The Treasury

Budget 2020 Information Release

July 2020

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

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[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;

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Fiscal Strategy Options

Date:	4 September 2019	**Report No:**	T2019/2447
		File Number:	MC-1-5-2 (Fiscal strategy)

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Consider** recommendations and discuss with officials at Budget Matters on **10 September**	Tuesday 10 September 2019

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Angus Hawkins	Senior Analyst, Macroeconomic and Fiscal Policy	s9(2)(k) [redacted]	n/a (mob)	✓
Renee Philip	Manager, Macroeconomic and Fiscal Policy		s9(2)(g)(ii) [redacted]	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: Fiscal Strategy Options

Executive Summary

This paper discusses the case for fiscal stimulus given the current economic outlook. The Treasury recommends, given the high degree of uncertainty in the economic outlook, it is prudent to develop a fiscal stimulus package that can be announced in the next three months, if required. This paper presents options for this package. We are seeking your view on which of these options we should develop further, so they can be ready for implementation if you later decide to implement a fiscal stimulus.

The economic outlook has weakened since Budget forecasts, but we do not believe we are on the verge of a crisis

There is a developing global media narrative that a recession is imminent. This is driven by US-China trade tensions and continued policy uncertainty in Europe; further inversion of the yield curve in the US; and financial markets remaining highly volatile. This has also contributed to continued low business confidence in New Zealand.

Despite this, in New Zealand the labour market, business investment and exports all remain healthy by recent standards. However, global and domestic factors will likely weigh on growth – we expect growth for 2019 to be closer to 2% than 3%, a downgrade from our Budget forecast.

However, uncertainty is high and the fiscal position is strong – which justifies preparing a fiscal stimulus that can be implemented if needed

We view the softening growth described above as the most likely outcome over the next months. A sharper fall in growth is the next most likely outcome; and a recession unlikely but possible. In normal circumstances, monetary policy would support the economy through any of these scenarios, particularly if the slowing is cyclical. But low interest rates mean the Reserve Bank's ability to use conventional monetary policy may be exhausted if growth falls significantly further. That could lead to the use of unconventional monetary policy options, untested in New Zealand and of uncertain effectiveness.

Any reliance on conventional or unconventional monetary policy tools would be reduced by the use of discretionary fiscal policy. With net debt at prudent levels, borrowing costs at historic lows and a higher than forecast surplus expected in 2018/19, there is space for a fiscal easing to support the economy if required. In our view, using fiscal policy to support monetary policy would be the lowest risk approach to supporting the economy if there is a further cyclical slowing in growth. Given the time taken to identify suitable initiatives, we recommend preparing a fiscal stimulus package for potential implementation. This stimulus package could support demand directly, or indirectly by increasing certainty and confidence. We recommend that considering the exact composition of the package, and its economic impact before committing to any announcement.

We have identified a longlist of stimulus options, of which we recommend you select a subset for us to develop further

The longlist of potential initiatives is grouped into three buckets, summarised in the table below. The list of options within each bucket is included in the recommendations below, and the detail in the annexes. We have indicated which of these options are preferred by the Treasury, but believe all options on the longlist are appropriate for further consideration.

You have indicated that you wish to announce a business tax package alongside the launch of the Economic Strategy on 22 September. We support this from both a macroeconomic and tax policy perspective. s9(2)(f)(iv) [redacted]

Bucket	Overview	Pros	Cons
A	s9(2)(f)(iv) [redacted]		
B	Rapid delivery projects	Quick to deliver and highly scalable. Likely to be geographically distributed. Small projects less likely to face capacity constraints. Increase in spending is temporary.	We have little oversight centrally of what projects might be funded. Requires further work with other agencies to design an appropriate funding mechanism that can ensure money is spent well and quickly.
C	Large scale capital projects	Minimal work required to develop these projects further. Increase in spending is temporary, and imposes only a one-off increase in debt.	Unlikely to have any short term impact given implementation lags. The positive impact will be purely through confidence effects.

In a slowing growth scenario short of a major recession, any fiscal package should also aim to meet secondary objectives. These could include improving confidence, mitigating any growth in inequality, and supporting long-run productivity growth. This will be best achieved by drawing stimulus options from all three buckets above to produce a combined package that balances these objectives. Ensuring there are other benefits of the initiatives will also minimise any downside of a fiscal package in the event that the economy turns out stronger than expected. This type of package differs from a stimulus package that would be designed to deal with a recession scenario, in which a greater weight should be put on stimulating demand in the economy relative to other objectives.

Risks to a stimulus include exacerbating capacity constraints and the effect on your Budget Responsibility Rules

We have previously advised that capacity constraints are a substantial barrier to adopting a looser fiscal policy. These constraints appear to be easing slightly as growth slows, although some structural issues remain, especially in construction. We also believe the economic risks of higher inflation from exacerbating capacity constraints are low, due to the ability of the Reserve Bank to easily address any emerging inflation with tighter monetary policy.

A weakening growth outlook and increase in spending will affect your commitments to maintain a sustainable operating surplus across an economic cycle and reduce net core Crown debt below 20% of GDP in 2021/22. Both targets will be challenging to achieve while implementing a fiscal stimulus. Providing debt remains within a prudent range, we do not recommend focusing on reducing debt to 20% in a particular year. The extent to which it is appropriate to deviate from the commitment to an operating surplus will depend on whether the lower growth is expected to be temporary or permanent. In the latter case, any loosening in the fiscal position may need to be reversed in future to restore the budget to balance in the long run.

s9(2)(d) [redacted]

The Treasury, subject to your agreement, will work with agencies to develop your chosen policy options further, for you to make final decisions by early November

If you wish to signal an earlier intention to implement a stimulus, there are options for doing so. In addition to your planned announcement of a business tax package later this month, you could also announce an increase to the multi-year capital allowance at a similar time. This would be earlier than the normal December announcement of allowances. The specific projects this will be spent on, to be drawn from buckets B and C above, could be announced at a later date. We can advise further on this if required.

Recommended Action

We recommend that you:

a **discuss** this paper with officials at Budget Matters on 10 September.

Agree/disagree

b **agree** to the Treasury developing a fiscal stimulus package for announcement later in 2019, if required.

Agree/disagree

c **select** which of the policy options from the table below you would like the Treasury to develop further.

Bucket	***Policy***	***Treasury preferred option***	***Selected for further development?***
A	s9(2)(f)(iv) [redacted]		
B	Minor roading improvements		□
	s9(2)(f)(iv) [redacted]		
	School Property Programme		□
	s9(2)(f)(iv) [redacted]		

	s9(2)(f)(iv)		
	DHB asset renewal	*	☐
	s9(2)(f)(iv)		
C	Delayed roading projects	*	☐
	Broader infrastructure pipeline	*	☐

d **agree** to the Treasury working with a small group of trusted officials in the relevant agencies to develop these policy options further.

Agree/disagree.

e **indicate** if you would like regular updates on the development of this package.

Yes/no.

f **indicate** if you would like regular updates on our view of the economic outlook in reference to fiscal stimulus.

Yes/no.

g **indicate** if you would like advice on the level of the multi-year capital allowance prior to November to support an early announcement.

Yes/no.

Renee Philip
Manager, Macroeconomic and Fiscal Policy

Hon Grant Robertson
Minister of Finance

Treasury Report: Fiscal Strategy Options

1. This paper discusses options for changing the fiscal strategy given the current economic outlook. It recommends that, given the balance of risks and high degree of uncertainty in the economic outlook, the Treasury develop a fiscal stimulus package that can be implemented in the next three months, if required.

2. We are seeking your view on which policy initiatives should be developed further for potential inclusion in a stimulus package, based on a longlist we have prepared. This will allow us to develop these initiatives to the point where we will be able to provide you and Cabinet with detailed advice on their impacts.

3. This advice has been prepared without the benefit of formal Treasury forecasts. The assessments of the economic outlook and impact of the packages are largely qualitative. As we prepare our economic and fiscal forecasts and develop the details of the initiatives over the next two months, we will be able to provide more precise estimates of the implications of a package for debt, deficits and growth.

Economic and fiscal outlook

We expect growth to be slightly weaker than forecast at Budget, but are currently well short of a recession

4. The global economic outlook has softened since our Budget forecasts, and the downside risks to growth have increased. We previously forecast 2.9% growth for the 2019 calendar year; we currently expect this to be closer to 2.2%, although this assessment is highly uncertain. The recent weakening in growth is driven by a combination of lower global growth and persistently low business confidence.

5. This general sentiment is shared by most external forecasters, including the Reserve Bank, commercial banks and international institutions. Most forecasters have downgraded their growth forecasts in recent months. However, all growth forecasts for 2019 remain above 2%, and growth forecasts over the next three years are in a similar range. No major private or public institutions are forecasting a recession as the most likely outcome in the immediate future.

6. This reflects ongoing strength in many areas of the New Zealand economy. Business investment, although weaker than it was before the financial crisis, is growing around the same rate as it has been for the past ten years. Overall export volumes and prices (with the exception of forestry) remain high. The labour market remains strong, with low unemployment. We have observed no increase in youth unemployment, typically a leading indicator of a weaker labour market. This, combined with strong wage growth, is also supporting healthy household consumption.

However, the outlook is highly uncertain, and the risks of a sharper fall in growth, or a long period of lower growth, remain

7. The strengths described above are based on backward looking indicators. Looking forward, businesses' expectations are more pessimistic. Expectations of businesses' own trading activity fell slightly in the June quarter of this year. Manufacturers are particularly pessimistic, reporting lower export demand, consistent with the weakening global picture.

8. The impact and future path of trade disputes between the US and China remains unpredictable. If tensions continue or worsen, they may lead to a contraction in demand for New Zealand exports from the Chinese market. Global demand may also

be weakened by slowing growth in Europe, and the risk of a weaker American economy as the effect of the recent US fiscal stimulus fades.

9. s9(2)(d) [redacted]

10. There is a possibility that risks around trade, global demand, financial market volatility and business confidence crystallise and trigger a recession in New Zealand in the next year. We currently view this risk as low. A more likely downside scenario is that the somewhat weaker growth continues, and becomes structural, rather than cyclical – for example, if global export demand falls, and does not recover. This would mean growth closer to 2% than 3%, in a period of continued high population growth. The consequence of this would be lower per capita growth, and relatively worse living standards for New Zealanders.

The fiscal position appears strong, but high surpluses are likely to be a windfall that will not persist into the next year…

11. The financial statements for 2018/19 are likely to be stronger than forecast at Budget 2019. The unaudited results show an operating balance excluding gains and losses (OBEGAL) surplus for 2018/19 of $8.3 billion, compared to a Budget 2019 forecast of $3.5 billion. Net core Crown debt for 2018/19 was at 19.5% of GDP, compared to 20.1% forecast at Budget 2019.

12. The stronger fiscal position in the last year is largely due to significant one-off items, such as a change in the valuation method of the rail freight network and tax process improvements. It is unlikely this fiscal strength and higher tax revenues will continue into the next financial year.

13. The position for 2019/20 is likely to be weaker than forecast, purely on the back of weaker economic data. Based on very rough calculations, we estimate the weaker economic outlook could halve the OBEGAL surplus of $1.3 billion that was forecast at Budget 2019. This estimate is highly uncertain and does not consider other influences on OBEGAL outside of economic factors. It also excludes the impact of the business tax package you will be announcing later this month. It is possible an OBEGAL deficit emerges in the next financial year even in a very moderate slowdown.

14. However, the strong outturns for 2018/19 will support a lower starting point for debt, which would provide more room against the Budget Responsibility Rule to maintain net debt below 20% of GDP in 2021/22. This is discussed in detail below.

…but, consistent with our advice prior to Budget, there are few macroeconomic risks from a modest increase in debt

15. Our judgement remains that maintaining net core Crown debt between 15% and 25% of GDP is a prudent target [T2019/661 refers]. We do not believe reducing net debt strictly below 20% in 2021/22 is required for a prudent fiscal policy. Maintaining net debt *around* 20% of GDP provides a sufficient buffer against future shocks and, as long as there is a credible and sustainable fiscal trajectory, small fluctuations in the level of net debt relative to the 20% target are not economically significant.

16. Interest rates also remain at historic lows. Ten year government bonds are currently trading on the secondary market at yields a little above 1%, compared to around 3%

this time two years ago.[1] This substantially reduces the immediate cost of borrowing. However, interest rates may rise in future, and bonds issued today may have to be refinanced at higher rates, imposing a higher fiscal cost from increased borrowing.

17. We see three scenarios of how the economy may develop over the remainder of 2019, each of which would require a different policy response. These are described in table 1 below. This includes a qualitative description of their economic and fiscal impact, before accounting for any response from government. Currently, we view scenario 1 as the most likely, with scenario 2 marginally less likely. Scenario 3, a recession, remains an outside risk.

Table 1: three scenarios for the economy

Scenario	*Economic Outlook*	*Fiscal Outlook*
1	**Slightly weaker growth** – growth for 2019 falls below BEFU forecasts, but remains above 2%. Possibility of a slight rise in unemployment; further cut in the OCR possible but not certain.	Future OBEGAL position likely to be weaker, possibility of deficit in 2019/2020. Impact on net core Crown debt uncertain; lower growth may be offset by the improved fiscal starting point from the previous year.
2	**Much weaker growth** – growth for 2019 drops below 2%. Rise in unemployment; OCR cut further.	OBEGAL deficit more likely than not. Increase in net core Crown debt above level forecast at BEFU likely.
3	**Recession** – growth falls substantially, and looks to turn negative in 2019 or early 2020. Unemployment rises; OCR reduced rapidly to zero or below.	OBEGAL deficit and significant increase in net core Crown debt certain.

18. In all these scenarios, and the subsequent discussion, we assume the weaker growth to be transitory, with the economy returning to near current estimates of potential in the medium term. While the economic outlook is uncertain, it seems likely much of the recent slowing is driven by temporary rather than permanent factors. We have therefore considered policy options to manage this over the short term – if we were facing a structural, permanently lower level of growth, or a recession, the set of policy options would be different to that outlined below.

Strategic policy options

19. Each of these three scenarios justify a reconsideration of the appropriate mix of macroeconomic policies. There are three macroeconomic levers that can respond to slowing growth: **monetary policy**, **automatic fiscal stabilisers**, and **discretionary fiscal policy.**

Monetary policy is typically the main stabilisation tool, but will become constrained if growth slows further

20. Loosening monetary policy through reductions in the OCR is typically used as the first tool of response in any slowdown. This reflects the ability of changes in the OCR to be implemented and affect the real economy very quickly in response to changing events,

[1] Consequently, issuing $100m worth of 10 year bonds today is likely to cost the Crown a total of $10m in nominal terms until the bonds reach maturity, compared to around $30m in late 2017.

and to be reversed if circumstances change. An important transmission mechanism of this will be the exchange rate, which will depreciate as monetary policy loosens, increasing the competitiveness of the export sector.

21. As highlighted above, it is not possible to reduce the OCR substantially if either scenarios 2 or 3 eventuate. This raises the possibility of negative interest rates, or other unconventional monetary policy tools, such as large scale asset purchases (also known as quantitative easing). Earlier advice [T2018/3106] outlined these options. International evidence on the effectiveness of these instruments is mixed. The Reserve Bank are working to develop an improved understanding of preferred unconventional policy options, and associated risks, by the end of 2019.

22. s9(2)(d) [redacted]

Automatic stabilisers should be allowed to operate in any scenario, but will not likely be sufficient to offset the slowdown in scenarios 2 or 3

23. Weakening growth will also trigger support from automatic fiscal stabilisers. This will include an increase in welfare payments and a fall in tax revenue. These will provide the first source of support to the economy if growth begins to slow. However, their overall impact is limited, with a 1% fall in GDP generally leading to about 0.5% of GDP increase in stimulus through this route.

24. It is important these automatic stabilisers are allowed to operate if growth slows. If, in scenarios 2 or 3, an OBEGAL deficit appears likely, we would advise against any tightening in the fiscal position to eliminate the deficit. In this scenario a deficit would provide important support to the economy, and any fiscal tightening risks exacerbating any incipient downturn.

Well-designed fiscal stimulus would be a good option in all scenarios given the constraints on monetary policy

25. The third and final policy option is a discretionary fiscal stimulus – an increase in spending or reduction in revenue. A discretionary fiscal stimulus should be designed to be **timely**, **targeted** and **temporary**:

    a. **Timely** stimulus will increase spending in the real economy as quickly as possible to maximise its impact. This will tend to favour simple, shovel-ready projects, or funding which can be disbursed through existing mechanisms.

    b. **Targeted** stimulus will focus spending where it is most likely to be passed through to the real economy through increased domestic consumption or investment.

    c. **Temporary** stimulus will be easy to withdraw, so the stimulus does not result in a permanently higher level of spending or lower level of revenue.

26. The judgement as to whether a fiscal stimulus needs to be implemented should rest primarily on how much support to the economy monetary policy and automatic stabilisers can provide, and at what cost and risk. In a ‘normal’ slowing in growth, we would advise monetary policy and automatic stabilisers as the first tools to support the economy. However, the current low level of the OCR changes this calculation.

27. In order to provide support to monetary policy, and reduce the risk of the Reserve Bank needing to resort to unconventional monetary policy tools, you may wish to implement a fiscal stimulus, even in scenario 1. Given the uncertainty of the outlook, and the possibility of further weakening growth, this would constitute a lower risk, ‘least regrets’

approach. This is particularly true given the low debt and low cost of borrowing in the current environment.

28. Discretionary fiscal stimulus also has the advantage of being a more targeted tool than either monetary policy or automatic stabilisers. It can be used to either alleviate the effects of slowing growth, or achieve Government objectives in a way other policy options cannot.

29. Loosening of fiscal policy has the potential to provide space for monetary policy, given currently low interest rates. As a rule of thumb, our analysis suggests that increasing government spending by 1% of GDP (~$3 billion) would lead to an increase in the OCR by 30 basis points. However, this analysis is uncertain, with estimates ranging between 10 to 45 basis points. This estimate will depend significantly on the exact package of fiscal stimulus. This does suggest that the scale of fiscal stimulus needed to meaningfully support monetary policy is large, with doubling budget allowances about equivalent to one 25 basis point OCR cut.

30. However, the exact design of a fiscal stimulus is critical to ensuring it remains a less risky option than monetary policy, and is able to achieve additional objectives (discussed below). For this reason we recommend you consider the exact composition of a stimulus before deciding whether to implement one. Options for composition of a stimulus are discussed in the next section of this report.

To prepare for all possible scenarios, it is prudent to design a fiscal stimulus now to allow for implementation if required

31. Table 2 summarises the discussion above, indicating our likely recommended policy mix for each scenario. As this table highlights, for any economic outlook, there is likely to be a good case for discretionary fiscal stimulus, with the case for such a stimulus increasing as the outlook worsens.

Table 2: summary of possible scenarios

Scenario	*Outlook*	*Likely recommended policy mix*
1	Slightly weaker growth	Monetary policy remains supportive, use of unconventional policy unlikely. Minimal contribution from automatic stabilisers. Discretionary fiscal stimulus not strictly required; but may be the ‘least regrets’ approach, depending on value of proposed initiatives and your level of risk aversion.
2	Much weaker growth	Monetary policy loosens further, possibly using unconventional policies. Allow automatic stabilisers to operate. Discretionary fiscal stimulus highly recommended, especially if it allows less reliance on unconventional monetary policy.
3	Recession	Monetary policy substantially looser, including use of unconventional policies. Allow automatic stabilisers to operate; but they are only likely to provide a small contribution. Discretionary fiscal stimulus essential, emphasising stimulatory effects over the value of initiatives. May require co-ordination with unconventional policy.

32. While new economic data released over the next two months will somewhat clarify our position, we will not be able to say with certainty which of these scenarios we face.

There is no clear-cut trigger to motivate an immediate stimulus. The judgement as to whether one needs to be implemented will rest on the balance of risks, and whether the costs of an 'unnecessary' stimulus are outweighed by the benefits it provides; or the costs of not implementing stimulus when it is required.

Design of a fiscal stimulus

33. This section focuses on the specific design of a package that could be announced in the next three months in response to scenario 1 or 2. A recession as described in scenario 3 would justify a different, more radical, set of fiscal policy options. **We have not considered more radical stimulus options as part of this advice due to the relatively low likelihood of a recession scenario.**

A fiscal stimulus can aim to address secondary economic objectives, in addition to stimulating overall activity

34. In the event of a slowdown in growth, maintaining demand and economic activity should be the primary objective of a stimulus. However, there are secondary considerations that will inform the mix of policies included. We recommend targeting the following secondary objectives:

- **Boosting confidence**, which will support short-term economic activity.
- **Minimising inequality**, targeting support at those most affected by any slowdown in growth.
- **Addressing long-run constraints**, such as improving infrastructure when there is spare capacity in the economy. This has the potential to raise long-run growth and productivity.

We recommend a fiscal stimulus is composed of a mix of policies of three 'buckets', each of which addresses a different mix of these secondary objectives

35. From our initial work, there are three broad categories of spending that are appropriate for inclusion in a fiscal stimulus:

s9(2)(f)(iv)

b. **Rapid delivery projects** – areas of infrastructure spending or existing funding streams for which we believe spending can be increased in the short run. These will require more work with agencies to develop in greater detail.

c. **Long-term capital projects –** larger investment projects which are currently unfunded but for which you could announce government support.

36. Confidence will be most effectively supported by a high-profile announcement of any stimulus, and appropriate communication strategy. These confidence effects, though impossible to estimate quantitatively, will be important in overcoming any reluctance of businesses to invest. Confidence is likely to improve from any substantive announcement, even if the effect of the spending may not occur immediately. This would strengthen the case for announcement of capital projects that might otherwise have limited immediate effect.

37. The ability of infrastructure to raise long-run productivity should also be considered. The value of the proposed investments is critical to achieving this, and whether there are productivity gains from a stimulus will rest on the quality of the spending proposals.

There are early, though still uncertain, signs the economy is entering a period where there is spare capacity in some sectors. This strengthens the case to signal a commitment to capital projects likely to improve long-run growth by addressing supply side constraints. Commitments at this stage will also provide certainty to the private sector of ongoing, long-term demand from government.

38. Reductions in growth, and in particular a weakening labour market, tend to disproportionately affect those at the edge of the labour market – for example, those who have recently joined the labour force or part-time workers. For example, during the GFC the unemployment rates for Māori and Pacific peoples rose by around 7 percentage points, substantially more than the 2 percentage point increase across the whole labour force. In the event of weaker growth, those losing jobs can be most effectively helped by changes in welfare provision that will mitigate the negative distributional effect of any downturn.

The timing, macroeconomic impact and effect of each bucket on debt and the deficit will also vary substantially

39. In order to assess the impact of a fiscal stimulus, we typically consider a 'fiscal multiplier'. This is the increase in GDP we would expect to see for each additional dollar of spending in that area. For example, a multiplier of 0.5 implies spending of $1 billion in a single year should raise GDP by about $500 million in that same year.

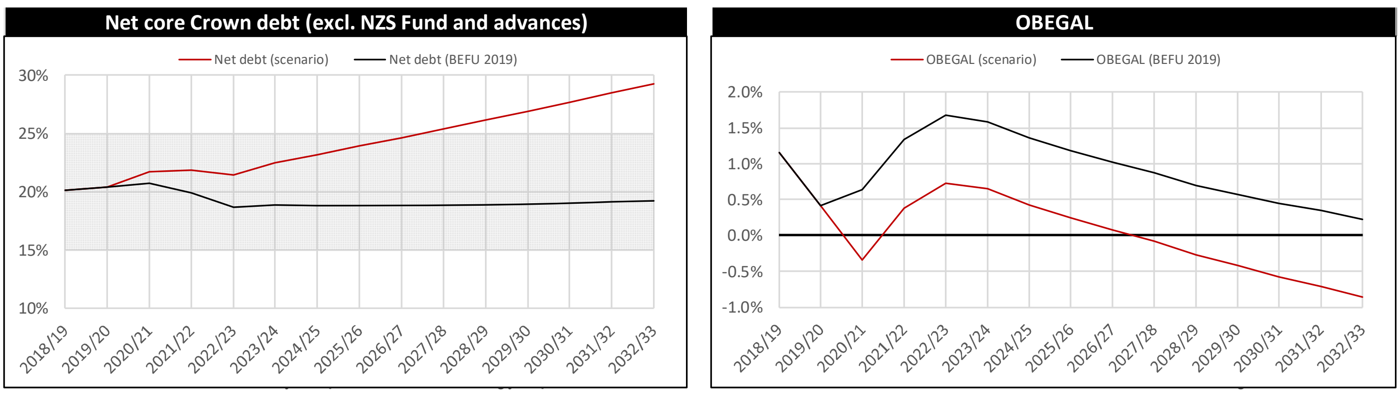
40. The value of fiscal multipliers are highly uncertain, and will vary by type of spending and the economic conditions. However, they can provide a useful guide to assess how targeted a given stimulus is. They also provide a useful benchmark to assess how large a stimulus would need to be to achieve a desired economic outcome.

41. Tax and welfare changes tend to stimulate the economy by directly increasing household incomes. They can be implemented relatively quickly, and have a short run impact on demand. The Treasury's latest research suggests multipliers for tax or transfers between 0.76 and 1.29 over the first year of spending. However, external estimates of these multipliers vary widely, from zero or below to above one.

42. Typically multipliers for tax and transfers will be higher where the stimulus reaches low income households, which are more likely to spend rather than save additional money they receive. Multipliers will be lower if any tax changes favour spending on imported goods – for example, tax breaks on cars are unlikely to have a stimulatory effect.

43. The principal drawback of welfare expenditure or tax changes is that they cannot easily be reversed without having a contractionary effect on the economy. While there are exceptions (discussed in the annex) the stimulus options we have identified in this category will permanently raise spending or lower revenue. This is illustrated in figure 1 below, which shows the impact of a 1% of GDP (c. $3.2 billion) increase in annual welfare expenditure, outside current allowances, and assuming no change in the BEFU 2019 economic forecasts.

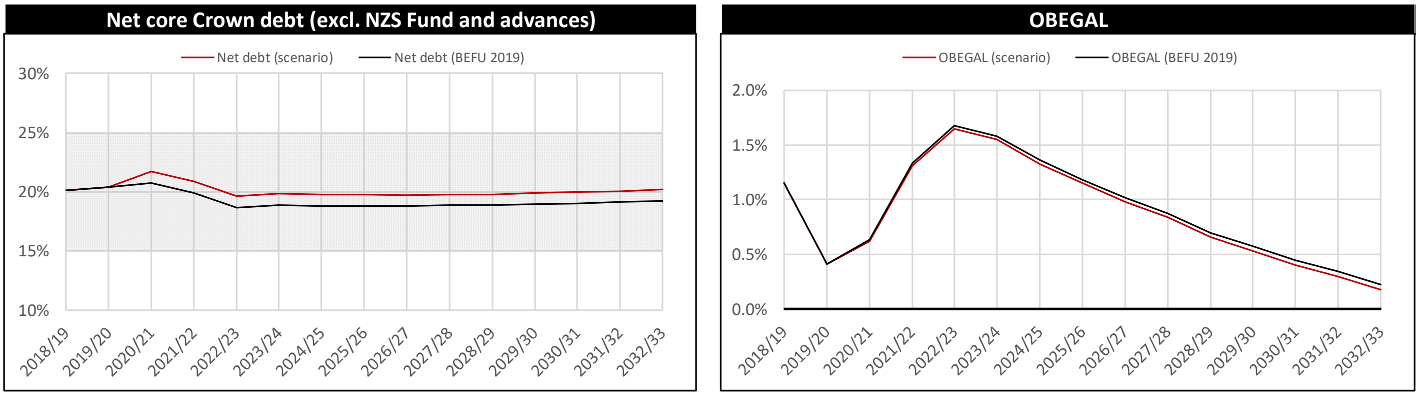
Figure 1: impact on debt and OBEGAL of a 1% of GDP increase in welfare expenditure



44. Capital spending is typically far slower to implement than changes in tax or welfare. This reflects long lead times on most capital projects. Evidence for New Zealand also suggests the stimulatory effect of capital spending is likely to be weaker. This reflects the tendency of many investment goods to be imported to New Zealand, rather than being domestically produced. This can be partially mitigated by focusing expenditure on less import-intensive policies.

45. However, capital spending will typically be temporary. While it will add to debt, it will not lead to permanently higher spending as changes to tax and welfare policy will. Figure 2 illustrates this using the case of a 1% of GDP (c. $3.2 billion) increase in capital expenditure for one year, based on BEFU 2019 forecasts.

Figure 2: impact on debt and OBEGAL of a 1% of GDP capital expenditure



The mix of the three buckets you choose will depend on your preferences over debt and deficits, and the secondary objectives you wish to achieve

46. The pros and cons of each bucket are summarised in table 3. s9(2)(f)(iv) [redacted] s9(2)(f)(iv) [redacted] Bucket B delivers short-term benefits and one-off costs, but the specific policies within it require substantial further development and contain several risks. Bucket C will deliver limited short-term benefits, for a one-off cost, and potential long-term benefit.

Table 3: summary of potential stimulus 'buckets'

Bucket	***Overview***	***Pros***	***Cons***
A	s9(2)(f)(iv) [redacted]		
B	Rapid delivery projects	Quick to deliver and highly scalable. Likely to be geographically distributed. Small projects less likely to face capacity constraints. Increase in spending is temporary.	We have little oversight centrally of what projects might be funded. Requires further work with other agencies to design an appropriate funding mechanism that can ensure money is spent well and quickly.
C	Large scale capital projects	Minimal work required to develop these projects further. Increase in spending is temporary, and imposes only a one-off increase in debt.	Unlikely to have any short-term impact given implementation lags. The positive impact will be purely through confidence effects.

47. A longlist of specific policies we have considered within each of these buckets is summarised in table 4 below, with further detail in the annexes. The Treasury would recommend any of these options as appropriate for a fiscal stimulus in any of the economic scenarios discussed.

48. **At this stage we are seeking your views to narrow table 4 to a shortlist of policies which we will develop further.** We recommend development of some policies from each bucket, prioritising based on your preferences regarding the secondary objectives and impacts on debt and deficit discussed above. We have indicated which of these options are preferred by the Treasury, but all options on the longlist are appropriate for further consideration. The Treasury preferred options are largely those policies we have previously advised be taken forward, but have been delayed due to funding constraints.

49. You have already indicated an intention to announce a business tax package alongside the launch of the Economic Strategy on 22 September. We support this from both a macroeconomic and tax policy perspective. s9(2)(f)(iv) [redacted]

50. Developing any of these options in more detail, but particularly those in Bucket B, will require engagement with agencies. Given the sensitivity of this topic and the degree of media interest in the current context, we are proposing restricting our engagement in each agency to a small group of trusted officials on a 'need to know' basis.

Table 4: Summary of Fiscal Stimulus options

Bucket	Policy	Principal beneficiaries	Indicative cost	Spending Timeframe	Secondary objectives			Treasury preferred option
					Improve business confidence	Reduce inequality	Long-run structural benefit	
A	s9(2)(f)(iv)							
B	Minor roading improvements	Wider economy	Uncertain	1 – 2 years	X		X	
	s9(2)(f)(iv)							
	School Property Programme	Education	Variable	1 – 2 years	X		X	
	s9(2)(f)(iv)							
	DHB asset renewal	Health	c. $200m p.a.	Next 3 years	X		X	*
	s9(2)(f)(iv)							
C	Delayed roading projects	Wider economy	Variable	3+ years	X		X	*
	Broader infrastructure pipeline	Wider economy	Variable	3+ years	X		X	*

51. We have also considered a number of other policy options, which we have variously decided against inclusion in the above long list, on the basis of being impractical to implement or in conflict with existing policy objectives. These include:

- Pay equity settlements
- Improving early childhood education
- Kiwirail asset replacement
- Increasing the Provincial Growth Fund
- Science and innovation funding
- Introducing (temporary) GST exemptions
- Temporarily reducing fuel excise duty
- Accelerating broadband infrastructure

Risks and uncertainties

Capacity constraints may limit the ability to deliver a fiscal stimulus, but there are signs these are easing

52. Indicators of capacity in the economy are mixed. While our aggregate estimates of the spare capacity are at or closer to zero, within specific sectors there is an indication of softer demand and expectations of spare capacity and an easing labour market in the future.

53. In the construction sector, where the bulk of any new stimulus funding in buckets B or C is likely to be directed, the outlook suggests the constraints are beginning to ease. Confidence, employment, new orders and job adverts are all down over the last year, which suggests capacity constraints may be easing in this sector. However, there remain long run structural challenges – such as the lack of specific skilled employees such as project managers – that may still inhibit the ability of the sector to meet an increase in demand from government.

54. Additionally, given the outlook for monetary policy, it is appropriate to be more relaxed than usual about exacerbating capacity constraints. Normally, increasing spending in sectors at or near capacity would stimulate inflation. However, the Reserve Bank is currently concerned about inflation being too low, and would welcome rising capacity pressures stimulating inflation, allowing the Monetary Policy Committee to raise (or not reduce) the OCR.

55. Capacity constraints are also likely to be improved in the long run by a certain pipeline of projects. This is offered in part through the infrastructure pipeline and multi-year capital allowance – but committing further funding through projects in Bucket C is likely an effective way to enhance this further.

A fiscal stimulus will impact your Budget Responsibility Rules; there are several approaches to handle this

56. Any fiscal stimulus, or slowing growth, will likely impact your progress against the following Budget Responsibility Rules (BRRs). The rules and probable impact are summarised below.

Reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office, subject to any significant shocks to the economy.

57. Any meaningful fiscal loosening is likely to mean missing this target in 2021/22. This could be justified by use of the 'subject to any significant shock' provision in the rule. However, the feasibility of this will depend on the size of any reduction in forecast growth. If, as currently expected, growth slows but remains above 2%, this will be difficult to justify.

The Government will maintain its expenditure to within the recent historical range of spending to GDP ratio.

58. This target is not strictly defined. If 2011 is considered as within 'recent history', core Crown expenses can rise to up to 34% of GDP from the current level of 29% of GDP. This is unlikely to bind in any feasible expenditure package.

Deliver a sustainable operating surplus across an economic cycle.

59. An increase in operating spending of more than $2 billion p.a. (or equivalent sized decrease in revenue) will mean an OBEGAL deficit in 2020/21 is likely. Changes in capital expenditure will not materially affect OBEGAL, except through increased interest payments.

Any stimulus risks introducing longer-run deficit; the likelihood of this is highly uncertain, though will become clearer with the benefit of fiscal forecasts

60. A temporary OBEGAL deficit can be consistent with the BRRs and countercyclical fiscal policy, so long as the deficit isn't structural, or if a return to a structural budget balance is reasonably forecast.

61. A structural budget deficit implies there will be a deficit on average over the cycle if future action isn't taken to reduce the structural level of operating expenditure or increase the structural level of revenue.

62. Running structural budget deficits, without a forecast return to a structural budget balance, could be considered as inconsistent with the Public Finance Act principles of responsible fiscal management, and your Budget Responsibility Rule to run a sustainable operating surplus over the economic cycle.

63. An increase in operational spending or a policy-driven fall in revenue of more than $1 billion p.a. (0.3% of GDP) would likely mean OBEGAL will be in a structural deficit in 2020/21. Fiscal stimulus greater than $6 billion (1.7% of GDP) in total over the forecast period would lead to a structural deficit over the whole forecast period.

s9(2)(d)

[redacted]

s9(2)(d) [redacted]

Next steps

We recommend the Treasury work with agencies to develop the detail of a shortlist of policy options for a final decision in November

67. Subject to your agreement, the Treasury will commence work to develop a detailed stimulus package based in the policy options you have selected for further consideration, working with officials in the relevant agencies. We can provide regular updates on the progress of this work if you wish.

68. We recommend a decision is taken on the exact composition of a stimulus package, and whether or not to implement it alongside the early November fiscal strategy advice ahead of the Budget Policy Statement. This will allow you make a decision with the benefit of the Treasury’s preliminary fiscal and economic forecasts. These will allow us to provide more precise estimates of the impact of a stimulus on debt, OBEGAL and (to a lesser extent) growth than the indicative figures above.

69. As noted above, it is unlikely that by this point there will be a clear trigger that indicates whether or not a fiscal stimulus should be implemented, although more economic data will be available. The main benefit of waiting is allowing time to develop the detail of policy options, and to allow the impact of these to be compared against the Treasury’s forecasts. This will allow you to make a more informed judgement on the costs and benefits of a stimulus.

There are options to announce looser fiscal policy sooner, including by indicating an increased level of capital funding, without specifying initiatives

70. A decision in November would not prevent earlier signalling that you are considering a stimulus package. This could be achieved through indicating in your speeches or other public comments that specific policy options, or a fiscal stimulus in general, are under consideration. s9(2)(d) [redacted]

71. Alternatively, you could make an early announcement of the amount by which you intend to increase the multiyear capital allowance. The Treasury is planning to provide advice on rolling out the next year of the multi-year capital allowance in November ahead of the Budget Policy Statement, and could accelerate this work if you wish to make an earlier announcement. This increase in the capital allowance could then fund stimulus initiatives from buckets B or C. It is unlikely any specific initiatives would be sufficiently developed for announcement in September or October, but the announcement of further capital spending would have an important signalling effect. However, the impact on net debt would be uncertain because the forecasts would not have been completed.

We will continue to monitor economic developments and can provide you regular updates in writing, or orally at Budget Matters

72. We will also continue to monitor economic data over the next months. We view the following as the key check-in points. Any surprise results in these data release may justify a more substantive review of the outlook presented above, and therefore the case for a further stimulus.

    a. **19 September** – June quarter GDP

    b. **25 September** – OCR announcement

    c. **1 October** – Quarterly Survey of Business Opinion

    d. **6 November** – Household Labour Force Survey

73. Finally, you will shortly receive a draft of the Budget Strategy Paper for consideration at Cabinet. This includes a reference to the fact that this work is ongoing. We recommend you take any further discussion of fiscal stimulus to Cabinet after you have made a decision on the composition of the package. Earlier or more substantive engagement, such as inviting agencies to submit policies for consideration, would risk running a parallel Budget process that would strain the capacity of both agencies and the Treasury.

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv)

[redacted]

Annex B – Rapid delivery projects

91. This annex describes the 'rapid delivery projects' that could be funded through a stimulus. In the recommendations in this report, we ask you to indicate which of these potential projects should be developed for further consideration.

92. These options s9(2)(f)(iv) [redacted] have been developed without input from agencies. Extensive engagement with agencies would be required to develop these proposals before they could be ready for announcement. There is a risk that the consultation process will find that some of these proposals are not viable.

93. We have identified six portfolios where there may be opportunities to quickly increase spending on a temporary basis and at a magnitude that could be significant at a macroeconomic level:

a. **Transport – Minor road improvements:** the New Zealand Transport Agency (NZTA) has a package of minor road improvements and safety works that could be brought forward to support an economic stimulus. Crown funding could be directly appropriated to NZTA to carry out these works, which would bypass the National Land Transport Programme/Land Transport Management Act framework. However, we do not have any details of the exact nature of these projects or the scale of funding that would be required, which would require further work to develop.

s9(2)(f)(iv) [redacted]

- **Option 2: One-off/time limited increase to 5 Year Ahead (5YA) funding** - The purpose of 5YA funding is to fund minor school capital upgrades (property redevelopments, repairs and refurbishments). All schools receive 5YA funding to do this essential capital and maintenance work, however the amount of funding varies between schools – this could be easily increased to fund additional one-off expenditures. 5YA funding is also ring-fenced which would provide parameters around the types of activities that can be funded.

s9(2)(f)(iv) [redacted]

In all of these options, the most substantial risk would be a lack of school or departmental capacity to spend the money quickly. We would seek to investigate how likely this is in any work developing these options further.

c. **Health – Minor asset and infrastructure renewal:** Providing DHBs with an additional pool of targeted capital funding for minor asset and infrastructure renewal would be an effective fiscal stimulus option that provides relatively “shovel-ready” investment with a broad distribution across major urban and provincial centres. Given the current state of assets and infrastructure, we estimate that an investment of $400-$600 million over a 2-3 year period should be manageable from a procurement and delivery perspective by individual DHBs using mostly local or regional market capacity. Even where major projects are underway (eg Dunedin), DHBs will have a backlog of minor projects that could be brought forward to stimulate economic activity.

   Once the National Asset Management Plan (NAMP) is completed in December 2019, there will be a common data set across the sector to better inform the scope and scale of a potential investment pool. Based on the findings of the NAMP, specific areas of minor asset and infrastructure renewal could be targeted at a national or local level. There could also be an opportunity to target sustainability investments to improve energy efficiency (with subsequent reductions in future operating costs) and reduce carbon emissions.

   Funding could be allocated proportionately to recognize the variable scale of DHB asset bases and local DHB and market capacity, (eg, proportionate with facility asset values) rather than requiring individual business cases for each investment (as would currently be the case for any new Crown investment).

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv)

[redacted]

Annex C – Large infrastructure projects

95. Large infrastructure projects, as discussed above, will not be able to be implemented quickly. However, their announcement will have important confidence effects, and in many cases help address long run infrastructure and productivity challenges.

96. If you wish to fund larger infrastructure projects, we recommend drawing from the established pipeline of infrastructure projects. You have previously been advised on the some of these projects, and the large gap between agencies' capital intentions and available multiyear capital allowance [T2019/2177 refers]. We view existing **delayed roading projects** as the most suitable for being brought forward quickly. This reflects that they are relatively advanced in their design, costs and benefits are well understood. There is also some, primarily anecdotal, evidence of spare capacity in the road building sector. A list of these projects is summarised below, based on previous advice you have received.

97. A number of other long-term projects from the infrastructure pipeline beyond roads are likely to be suitable for funding now. However, our knowledge of these, in particular their costs, benefits, and stimulatory impact is more limited. If you wish to increase capital expenditure substantially, we recommend that we work with agencies over the next two months to bring projects in the pipeline to the stage where we can comfortably advise committing funding.

Delayed Roading Projects

98. **Penlink** ($330 million; $100 million has been committed by Auckland Council and $100 million unconfirmed funding from NZTA): proposed alternative route between the Whangaparaoa Peninsula and SH1 at Redvale north of Auckland. This project has a high benefit-cost ratio and could help to facilitate residential and commercial development. Project is construction ready and 95% of property acquisitions are complete. Auckland Transport has been looking at ways to accelerate delivery, but the lack of confirmation of NZTA funding has hampered this. The Crown could potentially step in to provide the NZTA share.

99. **Mill Road** (in excess of $1 billion, but being re-scoped by Auckland Transport): proposed north-south corridor for Southern Auckland, connecting Manukau and Drury to the east of the Southern Motorway. It will be difficult to accelerate delivery; the first sections could begin construction in 2 years but major works still five to ten years away.

100. Twelve other NZTA roading projects were deferred due to a lack of funding and are currently being re-evaluated. s9(2)(f)(iv) [redacted] s9(2)(f)(iv) [redacted] More detail below is provided below.

Project	***Current Status***
Melling Interchange	Project delayed, project will be not be progressed before 2028.

s9(2)(f)(iv) [redacted]	
SH1 Otaki to north of Levin	Project re-scoped from four to two-lane highway. Construction timing and form of this new route will depend on growth and funding priorities across the rest of the country
s9(2)(f)(iv) [redacted]	
SH2 Tauranga Northern Link	Project re-scoped from four to two-lane highway. The new plans include a two lane route, one lane in each direction, between Te Puna and Tauranga alongside the existing road.
s9(2)(f)(iv) [redacted]	
East West Link	Re-evaluation ongoing.