. The purpose of a macroeconomic response would be to mitigate the impacts of COVID-19 on the wider economy. The aim would be to support living standards y providing broad stimulus, which in turn supports demand and business confidence, and consequently economic activity, jobs and incomes.

62. In general, monetary policy is preferred over fiscal policy as a macroeconomic stabilisation tool for a wide-ranging demand shock. This is because it has shorter lags compared to fiscal policy, interest rates can be changed quickly and, unlike fiscal policy, monetary policy decisions are easily reversed. Whi e interest rates are low, there remains some scope to lower them further. However for a substantial monetary policy easing, the Reserve Bank may resort to mone ary policy tools that are untested in New Zealand, and fiscal policy may be a preferable lever.

63. In addition to a monetary policy response, we would expect further exchange rate depreciation and support from the automatic fiscal stabilisers – that is reduced tax collections and increased welfare paymen s – should this situation deteriorate further.

64. Any fiscal policy response needs to be calib ated to the shock and how it transmits to the economy. COVID-19 is like y to cause a negative demand shock through a loss of export demand and cautious consumers. There is also potential for COVID-19 to cause a negative supply shock in New Zealand through supply chain disruption that reduces availability and increases prices of capital and intermediate inputs. As is the case currently in China, an utbreak in New Zealand would also create a supply shock if workers are taken out of the labour force temporarily.

65. In response to a negative demand shock, a demand side intervention (for example, an increase in welfa e payments) might be appropriate to cushion any impact on living standards, wh le also supporting confidence. The scale of any fiscal policy response would need o increase in proportion with the shock. However, demand side inte ventions will not address supply disruptions. For example, disruption to global supply chains caused by quarantine measures and travel and trade restrictions cannot be fully offset by measures to support demand domestically, given the challenges associated with quickly shifting excess productive capacity within the economy.

66. The nature of the response in each scenario is set out below at a high-level, with more detailed policy options for a potential recession set out in Annex 3.

67. As a next step, we will develop further macroeconomic advice that:

- sets out how demand and supply shocks will impact the economy in different scenarios;

- sets out the appropriate macroeconomic policy responses to different types of shocks, which will include analysis on the extent to which monetary and fiscal policy can effectively respond to a supply shock;
- addresses information lags by identifying leading indicators that that can inform our view on what the economic impact is, and when a substantial fiscal response is necessary; and
- draws on international experiences responding to COVID-19 and other similar shocks.

In response to a longer lasting domestic incomes shock, consider a further loosening in the fiscal stance

68. Scenario 2 envisages a prolonged shock to domestic incomes, but falls short of a large recession as per scenario 3.

69. In this scenario, we expect macroeconomic support will mostly be provided by monetary policy, the exchange rate and the automatic stabilisers. We also note monetary policy is already accommodative and that the capital investment package announced in December is providing a degree of support to the economy.

70. Any higher spending in Budget 2020 needs to be weighed against other considerations such as the Government's overarching fiscal strategy and maintaining value for money in expenditure. Short of a large-scale fiscal stimulus, which we recommend reserving for a large recession type situation as per scenario 3, the macroeconomic effects of slightly more spending are likely to be limited. To this end, temporary spending initiatives that do not create long-term fiscal sustainability challenges are preferable.

71. There are also choices about the composition of spending within the Budget. Spending more on the response to COVID-19 will necessarily leave less fiscal headroom for progressing other priorities. The appropriate balance will depend on the initiatives under consideration through the Budget process and the need to respond at a microeconomic level to the disruption caused by COVID-19. We can provide more advice on these tradeoffs as required.

In response to the potential of a large recession, deliver a large discretionary fiscal stimulus

72. Scenario 3 is a large recession, in which case a large scale fiscal stimulus would be appropriate.

73. 33 [redacted]

74. [redacted]

75. [redacted]

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76. [redacted]

77. [redacted]

78. [redacted]

79. [redacted]

Coordinating a fiscal policy response with the Budget

80. At this stage we have not seen a widespread economic impact that justifies a significant macroeconomic response as set out under scenario 3. However we are monitoring the situation closely and will continue to do so in the lead up to the Budget.

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81. [redacted]

82. [redacted]

Annex 1: A summary of potential economic policy responses to COVID-19, for further development (prepared by Treasury, MBIE, MSD and IR)

	Supporting people to maintain incomes and labour market attachment	Supporting businesses to maintain operational continuity and re-deploy staff	Macroeconomic policy approach
Leveraging existing policy settings and levers This involves upscaling current response activity, or augmenting/adjusting current and existing support and regulatory mechanisms to support the economic response to COVID-19.	**Increase MSD frontline staff (MSD)** This would reduce the risk of long waiting times and poor service for MSD payments with increased demand, supporting the effectiveness of other response options. Because of the uncertainty in demand and the 3-month lead time for recruitment, options for the scale and cost of staff recruitment would need to be developed, incorporating the degree of flex possible within existing operations. 33 [redacted] **Access to personal wellbeing and financial counselling (MPI)** For example counselling services provided via Rural Support Trusts, Fisheries, New Zealand's fisher wellbeing programme and the Forest Industry Safety Council. Small scale but could have a significant benefit for individuals. Limited capacity to scale up current initiatives. **Communications strategy (MBIE)** Using existing channels of communication to ensure policies are communicated to businesses. For example, deploy the business.govt.nz Boost platform to reach SMEs. Low cost and low risk as uses existing channels, will benefit businesses across the economy	**Tax relief (IR - Already underway)** Relief from late filing/payment fees, and help to set up instalment plans to manage tax debt. Taxpayers are able to reassess their provisional tax and seek refunds for overpaid provisional tax. Supports businesses struggling to pay provisional tax, GST and other tax types. Minor integrity risks, and systems already in place and operational **Redeployment of workers (MBIE/MPI – already underway)** Programmes within biosecurity and or conservation that could be used to deploy suitable forestry workers. There may be geographical, logistical and capacity constraints. 33 [redacted] **Primary sector support via Income Equalisation regime (IR)** Administered by IR, needs Minister for Primary Industries to declare an "adverse event" to loosen the rules around this regime. Supports agricultural businesses, subject to eligibility requirements, and provides no benefit to businesses not previously in the scheme. A low-risk option, easily implemented after the Minister declares an "adverse event".	Automatic stabilisers are already operating, including an exchange rate depreciation, and a likely decrease in tax receipts and increase in welfare payments.
New targeted microeconomic interventions Initiatives could be designed to target sectors, regions, firms, or household that are directly and immediately impacted.	**Removing benefit stand down periods (MSD - Already underway)** Removing the one week delay for benefit payments is a way to provide impacted individuals quicker access to income support. 33 [redacted]	**Employer Subsidy (MBIE and MSD)** A wage subsidy that employers and other impacted groups can access to support with the challenges associated with COVID-19, which could include funding such as wage cover or training, subject to suitable targeting criteria. This is likely to ease short-term, regional, business cashflow challenges and retain labour market attachment. This may be appropriate in the short-term and to the extent economic impacts are regionally-concentrated. An Employer Subsidy could also be rolled out nationwide if required. However, it carries significant fiscal risk if expanded across multiple regions or nationally and may also prevent economic adjustment. Any regional use of such a package should be communicated and include strict expansion decision criteria to avoid setting a precedent for other regions. Note this would require additional staff to administer. **Provisional tax threshold (IR)** 33 [redacted] 3 Remove some small businesses from provisional tax regime, targeted to those who have between $2,500 and $5,000 of tax to pay. Would provide a one-off cash benefit of $350m across the economy. Not sector specific and would reduce compliance costs for small businesses. Brings minor integrity risks and is fast to implement. Would be better to do sooner rather than later, so small businesses can stop provisional tax payments. First payment of the next tax year is on 28 August 2020 for many businesses. 33 [redacted] **Targeted Working Capital Support for Firms (Treasury)** Partnering with banks, to support firms that face temporary credit constraints, backed by government guarantees to some extent. Would take time to set up, but could leverage from the operational experience of the Export Credit Office. **Regional relief package (MBIE and MSD) eg Tairawhiti** A regional fund those employers and other impacted groups can access to support. Likely to ease short-term, regional, business cashflow challenges and retain labour market attachment. May be appropriate in the short-term and where economic impacts are regionally-concentrated. It carries significant fiscal risk if expanded across multiple regions or nationally. Any regional use of such a package should be communicated and include strict expansion	The less targeted these interventions are, the greater the fiscal cost could be, but there may be scope for reprioritisation.

		decision criteria to avoid setting a precedent for other regions. Because of the non-regional nature of COVID-19 it may not be practical to limit responses by region. Note this would require additional staff to administer. **Review immigration, temporary and tourist visa settings, visa rollover options (MBIE)** Reduces strain on labour supply, supports tourists and those potentially stranded in New Zealand. Complements re-engagement plan. Visa expiry dates can only be extended if an epidemic is declared (otherwise manual workaround required). Needs to be considered in conjunction with other responses. Would need to alance allowing the movement of people whilst protecting against the spread of the virus. **Consistent, market-focused medium- and long-term recovery plan (Education New ealand, Tourism New Zealand)** Includes recovery of Chinese market and diversification of New Zealand bus ness supp or destination planning and resilience of regions. Trade support to re-engage travellers for 2020/2 21 s ason. Specifics of the policies require further development. Compliments existing government activity, consi erable spillovers within regions and across sectors. Targeted marketing activities could be very effective equire barriers to movement of people to be removed, would take time to develop and implement, timing is criti al as e rly recovery support would be more effective but early implementation could be damaging. **Options for adjustment to employment law settings to addr ss gaps in leave or pay** Options require development and overlap with wage subs dies prop sals. Legislation necessary for many options, lead time of 2-4 months.	
A broader package of options to support economic activity		**Investment incentives** (targeted at a specific *ac vity*, ather an a sector) 33 [redacted] **Temporarily reduce in erest on tax d bt (Use of money interest, or UOMI)** Reduces the interest usines s ay on tax debt. Will benefit all businesses, but will be most beneficial for struggling businesses. e urrent rate for underpayment of tax is 8.35%. On average about $46m of UOMI is paid to Inland Revenue by bus esses each year. Do not recommend cutting the rate to zero as this should be reserved for situations when there is a emergency event where individuals' physical safety would be at risk if they were to comply with the tax obligations. Work would complement an existing tax policy project that is reviewing the formula setting underlying the calculation of UOMI rates. Reduces the incentives for tax compliance. Administratively straightfor ard bu requires legislation.	Cabinet can take the downside risks from COVID-19 into account when taking Budget decisions, and could consider a looser fiscal stance relative to what was signalled in the 2020 Budget Policy Statement. This could be across the economy and/or tailored to some of the specific economic impacts being seen.
Design and implement a large fiscal stimulus	**Large welfare package to increase main benefits (MSD)** Additional income support provided to all main benefit recipients to improve income adequacy. This provides a fiscal stimulus mechanism which is broader-based than targeted welfare. 33 [redacted] 33 [redacted] 33 [redacted]	33 [redacted]	If there is a reasonable expectation of a prolonged downturn, then a large fiscal package would likely be appropriate to provide a timely stimulus and support incomes.

Annex 2: Further detail on policy options for a large fiscal stimulus (prepared by Treasury with input from MSD and Inland Revenue)

Personal tax options

Measure & short term impact	Fiscal impact (per annum)	Temporary	Implementation timeframe	Long-term efficiency / distributional impacts (including compliance)	Operational / administrative impacts and risks
33 [redacted]					

33 [redacted]

Business tax options

Measure & short term impact	Fiscal impact (per annum)	Temporary	Implementation timeframe	Long-term efficiency / distributional impacts (including compliance)	Operational / administrative impacts and risks
Reinstate building depreciation Provides a stream of **expected** cash benefits to business that own buildings. No material cash benefit until end of 2020 Supports business confidence.	Scalable Eg. $600m (for a 2% DV rate)	No	**Implementation across the year possible**, but must apply for full 2020/21 tax year. To maximise effectiveness on behaviour, decision preferred as soon as possible. **Lead time** determined by legislation timeline – approx. **3-4 months**.	Reduces costs for the owners of affected buildings only. Should put downward pressure on rents for both businesses and individuals over the long term. Increases business investment and GDP over the long term.	Low Admin impact - No system changes for IR, but will require changes for businesses. Design questions (e.g. cost base to use, depreciation rate) will need to be decided on before implementation.

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<u>Lift provisional tax thresholds from $2,500 to $5,000</u> Provides cash flow benefit to taxpayers. Equivalent to a **one-off cash payment** to SME taxpayers. Benefit comes from a **timing advantage** by deferring tax payments to the end of future tax years.	One-off impact on cash balance and net debt of $350m Ongoing cost of $3m due to lost penalties and interest	No, but fiscal impact is one-off	**Implementation across the year possible**, but must apply for full 2020/21 tax year. To maximise effectiveness on behaviour, decisions preferred as soon as possible. **Lead time** determined by legislation timeline – approx. **3-4 months**.	Targets small businesses. Will reduce compliance costs for small businesses going forward. Tax still needs to be repaid eventually - may cause impacted businesses to have large tax bills/debt at the end of the year	Low Admin impact - No system changes for IR, but will require changes for businesses. Will reduce the number of taxpayers in the provisional tax regime. This could make enforcement and tax collection more difficult for these small companies.

Welfare options

Measure & short term impact	Fiscal impact (per annum)	Temporary	Implementation timeframe	Long-term efficiency / distributional impacts (including compliance)	Operational / administrative impacts and risks
<u>Main benefits increase by $25 per week for families *with and without* children</u> Increase to short term private consumption spending. Impact potentially high due to the high propensity of low income households to spend rather than save additional income.	Scalable $420m per annum	No	Usually a **4 month lead time** from decision to implementation. Faster implementation may be possible at some times of the year, subject to consultation with MSD – **Main benefit changes for 1 July** could be possible if **decisions** are made by **31 March**. Changes to main benefit levels can be made via order in council and do not need legislation.	Targeted to beneficiaries (approx. 300,000 of the lowest income individuals and families). Excludes low-income working families and New Zealand' recipients. Consistent with the long-term direction of the Government's Welfare Overhaul. Previous advice had indicated that main benefits are not adequate; this proposal addresses income adequacy concerns and supports child poverty reduction.	**Any implementation outside of 01 April significantly increases operational workload for MSD**, as exceptions need to be manually processed. 33 [redacted]

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