TE TAI ŌHANGA
THE TREASURY

Reference: 20200322

10 September 2020

Dear

Thank you for your Official Information Act request, received on 3 September 2020. You requested:

> *"…a copy of all material supplied in response to an OIA request regarding helicopter money."*

Information being released

Please find enclosed the following document:

Item	Date	Document Description	Decision
1.	12 August 2020	Binder of Information released in response to OIA request 20200215	Release in full

The document listed above contains redactions where information was withheld under the original request under one or more of the following sections of the Official Information Act, as applicable:

- advice still under consideration, under section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials
- under section 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
- under section 9(2)(h) – to maintain legal professional privilege
- direct dial phone numbers of officials, under section 9(2)(k) – to prevent the disclosure of information for improper gain or improper advantage.

Some information was redacted because it was not covered by the scope of the original request. This is because the documents include matters outside the specific request.

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Direct dial phone numbers of officials were redacted under section 9(2)(k) in order to reduce the possibility of staff being exposed to phishing and other scams. This is because information released under the Official Information Act may end up in the public domain, for example, on websites including the Treasury's website.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Please note that this letter (with your personal details removed) may be published on the Treasury website. In addition, the original response to OIA request 20200215 and the binder of material you have requested is scheduled to be made publicly available on the Treasury website within the next two weeks.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Renee Philip

Renee Philip
Manager, Macroeconomic and Fiscal Policy

20200215
Table Of Contents

Announced Covid-19 Stimulus and Support Measures – Selected Countries, as at 5 March 2020

	Support for individuals	Deleted - Not Relevant to Request
Australia – details tba	• Financial boost for pensioners • Considering support for depositors (deeming rate)	
Italy	• Tax cuts	
South Korea	• $2.5B in gift vouchers for low income households and seniors • Childcare subsidies • Tax refunds on purchases of energy-efficient home appliances	
Hong Kong	• Cash handouts $1284 per adult.	
Singapore	• Cash handouts between $100 SGD and $300 SGD per adult.	

Malaysia	• RM1000 tax credit for expenditure related to domestic tourism • RM100 travel vouchers per person • One-off payment of RM600 each to taxi drivers, tourist bus drivers, tourist guides and registered trishaw drivers.			
United States				

Last updated: 31/3/20

Summary of international tax measures in response to COVID-19

Deleted - Not Relevant to Request

Pages 2 - 7 of this this document have been deleted as they are not relevant to this request.

Last updated: 31/3/20

Deleted - Not Relevant to Request

<u>Australia</u> – On 12 March, announced two one-off payments of A$750 to benefit and public pension recipients to support domestic consumption and boost confidence. Timing - First Payment Paid automatically from 31 March 2020. Cost: A$4.8 billion. Second Payment Paid automatically from 13 July 2020. Cost: A$4.0 billion. Total cost A$8.8 billion (approx. 0.5% of GDP)

Northern Territory Home Improvement Scheme ($30m): households are offered a voucher for physical improvements to land and/or buildings, and repairs and maintenance services. $6,000 for homeowners and landlords who also contribute $2,000, OR $4,000 for those who contribute $1,000.

<u>US –</u> President Trump has approved (27 March 2020) a US$2 trillion stimulus package which will include $290B of direct payments to households. Americans with incomes up to $75,000 will receive a one-off payment of $1,200 (or families with incomes of $150,000), and $500 per child aged 16 and under. The assistance phases out for people who earn more, up to $99,000 per individual.

Implementation timeframe – Treasury Secretary Steven Mnuchin said he expected most people to get their payments within three weeks.

<u>Hong Kong –</u> As part of the 2020-21 Budget announced on 26 February 2020, the Hong Kong Government will provide HK$10,000 (approx. US$1200) cash payment to all adult residents of Hong Kong.

Last updated: 31/3/20

Singapore - Budget 2020 included a $1.6 billion Care and Support Package for households. once-off cash grants of between $100 to $300 for qualifying Singaporean adults additional help for lower income Singaporeans through Workfare Special Payments, PAssion Card top-ups, Grocery Vouchers, additional GST Vouchers-U Save and rebates for service and conservancy charges.

Deleted - Not Relevant to Request

Pages 10 - 12 of this document have been deleted as they are not relevant to this request.

Brief on Australia's cash payment scheme in response to the GFC

Purpose

To inform development of stimulus cash payment in response to COVID-19

Overview and design

- Two rounds of cash transfers to households: announced in Oct 2008 and Feb 2009 respectively. Total fiscal cost was $A21b (Total GDP in 2008-9 was AUD$1.196T according to Australian Bureau of Statistics.) The total package therefore represented approx. 1.8% of GDP.
    - Oct 2008 package: $A8.7 billion in total for lump-sum payments (excluding $1.5b first home buyer subsidy). These were comprised of:
        - $4.8 billion to pensioners, and
        - $3.9 billion to low- and middle-income families receiving Family Tax Benefit A (FTBA)[1]
    - Feb 2009 package: $A12.7 billion (1.0% of 2009 GDP) in lump-sum transfers to households. Five broad categories of transfers were offered:
        - *Tax Bonus for Working Australians*, an income-tested one-off payment to individuals ($900 for individuals with taxable incomes of $80,000 or less, $600 for individuals with taxable incomes of $80,001-$90,000, and $250 for individuals with taxable incomes of $90,001- $100,000)
        - *Back to School Bonus*, a payment of $950 per child for low-middle income families receiving FTBA (see footnote 1) with school-aged children;
        - *Single-Income Family Bonus*, $900 to each family entitled to Family Tax Benefit B (FTBB)[2];
        - *Training and Learning Bonus*, a one-off payment of $950 to each recipient of youth allowances;
        - *Farmers' Hardship Bonus*, $950 payment per household to Australian farmers.
        - Households were allowed to receive more than one payment if they met the eligible criteria for each payment.
        - Payments were non-taxable and ignored for the purposes of calculating other income support payments.
- While not the focus of this note, the Australian Government stimulus package also had a sizeable infrastructure investment component.

[1] Family Tax Benefit A eligibility depends on family income and the number of children (similar to our Working For Families Family Tax Credit), and ceases at around $100,000 for a one-child family, or at about $125,000 for a three-child family.

[2] Family Tax Benefit B eligible families are single parents or couples where the primary earner has an income of less than about $150,000, and the secondary earner has an income below about $20,000 (both thresholds vary according to the number of children)

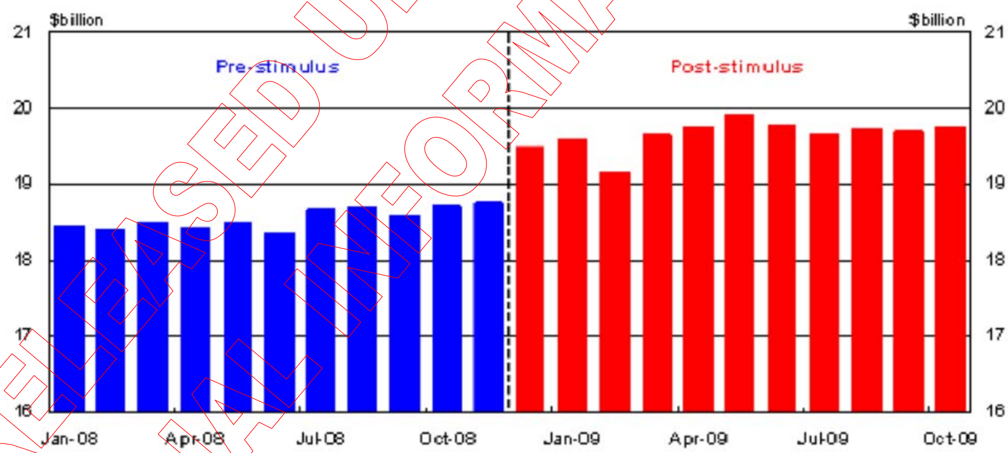
Administration

- October package – announced 15 October 2008; payments made from 8 December 2008, i.e. roughly 2 month lead time from announcement to implementation.
- February package – announced early Feb 2009; payments made April and May 2009. Ie. 2-3 month implementation period. It appears the payments were automatically made into bank accounts.

Was the cash payment scheme an effective stimulatory tool?

Source is the Australian Treasury unless stated otherwise.

- ***Retail trade turnover*** showed a noticeable increase in December 2008 when the first payments were made, increasing by 4%. It had shown almost no growth earlier in 2008. By April 2009, Australian retail trade turnover was 4.8 per cent above its pre-stimulus level.



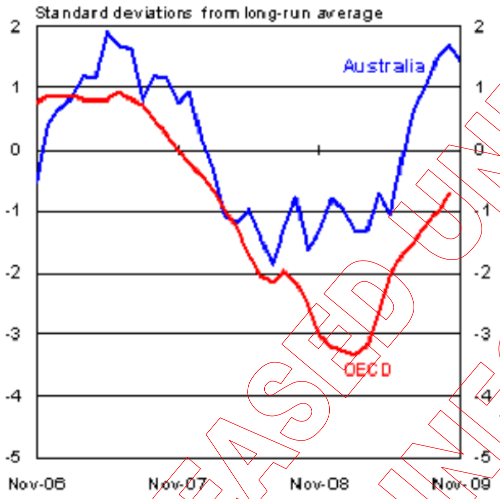
- The fact that the increased spending occurred when the payments were *received* (rather than when they were *announced*) suggests that the recipients of these payments were largely liquidity constrained (or that they were rule-of-thumb consumers whose spending adapted to the amount of money readily available for spending).

- This pattern of behaviour also fits with international evidence that consumption spending tends to rise on receipt of windfall income gains, rather than when consumers became aware that they will receive such windfalls.

- Retail trade turnover can therefore provide a good early indication of whether a cash payment scheme is working. If the data show a sizeable positive effect, this is likely to feed into increased consumer and business confidence (and vice versa).

Consumer confidence

- In the early stages of the crisis, both consumer and business confidence in Australia fell in a similar manner as in the rest of the OECD (see charts below).
- But after that, confidence measures in Australia bounced back strongly. The cumulative rise over the four months to September 2009 was the largest four-month rise in the thirty-five year history of the series.
- In the Australian Treasury's view, the release of the March quarter 2009 National Accounts in early June was particularly influential for consumer confidence, as this showed that Australia had avoided two consecutive quarters of falling real GDP, and therefore a technical recession (after a fall in the December quarter).



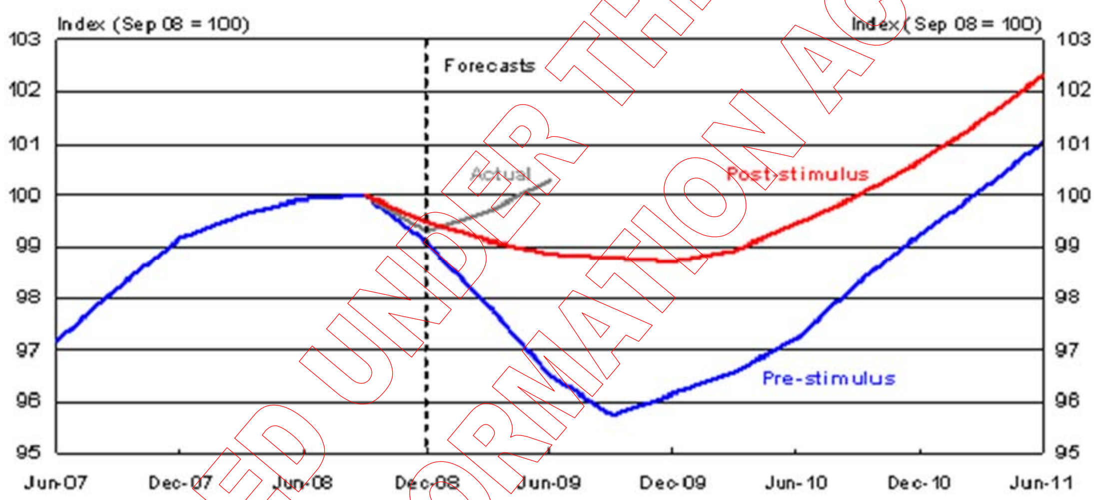
Business confidence

- Business confidence experienced a similar rapid rise around the same time (consistent with the OECD trend), but at a more rapid rate.

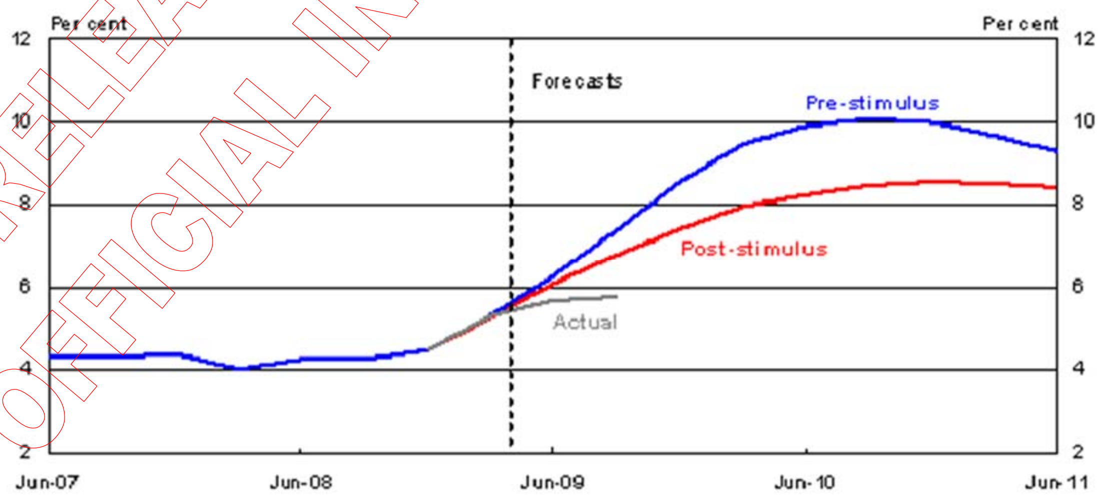
Real GDP

- The below charts compare actuals with forecasts, for both real GDP and the unemployment rate, using the Treasury's estimates of fiscal multipliers (see appendix 1).
- The charts show that actual output was much higher than expected.

Real GDP - actuals and forecasts from May 2009 Budget



Unemployment rate - actuals and forecasts from May 2009 Budget



Effect of fiscal stimulus on GDP growth

- The chart below shows Treasury's estimates, from the 2009-10 MYEFO, of the effect of the discretionary fiscal stimulus packages on quarterly GDP growth.
- These estimates suggest that discretionary fiscal action provided substantial support to domestic economic growth in each quarter over the year to the September quarter 2009 – with its maximal effect in the June quarter – but

predicted that it would subtract from economic growth from the beginning of 2010.

- The estimates imply that, absent the discretionary fiscal packages, real GDP would have contracted not only in the December quarter 2008 (which it did), but also in the March and June quarters of 2009, and therefore that the economy would have contracted significantly over the year to June 2009, rather than expanding by an estimated 0.6 per cent.

Modelling evidence

- Using a DSGE model, comparing to the counterfactual of no transfers to households, Li and Spencer, 2016, found that stimulus transfers and monetary easing actions have been almost equally important in helping the economy to avoid a recession in the aftermath of the GFC (the fiscal stimulus scenario isolates for transfers, as there was also infrastructure spending. Transfers amounted to approximately 50% of the fiscal stimulus).

- Modelling results:

Scenario	**Dec 08 quarter GDP growth rate % (annualised rate)**	**Mar 09 quarter GDP growth rate % (annualised rate)**	**June 09 quarter GDP growth rate % (annualised rate)**
Experiment 1: No policy interventions (simulated)	-3.62	-3.36	-6.49
Experiment 2: Monetary stimulus only (simulated)	-0.69	0.17	-1.84
Experiment 3: Fiscal stimulus only (simulated,	Approx. -0.69	-1.72	Approx. -1.84

isolating for cash payments to households)			
Combined effect (actuals)	1.75	1.15	1.02
Percentage point increase in GDP growth rate due to cash payments (difference between 1 and 3)	2.93	1.64	4.65

Survey evidence

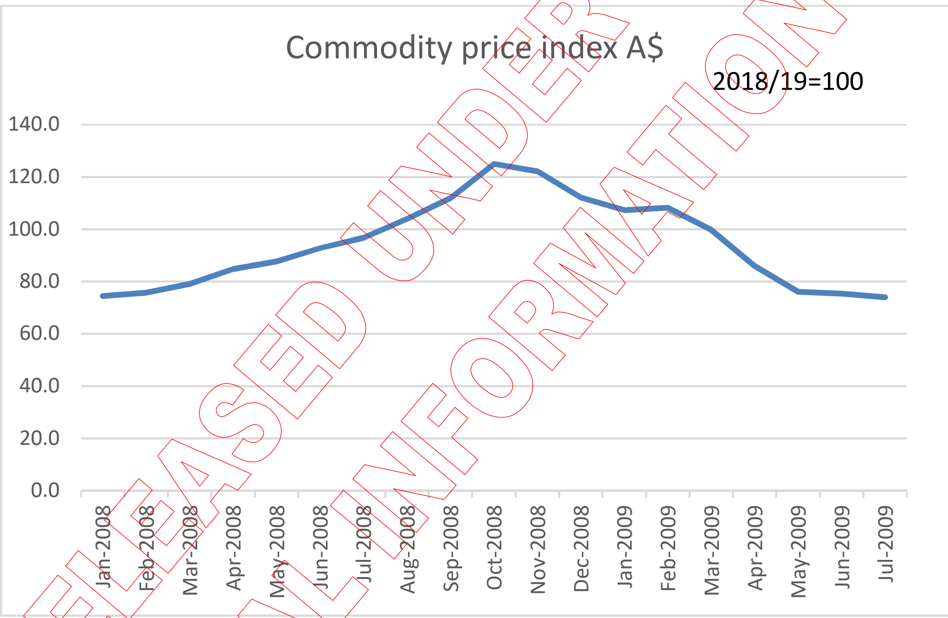
- Leigh (2012). Forty percent of households who said that they received a payment reported having spent it, based on survey evidence. This is a higher spending rate than has been recorded in surveys assessing the 2001 and 2008 tax rebates in the United States.
- Importance of labelling in making payments more salient - One possible explanation for this is that individuals are more likely to spend "bonuses" (as the Australian payments were described) than "rebates" (as the US payments were described).
- Using an approach for converting spending rates into an aggregate marginal propensity to consume (MPC), the Australian results are consistent with an aggregate MPC of 0.41-0.42. *Since this estimate is based largely on first-quarter spending, it may understate the longer-run impact of the package on consumer expenditure.* [italics mine. This is a critical point. This is consistent with the first year MPC estimate from the OECD, but significantly lower than the OECD and Treasury estimates for the second year MPC (0.7-0.8, and 0.6 respectively)].

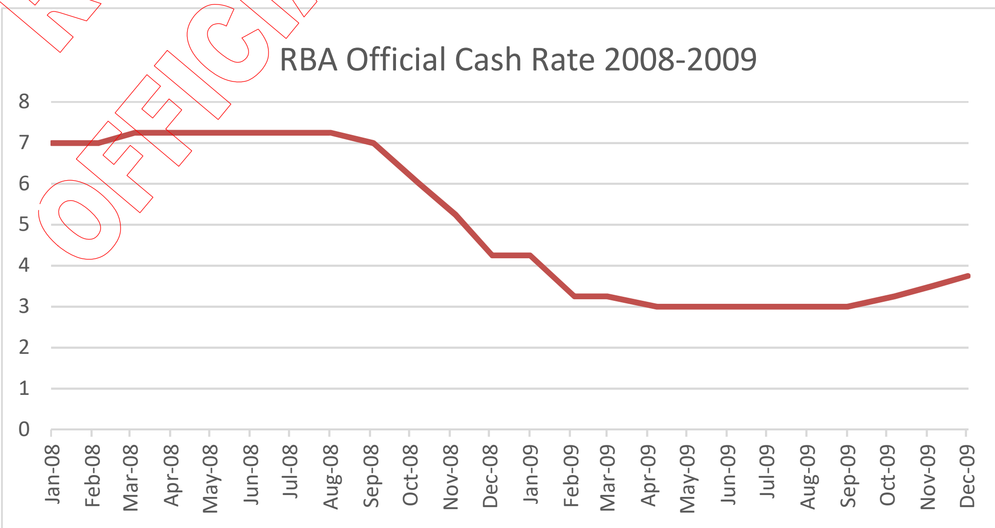
A contrary view

- Makin (2014) is critical of the view that Australia's fiscal stimulus programme was important in helping Australia avoid technical recession.
- In his view, lower interest rates, a major exchange rate depreciation, strong foreign demand for mining exports, and a more flexible labour market were more important factors. His arguments hinge on the Mundell-Fleming model, which posits that a fiscal stimulus works contrary to expansionary monetary policy, increasing the interest rate and exchange rate and therefore worsening international competitiveness and exports.
- While it is true that expansionary monetary policy and a commodity boom helped Australia recover quickly, I find his claim that fiscal policy was ineffective or counter-productive unconvincing. The Australian Treasury responded to his claims, arguing that the conditions of the Mundell-Fleming model did not hold during the GFC for Australia. Australia's trade share was small enough to imply positive fiscal multipliers and capital was less than fully mobile. This meant that the exchange rate effect described above was more muted – indeed, Australia's

exchange rate fell sharply during the GFC, playing its shock absorber role by supporting exports.

- Empirical studies found that the negative effect of the exchange rate on fiscal multipliers is significantly greater for countries with large trade shares, as more of the stimulus spending is on imports and leaks offshore. As Australia has a relatively low trade share compared with other advanced economies, fiscal policy could be expected to be relatively more effective.
- In addition, the consumer and business confidence data outlined above indicates that rapid and large fiscal and monetary stimulus, working in concert, played a critical role in increased consumer and business confidence, and boosting aggregate demand.





Conclusions

- Overall, it is likely the Australian cash payment scheme was an important factor (combined with infrastructure spending, expansionary monetary policy and increased demand for commodity exports) in causing the economic shock to be short in duration and weak in magnitude.
- It is more difficult to isolate the effect of the cash payment scheme versus these other factors. Based on the findings of Li and Spencer (2016), monetary and fiscal policy probably had about equal importance.
- It appears that the expansionary macroeconomic policy generated a positive feedback loop in the economy. Macroeconomic policy supported economic activity. When data came out on this increased activity (particularly the June 2009 release), this in turn convinced consumers and businesses that the slowdown would be relatively mild. This increased confidence led consumers and businesses to continue to spend, and led businesses to cut workers' hours rather than laying them off, which in turn helped the economic slowdown to be relatively mild, in reality.
- The correlation of the cash payment delivery with upticks in consumer spending, and followed shortly afterwards by increased consumer and business confidence, support the hypothesis that the cash stimulus was effective. Increased commodity prices alone cannot explain this. Commodity prices were already well below their peak at this point (they peaked in October 2008). However, it is likely that monetary policy played an important role. The Reserve Bank of Australia began dropping interest rates in September 2008, and they bottomed out in April 2009. This correlates well with the increased confidence measures (allowing for time lags).
- In terms what this means for New Zealand's current situation, a few inferences could be drawn.
    - Firstly, the effect of a cash payment scheme on raising consumer and business confidence, and thereby generating a positive feedback loop in the economy, should not be underestimated.
    - Secondly, the exchange rate effect described in Makin (2014) is less relevant in a world where global demand has dropped (China's demand for Australia's mining exports remained strong in the aftermath of the GFC). In today's world, global demand has reduced which means that even if the New Zealand dollar is weaker, it is likely to have little effect on stimulating exports. Nevertheless, design of fiscal stimulus programmes should involve consideration of import leakage, given that imports are a relatively high share of New Zealand GDP (28% compared with Australia's 21%, World Bank, 2018).

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Appendix 1: Estimates of the Marginal Propensity to Consume

The Australian Treasury assumed that 70 per cent of the cash transfers would be spent over the horizon of the forecasts, with the remainder saved.[4] By contrast, for government investment spending, the spending propensity was assumed to be 1.

To derive fiscal multipliers, these spending propensities were adjusted for the import share of the spending, assumed to be 15 per cent, which is the share of endogenous imports in Gross National Expenditure. This led to fiscal multipliers of 0.6 for cash transfer payments and 0.85 for government investment spending.

These multiplier estimates are at the conservative end of the range suggested by the OECD and IMF. The OECD (2009) suggests multipliers for cash transfers for Australia of between 0.7 and 0.8 by the second year. For infrastructure spending, the comparable numbers are between 1.1 and 1.3, while the IMF (2009) estimates multipliers of between 0.5 and 1.8 for infrastructure spending across the G20 economies (Table 1).

Table 1 – OECD and IMF estimates of fiscal multipliers

	OECD - Australia		IMF - G20
	Year 1	Year 2	
Cash transfers to households	0.4	0.7 to 0.8	
Government consumption	0.6	0.7 to 1.0	
Infrastructure	0.9	1.1 to 1.3	0.5 to 1.8

Appendix 2 - *Text from Li and Spencer to double check if I made errors in transcribing:*

With fiscal stimulus alone (Experiment 3) or monetary easing alone (Experiment 2), output growth would have turned mildly negative for at least two quarters. Ignoring the effect of monetary policy and therefore isolating for the effects of the transfers (Experiment 2), output growth turns negative to 0.69 per cent in the December 2008 quarter, which is considerably lower than the observed 1.75 per cent output growth rate in December 2008. It then rises moderately to 0.17 per cent in the March 2009 quarter before again dropping considerably to 1.84 per cent in the June 2009 quarter as compared with a positive output growth of 1.02 per cent in the data. Therefore, the two rounds of stimulus transfers has allowed the economy to avoid two quarters of negative output growth, and they have also served to considerably reduce the volatility of output growth during the period.

With no policy interventions (Experiment 1), the Australian economy would have experienced a recession with large negative output growth over the three quarters from December 2008 to June 2009 (the simulated output growth rates are -3.62 per cent, -3.36 per cent and -6.49 per cent in these quarters, respectively)

Date: 7 April 2020

To: COVID Governance group

From: COVID Policy team

Is a wider response strategy needed: ex-post Pandemic insurance

Purpose

1. This note asks whether we should investigate seriously the possibility of broad and systematic approach to dealing within the current crisis. It recommends that a small team within Treasury and IRD be tasked with an assessment of the feasibility of the approach described below.

2. Note that speed is essential as an ex-post insurance product may render some of the current proposal under development unnecessary.

Introduction

3. Since the onset of the COVID crisis we have been developing policy economic responses to radically changing situation. This has been done exceptionally quickly. However, whenever we have put one policy in place it out of date almost before it is implemented. This note asks whether a broad policy response is needed.

4. The Government has established a rapidly evolving smorgasbord of policy responses. In general these are broadly consistent with the sorts of measures one finds in other country responses (see Annex 2 for a simple graphic). However, the current problem is a whack-a-mole game where we no sooner identify and address one gap than another emerges. Here is a short list of what we are working on this week:

   a. A redundancy payment and/or accommodation supplement for lower income workers struggling to meet rent on the wage subsidy
   b. More direct cash flow grant support for business that could, based on Australian example amount to $5-10 billion
   c. Advice on the future of the wage subsidy
   d. There are also likely a rage of smaller sector based recovery packages

5. Lastly, the scenarios on the health control remain uncertain and there appears to be a very real risk that the remainder of the year will include extended periods of restraints on business activity and border closures. A key issues we grapple with in

all our design choices is the extent to which we are preserving jobs and/or firms that are may not be needed over the next several years.

Proposal

6. The proposal made by Michael Reddell (The old world) is to provide ex-post insurance of net income based at coverage of 80 percent of the income of the previous tax year. Insurance would apply to both firms and household – see more below. This insurance would be legally committed now in legislation to allow firms and household to borrow against future incomes. The actual payment would be made in subsequent year once the situation was clear.

7. There are several key principles behind the proposal:

(i) No one is to blame for the outbreak of the epidemic and the economic burden should therefore be shared as widely as possible. The unfortunate workers and owners of hotels and cafes are the victims of heavily

(ii) We need to try and ensure that the near-term economic damage does not permanently harm the recovery, while accepting that some firms and jobs will be lost

(iii) Public support is necessary because it addressed an economic externality – widespread business failure which will slow the recovery and rebound in employment

(iv) Consumers and firms burdened by debt are less likely to spend during the recovery – risking a weak and slow recovery in aggregate demand for after the lockdown.

Economics and incentives

8. The ex-post insurance model has some favourable economic features. This includes:

   a. Insurance would be paid regardless of economic activity. Those firms and individuals that needed to restart would be free to do so with assurance of some safety net. This means that the potentially damaging economic effects of maintaining firms and individuals in place would be minimised.

   b. Support would be more focused. It would be provided only to those firms and individuals that see income fall by more than 20 percent.

   c. The support would help address the risk in the current context that addition debt will be accumulated that could lower future growth prospects.

9. Ex-post insurance has the favourable feature of being simply to understand, relatively easy to implement and can dove tail nicely with the Governments existing

policy approach. It also has the feature of being robust to the level of controls and removing the risks that we increasingly add ever more policy measures as problems arise in a piecemeal fashion.

10. Ex-post insurance will not address the need for substantial economic damage where real prices and demand have changed.

11. Ex-post income insurance will not address the sizable losses in the value of assets. In fact any approach that tried to would not be fiscally suitable.

Fiscal cost

12. The fiscal costs of such a program are likely to be large – although maybe not too different than where we might end up with more piecemeal approaches. The scale of the costs would depend on the scale of the GDP and income losses and their distribution. In a scenario where GDP was to fall by around 20 percent, the loss of income form some sectors is likely to be much larger.

13. In one sense this would act like the ultimate automatic stabiliser scaling up the fiscal response in proportion to the size of the shock.

14. Further work would be required to examine the costs. There are some reasons why the guarantee may not be as expensive as first considered. For example, the public sector and essential services part of the economy are not likely to require support. Large parts of the essential services sector will probably do well from the immediate effects of the level 4 controls. Sectors such as the financial sector may also not need coverage or may make few calls on the guarantee. The guarantee might need to best tested against the economic scenarios prepared by the forecast team.

15. There are also two main options to limit the fiscal damage. One is to charge and ex-post insurance premium much in the way that deposit insurance is funded in many jurisdictions. This could have a long tail so as to avoid potential macroeconomic consequences of in the recovery period.

16. The second approach to fiscal costs is to consider whether it might be preferable for household insurance to be provide at graduated levels. For example, insurance could be provided at 100 percent for the first several deciles at almost no cost. Further graduation could apply so that income beyond $200,000, $500,000 and $1 million could be insured at a much lower replacement rate. This would add complexity – perhaps too much – but could make the program overall more equitable and consistent with fairness. It would also have an economic rationale in that the actual impact of the COIVD-19 shock is much easier to manage for those with significant net assets working in occupations that are less affected by business closure.

s9(2)(h)

<u>Equity</u>

18. The impact on income or wealth inequality poses an immediate concern. Current approach have generally aimed to shield those most affected or provided basic level of support even when those affected have been on higher incomes (i.e. the wage subsidy is a flat rate and not a European style unemployment insurance).

19. It is critical to note that there is a sense that those hardest hit by the crisis are those least likely to be able cushion themselves. In the immediate period, generally higher income state workers have been shielded from lower wages during Level 4 controls and will have certainty about job and income prospects. Those sectors hardest hit by closures and lower demand in many services tend to be lower skilled and lower waged. These employees will bear a significantly higer adjustment costs and have fewer financial and personal resources to adjust to the shock.

20. However, the net impact on equity can be managed through changes in the tax systems used to fund this ex-post guarantee in the future. Analysis could identify the incidence of the guarantee in a broad fashion and adjust future taxes in a way that delivered a more equitable outcome.

<u>Robustness to different states of the world</u>

21. There are two attractive feature to ex-post insurances. The first is that the insurance is in some sense calibrated to the shock. In the event we spend much longer than we all hope at higher alert levels then the income transfer will increase. This means that instead of trying to adjust the policy mix in a rather ad-hoc fashion with the risks of significant mistakes and deadweight costs we have more control.

22. This approach will not mean that there is no need for existing support measures. In fact they will dovetail with both key measures of the Business Finance Guarantee and wage subsidy. Any support directly provided would be registered for the purpose of the guarantee as income. The immediate support is also need to address the risk that people may be finance constrained and not able to use the guarantee to access needed liquidity.

23. The income guarantee would, however, render some of the more immediate programs or proposed programs unnecessary. This includes further business grants, and support for commercial and housing rent costs.

Operational aspects

24. The income guarantee would ideally be given effect in legislation. The operation of the program would be given effect through the tax system. It would be important to ensure that the nature and form of the legislative guarantee could be used as collateral with the financial institutions.

Questions and risks

Key questions to answer:

- How can we be sure that the guarantee will address widespread solvency issues for firms and households?
- Do we think that the best response in uncertainty is an iterative solution that can be adjusted as the crisis evolves or a more broad-based solution which may be wrong?
- Is the potential fiscal cost likely to be prohibitive?

Annex 1: Michael Redell's insurance proposal

Recall the key dimensions from a couple of earlier posts:

- Parliament would legislate urgently (preferably, or the guarantee powers in the Public Finance Act would be used) to guarantee that every tax-resident firm and individual in the coming year would have net income at least 80 per cent of their net taxable income in the previous year (loosely the 2019/20 and 2020/21 tax years, but of course the slump will already have been serious this month),
- the guarantee would be restricted to a single year (Parliament and the Minister can't bind themselves not to extend, but the framing would be a one-year commitment),
- it is a no-fault no-favourites approach. My taxes have to prop up Sky City just as yours will have to support people/firms you really can't stand. Picking favourites is a recipe for corroding trust and the willingness of the public to see the public purse used responsibly to get us through the next few years,
- since the guarantee would be legally binding, and structured to be assignable, financial institutions should generally be willing to extend credit on the security of the guarantee (they don't need the cash upfront, just the assurance that the Crown can't really walk away). This is primarily relevant to businesses, given the 'mortgage holiday' banks have already agreed,
- the guarantee need not displace actual immediate income support measures, designed to get cash in the pockets of households now (rather any such state payments would be factored in when everything was squared up at the time of next year's tax return), but especially if you are in lockdown and any mortgage commitments are deferred, high levels of immediate cash are less an issue than usual (not much to spend cash on).
- for firms, the guarantee would not be conditioned on any commitment to stay in business. In you are a heavily indebted tour operator in Rotorua and you think it will be three years until "normality" returns, walking away (closing down) now may well make a lot of sense. The 80 per cent guarantee for one year is simply a buffer, that limits the downside for the first year, and buys some time both for the business(owners) and their financiers. For some, however, it will be enough to give them time, and access to credit, to get their firm to a scale best suited to being able to come back. But that needs to be their judgement, and that of financiers, not a template imposed from Wellington.
- for individuals, the income guarantee will also help to underpin public support/tolerance for whatever restrictions remain in place for an extended period. In addition, I quite liked the idea the New Zealand Initiative put forward the other day (of allowing people to borrow – capped amounts – directly from the Crown, akin to a student loan, with income-contingent future repayments) and also like Michael Littlewood's proposal – akin to what has already been done in Australia – of allowing people easy access to a capped portion of their Kiwisaver funds, it being after all their own money, and times being very tough. (KiwiSaver and COVID Littlewood)
- there might be merit, fiscally and from a fairness perspective, in considering supplementing the downside guarantee with a one-year special additional tax on any 2020/2021 earnings more than 120 per cent of the previous year (there

wouldn't be much revenue in it, and it plays no stabilisation role, but there might be an appealing political/social symmetry).

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Ex-post pandemic insurance (EPI)

Date:	09 April 2020	**Report No:**	T2020/935
		File Number:	MC-1-6

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	Note the proposal for public ex-post pandemic insurance and its potential to provide a broad-based response. Indicate whether you would like further work on the proposal.	None

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Mario DiMaio	Principal Advisor, Covid-19 Strategy and Policy	s9(2)(g)(ii)	N/A (mob)	✓
Alastair Cameron	Manager, Covid-19 Strategy and Policy		N/A (mob)	

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: Ex-post pandemic insurance

Executive Summary

This paper outlines illustrative parameters for a single broad approach to address the falls in household and firm income. While this approach is probably more expensive, it may provide more fiscal support for the economy by proving a more comprehensive, general and enduring support through the pandemic to households and firms.

The current economic policy response is evolving rapidly in response to the health strategy. The initial stage of the response is focused on cushioning the impact on households and firms. This objective has been to minimise firm failures and ensure continued attachment of workers to firms. To date the response has been effective in minimising economic damage. The approach has also been agile and flexible as new information emerges on gaps.

However, the current strategy carries the risk of being overtaken by the speed of events and constrained by the capacity to implement policy measures. The high level of uncertainty about the path of the heath crisis and restrictions on economic activity are making policy challenging. The high level of uncertainty is also likely to have a significant impact on households and firm behaviour in the recovery.

There are currently a wide range of bespoke and targeted solutions being put forward to address the drop in firm and household incomes during the COVID pandemic. This risks creating a system that is complex, difficult to administer, not adaptable to uncertainty and change and with high compliance costs. An added issues is that the key public sector agencies are straining at capacity to deliver existing programs and this will be exacerbated as demand scales up. There is an opportunity as the Government considers when and how to move out of level 4 to consider a different approach that could be robust to different health scenarios.

This note provides a broad outline of a proposal for an alternative policy approach of an ex-post pandemic insurance (EPI). Society has developed a range of tools for dealing with large natural disasters. The COVID-19 episode is a unique event, whose scale and impact was difficult to anticipate. In the face of a large shock an insurance payment, financed using the Government balance sheet, can help to spread the cost over a larger group of people and over time. It appears fairer to allow the government to allocate the burden of the income shock from COVID-19, than to have it determined by chance – this is what pandemic insurance ensures.

The Government could provide a broad-based income guarantee to all firms and households in New Zealand at some proportion of last year's income (or the fall in income). The objective would be to recognise the unique and unanticipated nature of the shock and preserve the functioning of firms and employment to support a more rapid recovery. The guarantee would provide legal certainty and could substantially reduce the risk of widespread business failures and stress on households balance sheets.

The advantage of EPI is that it would provide high levels of certainty for firms and individuals. The highest level of support would be provided to those individuals who have lost the most income. The guarantee could be used for firms and households to access finance. This would translate into significantly lower risk of business disruption and less labour market disruption. An EPI could replace many of the current specific interventions in place or being designed by the Government. In large part the cost of the transfers that have already been made to affected people would offset the costs of the EPI.

There are at least three strategic trade-offs and concerns with respect to an EPI. The first is whether the fiscal costs would be manageable; the second is whether the guarantee would have unintended consequences; and the last is whether the operational and integrity risks of the EPI could be managed.

- The fiscal costs of an EPI are likely to be substantial. Very approximate estimates suggest that an EPI could cost around $30 billion or around 10 percent of current GDP. This is likely to be manageable within the current response envelope. However, the costs of the scheme could increase sharply and in a more serious downturn the cost could more than double. However, these costs would not be large enough to put at risk fiscal sustainability.
- Designing an ex-post insurance option is difficult because this will affect incentives for firms and individuals. Unlike a normal insurance event individuals and firms will still be able to influence the current year's income. An EPI set at 80 percent would imply an effective marginal tax rate of 100 percent below this level. Adjusting the design of the insured amount to focus on losses in income could ameliorate this concern a little.
- The operational and integrity risks to the EPI are very significant. The sharp difference in treatment of losses will create strong incentives to shift revenue and expenses to maximise losses in the current year. Corporate taxpayers' affairs and structures can be highly responsive to incentives created by the tax system. Current tax rules are not designed to manage the large risk of revenue and cost shifting between years. While there are some ways to manage the risks, it is likely that this will add to the administrative burden and complexity of an EPI.

If you are interested in exploring the idea of a simplified and single approach further, we would provide further advice in mid-April on a feasible option that could be implemented quickly.

Recommended Action

We recommend that you

indicate whether you wish to receive further advice on the design of an ex-post pandemic insurance.

Yes/no

Alastair Cameron
Manager, Covid-19 Strategy and Policy

Hon Grant Robertson
Minister of Finance

Treasury Report: Ex-post pandemic insurance

Purpose of Report

1. This report provides a very preliminary analysis of a proposal for ex-post pandemic insurance. Ex-post pandemic insurance (EPI) would commit the Government to guarantee a proportion (60-80 percent) of last year's income for individuals and firms.

2. Based on the assessment below the report seeks your guidance on whether this approach warrants further work.

3. This report has been prepared under extreme time pressure and represents our initial analysis only.

Context

4. The current economic shock from COVID-19 is the largest and most rapid economic shock New Zealand has faced. It is also characterised by heightened uncertainty regarding the timeline for a resumption of business activity. The international environment and the restoration of demand in tourism and education are also weighing on the future economic outlook.

5. The main economic outlook in the BEFU forecasts suggest a substantial fall in GDP. Annual average real GDP growth is forecast to reach a trough of near -11% by March 2021. The unemployment rate forecast to exceed 10% by September 2020. In absolute terms, the number of unemployed people is forecast to reach close to 287,000 by September 2020, compared to 110,000 in December 2019.

6. A much larger fall in GDP is possible should New Zealand spend a longer time in level 4 restrictions (3 months in total). Under this scenario real GDP may fall to around -17% in the year to March 2021 and unemployment peaks near 10% in June 2020. The high degree of uncertainty about the health situation increases the uncertainty for business and households. In this scenario the fiscal response increases to around $60 billion.

7. Households and firms are responding by adjusting expenses, use existing financial savings and taking on additional debt. However, the financial buffers held by many firms and households are likely to be too small to manage the shock to balance sheets. In an ordinary business cycle, firms fail in response to changes in relative prices or because they have lower profits and productivity. However, for the most part the current shock is due to the response to health conditions and does not reflect any economic signal.

8. Without government support, the size of the shock would lead to widespread closure of firms, loss of employment and potential financial sector damage. The current policy mix has been set with the goal of minimising the economic disruption during the most intense phase of economic disruption – with a view that many of the businesses struggling would be economically viable in the medium term. This is aimed at minimising the potential for permanent economic damage, but if there was a need for substantial structural change it may delay it.

9. While the current public health related restrictions imply that the economic shock is initially a shock to supply, the disruptions to economic activity have rapidly created a situation where households and firms are facing a sizable reduction in income and are

very uncertain about future income. This will have a large impact on demand. Furthermore, lower tourist numbers and weaker prices for New Zealand exports will also act as a drag on demand for New Zealand produced goods and services. Demand management tools, including monetary policy but also in the current context fiscal policy, will need to support activity once the substantive part of the economic restrictions are eased.

10. The government policy response has focused on cushioning the impact on firms, households and institutions. The initial fiscal response comprises around $20 billion in the form of wage subsidies, income support assistance, and tax measures. The Government, working with the Reserve Bank and the financial sector, has sought to ensure ongoing access to finance. Additional policies to buttress income adequacy and provide support for SME are to be considered by Cabinet shortly.

11. The Government response has been agile in light of the rapidly evolving situation. The response measures include the broad mix of policies that have been adopted elsewhere. The adaptive response has the advantage of being tailored to the situation as it evolves in a highly uncertain environment.

12. However, the adaptive strategy runs the risk that it is not proportionate to the size and depth of the shock the economy is experiencing. Many firms and households face the potential for substantial reductions in income. The current set of policies also leads to frequent changes in the policy response and strains on policy implementation. In the last week you have considered advice on additional assistance for lower income individuals of the wage subsidy, more direct relief of businesses, and advice on the future of the wage subsidy. Finally, consistent policy changes do not help provide certainty to New Zealand households and businesses – where increased certainty is especially valuable in such an uncertain environment.

13. An alternative strategy which could provide broad-based support to firms and households would be an insurance-like instrument. This would guarantee to firms and households that income would not fall below a certain thresholds of last year's income. The proposal has been made in the New Zealand context by Michael Reddell (ex-RBNZ and ex-Treasury).

Analysis

The EPI proposal

14. There are several key principles behind the proposal:

- No one in New Zealand is to blame for the outbreak of the epidemic and the economic burden should therefore be shared as widely as possible.
- The Government is best placed to ensure that large and infrequent shocks like this are transferred across people and time – similar to the EQC model
- A key goal is to ensure that the near-term economic damage does not permanently harm the recovery, while accepting that some firms and jobs will be lost
- Consumers and firms burdened by debt are less likely to spend during the recovery – risking a weak and slow recovery in aggregate demand for after the lockdown.

15. The key features of an EPI could include:

- A guarantee to transfer government resources to ensure this year's income is some minimum proportion of last year's income- Michael Reddell has proposed that all taxpayers are guaranteed to have an income in 2020-21 that is at least 80% of their income in 2019-20.
- The guarantee would apply to businesses, households, not-for-profit entities and iwi entities
- The guarantee would be legally committed now to allow firms and households to borrow against future income
- It could be designed so that individuals and smaller firms could receive payments now or in the subsequent year once income is clear
- Public support is necessary because the Government is addressing an economic externality – widespread business failure - which will slow the recovery and delay a rebound in employment.

Impact on firms' economic incentives

16. The primary objective of EPI is to help firms manage through an exceptional shock. By design equalising income (profits) back to 80% of the previous year's income is very effective at compensating the biggest losers. The effectiveness of this approach means that there would be greater buy-in to fund the costs of the insurance and it may also support general risk taking (if firms know that in extreme scenarios there will be support).

17. A secondary objective of the EPI is to support firm solvency and viability. By providing the most support to those firms with the biggest losses in the scheme it will provided needed cash flow to firms and will also provide, at the margin, some support for viability (where firms put a high weight current conditions in uncertain environments). Firm solvency and viability is particularly important to maintain intangible capital, and in a country like New Zealand with relatively low hiring and firing costs, they will quickly be able to scale up production and employment as market conditions improve.

18. A third objective is simplicity and reduction of compliance costs. Having a multitude of targeted responses makes it more difficult to administer, more difficult to apply for, reduces the capacity for firms to optimise to their current circumstances and risks some game-playing. Perhaps the biggest advantage to the proposal is in its simple design.

19. There are three major disadvantages of the scheme from an economic point of view. The first is that it is expensive. It would provide very large gains to the biggest losers from COVID-19. By providing full compensation for a loss this in effect socialises many of the losses that would then need to be recouped through higher taxes later on. This could be designed around by having a co-payment design with the loss, or setting the 80% threshold at a lower level. The fiscal cost is discussed further below.

20. The second is that it focuses compensation on the firms who have lost the most, and provides little support to those that may return fastest to profitability and viability (who suffer the least). This is important because it may be that some firms who face the biggest losses may not be viable for some time. This proposal may work against policies that might support reallocation towards firms with the best prospects and which could support short-term prospects and long-run economic growth and productivity. However, it is still expected that non-viable firms will choose to wind up; the income guarantee provides taxpayers with some financial cushion and time to plan for the future.

21. The third is that it contains powerful incentives to game the scheme and works against normal market outcomes. In the scheme there is no incentive for firms to raise the profitability between loss and 80% of previous income, and this risks either game playing (such as bringing forward costs from future year), or incentives to raise revenue and profitability. The design of the scheme could go some way to mitigating the poor effects on economic incentives,

22. These effects on incentives should be given serious weight. As a very extreme example, if I am making 80 percent of my income it would be rational to bet my wages on a coin toss as I would get to benefit from the win and the government would compensate me for the loss. There are some design features that may ameliorate some of these incentives but they remain a serious concern.

23. On balance the appealing features of the scheme are the high levels of compensation, the flexible and efficient way of supporting firm solvency and its simplicity. The weaknesses are its cost (because it provides very large amounts to a small number of firms who suffer the biggest losses), it's lack of targeting on firms that are likely to aid the recovery and potential for gaming.

Consistency with existing firm policy response

24. The EPI should be thought of as a substitute for almost all of the existing proposals on the table:

- Loss carry-through provisions and related tax options (the loss carry back provision for example should not be implemented with an EPI)
- Small and Medium Enterprise support
- Extending the wage subsidy beyond the initial 12 weeks
- Other targeted support for input costs, such as rent, debt servicing and other costs
- The Business Finance Guarantee
- Potential for government to provide bespoke deal for large and economically significant firms
- A range of equity injections already agreed for firms in the transport sector
- Work on lifting the debt guarantee gap for larger firms,

25. As mentioned above one of the key advantages of the EPI is the simplification of support arrangements and given its potential generosity the absence of the need to scale it manually up should conditions deteriorate, and the costs would reduce if conditions improve (as the number of firms with large reductions in losses falls).

26. Another advantage of focusing on income, rather than input costs, is that it enables firms to respond to conditions as they arise, rather than locking in current arrangements too much.

Ex-post household pandemic insurance (EHPI)

27. An equivalent scheme to the firm model could be developed for households, where households are provided compensation to keep their income at 80% of previous year's earnings. This model is similar to a traditional social insurance model. This has already been raised in the work by the Productivity Commission on the future of work. The Productivity Commission noted the positive features in sharing risks associated with rapid technological change and adaption.

28. The advantage of this approach is that it provides a step down in income as households with high costs transition to lower income levels. The disadvantage of this approach is that for a given cost, it provides more support to households that have middle and high incomes (that fell from the previous year), rather than those with the lowest incomes.

29. Given the exceptional nature of the current shock there may be value in thinking about short-term support for those households over and above usual benefit payments. Over the long-run, if there is popular support, then there may be the case for a social insurance mechanism.

30. One issue with focusing support only on the firm side is that it provides a lump sum gain to firm owners, rather than households, working against income distribution and poverty objectives. In the design of any scheme to respond to COVID there is a legitimate question about who should benefit from government compensation: vulnerable households, households with the biggest income losers, firms and entrepreneurs.

31. There are a number of design choices that could support a more feasible EPI (co-payment, lower caps, and a commitment to fund the scheme ex-post through progressive tax measures), but critical elements in whether to proceed are how to weigh up the benefits if the scheme (simplicity and adaptability) with some of the necessary trade-offs. The critical judgement is that it would be most useful if there is supressed economic activity (or uncertainty) for some time that would support a large scale response of this nature to limit the excess disruption to the market, rather than the application of usual stimulus, recovery and market mechanisms in the case of a return to more normal market conditions in 1-3 months.

Key design features

32. The design of any ex-post design requires careful consideration to try and avoid some of the potentially perverse incentives or losses in income that a widespread guarantee could create. There are three broad design considerations: (i) the design of the insurance coverage; (ii) whether to front-load or back-load any payment; (iii) whether there should be any potential exclusion from the coverage of the guarantee on the corporate side; and (iv) the definition of the income base to address integrity risks (see below).

Design of insurance coverage

33. There is a potentially sharp trade-off between broad insurance cover and work incentives. Unlike a normal insurance event, individuals and firms will still be able to influence the current year's income (that they are being insured for). An announced guarantee of current year income based on a proportion of the previous year's income (the Reddell proposal is 80 percent) would create a 100 percent effective marginal tax rate (EMTR) if income is below 80 percent of the previous year's income.

34. We expect most workers will not want to take 20% income reduction and lose their connection to a job, especially in a weak economic environment. However, it seems likely that there would be some workers and firms who would be willing to stop working and receive 80% of last year's income. The same incentive effects of a 100 percent marginal tax rate on profits below 80 percent of last year's income would exist for firms.

35. One option to ameliorate the effect on work incentives is to share more of any losses between the taxpayer and government. This would make the scheme less generous. For example, instead of replacing a taxpayers net income to 80 percent, the government could compensate for 75% of losses below 80% of the previous year's income. This would mean that every taxpayer would be guaranteed at least 60% of previous year's income. The actual replacement rate will depend on earnings. The effective marginal tax rate would then be 75% until net income is 80% of the previous year.

36. For workers deciding of whether employment is worthwhile, the coverage of the insurance is now only 60% of previous year's income. Intuitively, it seems unlikely that many workers would be prepared to take a 40% income reduction. The level of income replacement for unemployment is broadly comparable to those applying in the social insurance systems of many OECD countries. For example, the average net replacement rate for unemployment is 68% for a single person on 67% of average wage in OECD.

Payment design

37. Another key design choice would be whether to font-load or back-load payments for individuals or firms. The current tax system provides the best vehicle for the provision of any income guarantee and is designed so that the guarantee would be paid once the current tax year is completed. In principle the provision of such a guarantee backed by the state should provide sufficient certainty for banks to provide required credit on the basis of the guarantee.

38. While this would address uncertainty about income levels, some individuals – particularly those who are credit constrained - may face obstacles. The Government's current approaches to proving cash support in the form of wage subsidies and unemployment benefits would continue – are addressing the bulk of immediate cash flow needs. Further discussions would be needed with the banking sectors to assess whether the commitment would provide sufficient certainty.

39. An alternative option would be to provide a sizeable upfront lump-sum cash payment to individuals (and potentially small firms). This payment would subsequently be returned in part depending on the extent of the loss in income for the individual or firm. For individuals who had suffered minimal loss in income the full amount of the cash payment would be returned. They would have received an interest free loan. For individuals who had suffered modest losses then part of the initial payment would be returned.

40. The provision of upfront cash payments would substantially increase the challenge of implementing the scheme. Overpayments may also place many households in tax debt to IRD, creating pressures for leniency. It may also create challenges for some individual in managing sizable payment of upfront cash. The alternative is to ensure that existing cash-flow assistance is provided in reasonably generous amounts to those individuals that have recently suffered a loss in employment and income.

Coverage design

41. Ex-post insurance would largely be an income transfer across individuals within New Zealand. To the extent it added to long-lasting increase in public debt it would also represent a transfer across generations. However, the guarantee to income to the corporate sector would partly represent a payment to overseas shareholders. This would represent a net loss in welfare to New Zealand. Some measures could seek to ameliorate this concern, for example the exclusion of the financial sector and perhaps rules around the treatment of large foreign owned firms, This would require further thought,

Fiscal cost

42. In addition to the detailed design considerations discussed elsewhere in this report, to be viable a pandemic insurance scheme needs to be affordable and consistent with the objectives for fiscal policy through different phases of the response.

Affordability

43. Whether a pandemic insurance scheme is affordable or not depends on the cost of the scheme and the available fiscal space. Both of these factors are unknown.

44. The cost of the scheme will in part depend on its eventual design, and in particular the treatment of business losses and how confidently we could address equity concerns. Based on the baseline forecast in the BEFU we have developed an estimate that the costs could be around 10 percent of GDP – or around $30 billion. Should the scenarios of higher losses on GDP this might double the potential cost to closer to 20 percent of GDP.

45. Fiscal space is the difference between actual public debt and the upper limit of public debt. Last year, the Treasury advised that the prudent upper limit for debt in New Zealand is around 50 to 60% of GDP (T2019/661 refers).1 We recommended this upper limit not because we thought New Zealand would lose access to debt markets at this point, but because we considered that the costs would likely outweigh the benefits beyond this level. In the wake of COVID-19, the prudent level for debt will necessarily be much higher. There are several reasons for this, including:

   i. The marginal benefits of increased debt will be temporarily high.

   ii. Lower interest rates have lowered the costs of debt.

   iii. It is efficient and equitable to spread the costs of this extreme shock into the future.

2. While a pandemic insurance scheme will undoubtedly be expensive, it will not necessarily be unaffordable. Debt can be stabilised at even very high levels of debt provided the government's interest rates does not significantly exceed the economic growth rate and the government's fiscal balance is sufficient.

3. Current macroeconomic conditions suggest the first of these conditions will be met in the recovery period. This will be supported by monetary policy keeping interest rates low. Whether the second condition can be met will depend on the Government's ability to reduce fiscal deficits after the recovery period.

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[1] The Treasury will provide an updated assessment of what an upper limit for debt could be after Budget.

4. Access to debt markets would need to be considered. It is unlikely that a fiscal cost of 10-20% of GDP would have any material impact on market access.

5. The scale of the costs should also be considered relative to costs incurred under the current strategy of ad-hoc policy measures.[2] Current estimates are that net core Crown debt will increase by at least 35% of GDP as a result of reduced economic activity and increased government spending. The increase in net debt will be even greater if the downturn is more severe than forecast; if more than 4 weeks is spent at alert level 4; or, if the costs of support policies in the containment period exceed the $50b set aside in COVID-19 Response and Recovery Fund (CRRF). Furthermore, we advised recently (T2020/784) that our very preliminary estimate was that net debt would need to increase by approximately 10-20% of GDP to support the post-containment period recovery.

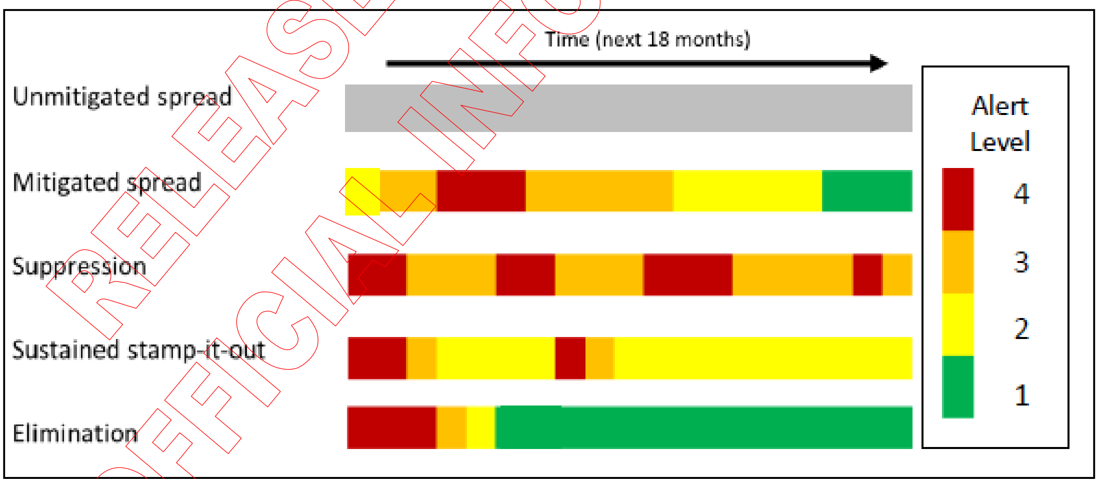
Compatibility with macroeconomic policy objectives

46. Subject to affordability and operability, a pandemic insurance scheme could be an effective macroeconomic policy intervention that is well tailored to the unique circumstances presented by COVID-19.

47. During the containment period, the scheme would maintain firm solvency and employment attachment, support living standards and income adequacy for individuals, and limit reductions in aggregate demand driven by income uncertainty.

48. The benefits will be even greater if the scheme provides the necessary social licence for an effective elimination strategy that may be more costly in the short-term, but more economic in the long-term.

Figure 1. Public health strategies for COVID-19



49. Realising these benefits in the containment period this would mean that depth of the recession would be less than otherwise might be expected, enabling a swift recovery.

50. After the containment period, the goal of fiscal policy will be to spur the recovery. Assuming payouts are processed shortly after the end of the 2020/21 tax year, the scheme would deliver a substantial stimulus just as New Zealand expects to begin the recovery phase.

[2] In many cases where costs have already been incurred, those costs would not be additional to the costs incurred under a pandemic insurance scheme. For example, nearly all of the costs incurred under the wage subsidy scheme or through increased benefits would increase incomes for individuals or businesses. Where there payment are made to those incurring a greater than 80 percent drop in income they would reduce cost of the EPI.

51. After the initial recovery period, a primary macroeconomic objective will be returning to surplus. Assuming the scheme is a one-off for this year, the scheme would minimise structural spending changes and would make returning to surplus a lot easier. Should the scheme be permanent, there would be a clear case to offset the costs with permanent revenue measures.

52. Active use of fiscal policy will also reduce the need for monetary policy to stabilise the economy. As monetary policy is constrained, the result would be less use of alternative monetary policy (AMP) tools than would otherwise be the case. Consequently, risks to the Crown's balance sheet arising from the use of AMP tools would also be mitigated. Further out, It however, the monetary policy reaction would be the same for any scale policy intervention of a similar size and effectiveness.

53. More generally, a pandemic insurance scheme has the potential to mitigate other risks to the Crown. As a result of the disruption caused by COVID-19, the Crown has taken on a number of contingent liabilities and more are expected. By providing certainty to households and businesses, the private sector would be better placed to manage any such risks, reducing stress on the Crown's balance sheet.

Legal framework

s9(2)(h)

[redacted]

Equity and fairness

56. We can consider the equity impacts of the scheme in three main respects – in terms of the *horizontal* and *vertical equity* of the insurance payments themselves, and in terms of the equity impacts of the *financing costs* of the scheme.

57. The second round effects on equity are likely to be more complex and depend on whether the approach aids a more rapid economic recovery. To the extent that ex-post insurance minimises economic disruption, it would have a positive impact on more vulnerable populations. Those sectors hardest hit by closures and lower demand in many services tend to be lower skilled and lower waged. These employees will bear a significantly higher adjustment costs and have fewer financial and personal resources to adjust to the shock. Ensuring a more rapid recovery in activity and employment for marginal workers is likely to be important goal in the recovery.

Horizontal equity considerations

58. The scheme will provide the same proportional benefit to all taxpayers who suffer loss during the period of the pandemic. In this respect, it is a horizontally equitable intervention.

59. However, not all reductions in income will be attributable to the pandemic. Some taxpayers may experience a reduction in income for reasons unrelated to the pandemic (for example, a firm may have been losing sales to a competitor even before the full effects of the pandemic were felt, or an employee may cease work due to retirement, ill-health or arrival of a new child). In this case, the scheme will deliver the same proportional benefit to taxpayers who are actually in quite different positions.

60. Also, previous years income may be a poor proxy for the taxpayer's current income expectations and associated financial commitments (for example, recently graduated students joining the full-time workforce, or parents returning to paid employment). Taxpayers in the same current circumstances will be treated quite differently depending on their past circumstances, with those on higher past incomes receiving more support.

61. It will be difficult to design a scheme that can distinguish between 'deserving' and 'undeserving' recipients. Some degree of rough justice will be unavoidable in a scheme that can be designed and implemented quickly, and adjusts assistance to current and/ or past incomes. Given the depth and breadth of the economic shock caused by the pandemic, however, it would seem preferable to err on the side of generosity in designing the scheme.

Vertical equity considerations

62. While the scheme will provide the same proportional benefit to all taxpayers, it will deliver a greater dollar benefit to higher-income taxpayers who suffer a reduction in income. These taxpayers will have experienced real disadvantage as a result of the pandemic.

63. However, they might also be expected to have greater resources to support themselves through the crisis than lower-income taxpayers who derive a smaller dollar benefit. Also, given the diminishing marginal utility of consumption, a given income reduction is likely a lesser welfare loss to a higher-income household than lower-income household. To this extent, the outcomes generated by the scheme may be inconsistent with the principle of vertical equity.

64. Higher-income earners may also have more scope to financially engineer to access benefits.

Financing considerations

65. The ultimate equity impact of the scheme will depend on how the costs of the scheme are distributed across taxpayers and over time. These costs could be met through existing revenue streams (which would crowd out space to fund other spending initiatives), or through temporary or permanent increases in taxation. These changes will, in turn, have their own impacts on equity (as well as on the efficiency and integrity of the tax system overall).

Operational and administrative impacts

66. The tax system is the most likely means of delivery for a pandemic insurance scheme. At present, there are significant demands on Inland Revenue's administrative capacity. However, some of this pressure will reduce over the next fortnight as Inland Revenue completes the next release of its Business Transformation process.

67. Officials will be able to complete a full assessment of the administrative feasibility of a pandemic insurance scheme once the design parameters of the scheme have been firmed up.

Robustness to economic and health scenarios

68. An ex-post insurance scheme will ensure that the response is broadly calibrated to the shock. In the event New Zealand spends a much longer at higher alert levels with larger falls in income then the income transfers will automatically increase. This might be preferable to trying to adjust the policy mix to anticipate or reflect health measures with the risks that policy response will be somewhat behind the curve.

Risks

69. The EPI poses significant tax integrity risks. However, these may be able to be mitigated depending on the scheme's design. For example, caps to the scheme will reduce or eliminate incentives to misuse the scheme. In general, the need to design measures to address integrity risks will increase the policy and administrative complexity of the scheme.

70. A summary of the risks are (assuming the guarantee applied to the 2020/21 tax year):

- It provides an incentive to shift revenue out of the 2020/21 tax year.
- It provides an incentive to shift costs into the 2020/21 tax year.
- If irregular income is included it may lead to unintended support or a lack of support.
- There is a risk of "double-support" due to the income package occurring for both corporates and individuals that are paid dividends.

71. A key design issue will be whether the scheme is based on:

- The fall in taxable income relative to the 2020/21 tax year (as Michael Reddell proposed).
- The fall in gross assessable income (i.e. taxable income before any expenses).
- The prior operating expenses of firms (i.e. the Government could make up any shortfall needed to cover operating expenses in the 2020/21 tax year).

72. Both the taxable income and gross assessable bases could rely on existing tax definitions. Both of these bases will influence the relative incentive to shift revenue or expenses between time periods for firms, or for households to shift when they report income.

73. Both the taxable income and gross assessable bases would create an extremely strong incentive for taxpayers to shift revenue out of the 2021 year. This is already a risk that the tax system has rules for, but is presently just a timing risk. Under this scheme the incentive to shift income out of the 2021 year become much greater as taxpayers may get reimbursed up to 100% of the amount shifted. Such shifting can occur both through the timing of their decision to *undertake real transactions* (eg delaying sales), and the *reporting of transactions*, to the following year - where the former has additional efficiency consequences.

74. The taxable income base would also create an extremely strong incentive for taxpayers to: bring forward expenses; incur expenses that are uneconomical and which they would not otherwise incur; and incur expenses to related parties. In this last case, the Government may effectively end up reimbursing the taxpayer for the expense incurred, even where the expense has merely been paid to a related party and the taxpayer has not suffered the true economic burden of that expense.

75. The gross assessable income base could be an alternative concept used to avoid the expense risks above. Conceptually, this also makes some sense as a lockdown and/or border restrictions would generally be expected to lower a firm's gross income but not increase its costs (if anything it is likely to reduce costs as variable costs would be less).

76. As the goal is to ensure that businesses maintain productive capacity, and so continue to pay many of their variable costs, a policy that is based on revenue/gross taxable income that is contingent on continuing to pay operating expenses (particularly wages) based on the prior year could meet the same policy target with lower integrity risks.

77. A risk of double reimbursement may also arise from the interaction of the scheme with dividend imputation. Excluding falls in dividend income could address this issue but make the scheme more complex.

Next Steps

78. There are currently a wide range of bespoke and targeted solutions being put forward to address the drop in firm and household incomes during the COVID pandemic (wage subsidy, temporary household income support, BFG, loss carry forward). This risks creating a system that is complex, difficult to administer, not adaptable to uncertainty and change and with high compliance costs. There is an opportunity as the Government considers when and how to move out of level 4 to consider a different approach that could be robust to different health scenarios.

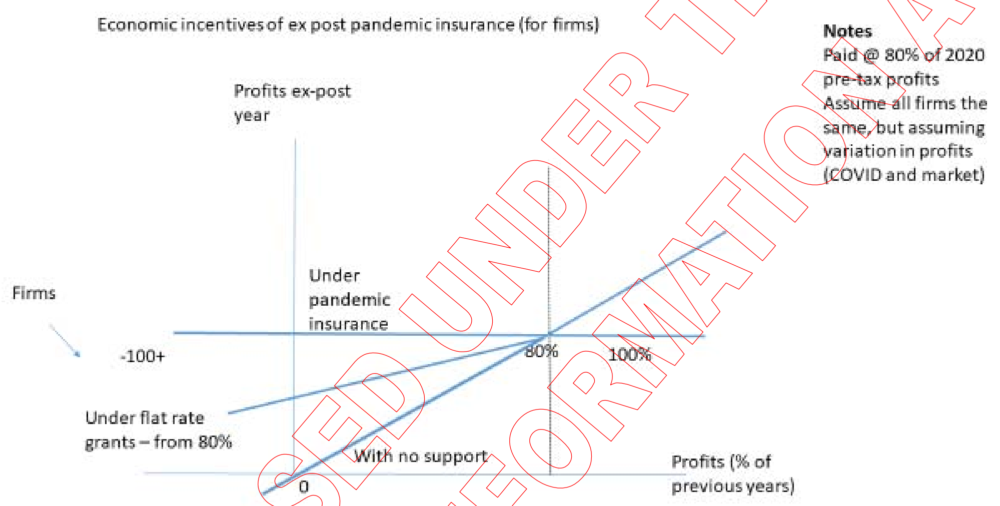
79. This paper outlines illustrative parameters for a single broad approach to address the falls in household and firm income, which while probably being more expensive would provide more fiscal support for the economy generally, and more comprehensive, general and enduring through the pandemic to support households and firms. If you are interested in exploring the idea of a simplified and single approach further, we would provide further advice in mid-April on a feasible option that could be implemented quickly.

80. For further work, we would need to compare the EPI against and alternative, the most likely of which is combination of a wage subsidy plus generous business grant. We would also need to consider how the EPI would be sufficient to stabilise the macro economy, or whether higher level of fiscal stimulus also needed.

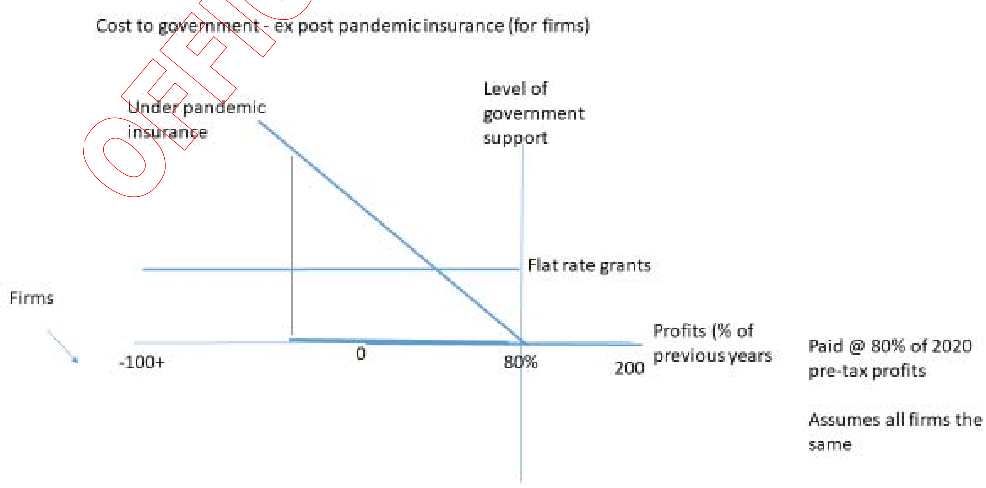
Annex 1: Description of the firm scheme

1. This annex compares the provision of ex-post insurance with a flat-rate grant program for firms and without support. It also identifies in a stylised fashion the allocation of support among firms.

2. The graph below show the percentage of previous years' profit on the x axis and profits in the ex-post year on the y axis. We see in all three states firms above 80% of previous year's profit receive the same amount. Under pandemic insurance that firms profit in the ex-post year is guaranteed at 80% of previous profit so stable below that level. We see that flat rate payments to firms (unrelated to decline in income) results in the middle line.



3. The next graph shows the cost to government by decline in profits from the previous year. This show that there is no cost to the government for those firms above 80% of income. Under the current arrangement there is no support provided. A flat rate payment to all firms results in higher payments for firms with smaller drops in income. Under a scenario of ex-post Pandemic insurance there are very small payments to those firms close to the 80% cap and very large payments further out.



Some key design choices of ex post pandemic insurance

Front loading vs back loading insurance payments:

- Pay insurance payment at end of tax year to taxpayer. Example: Reddell's proposal.
- Immediate payment to taxpayer and then recoup costs at end of tax year. Examples: Corona loans or Mankiw's proposal.

Trade off between insurance cover and effective marginal tax rates

- Redell's proposal is a guarantee that prospective income will be 80% of last year's income. Unlike normal insurance after an event, payout depends on future behaviour of taxpayer. This creates 100% effective marginal tax rate if income is below 80% of last year's. Many workers would not want to take 20% income reduction and lose their connection to a job, especially in a weak economic environment. But it seems plausible that there would be many other workers who would be willing to stop working and receive 80% of last year's income.
- As an alternative, Mankiw proposes a scheme whereby EMTR is likely less than 100%. There is a surcharge tax rate equal to the ratio of insurance payment and last year's income. This reduces the insurance cover so it only covers a smaller proportion of previous year's income using realistic parameters, and proportion of replaced earnings decreases with income.

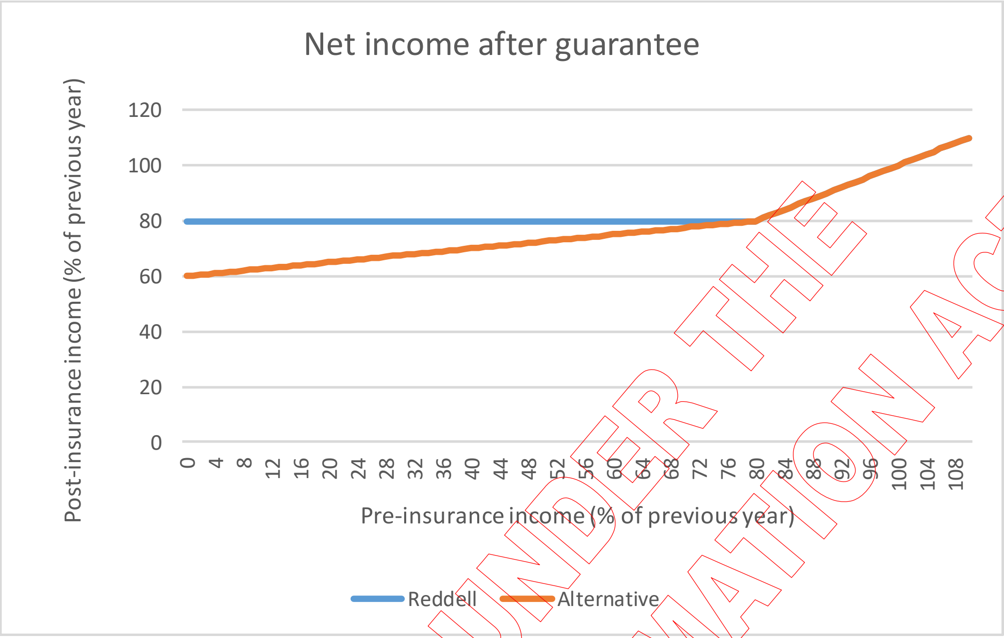
A standard insurance tool to align incentives is to use co-payments/risk sharing. I propose a further option that has features of both Reddell and Mankiw where generous insurance cover is provided but losses are shared by both taxpayer and state.

My proposal would be that if a taxpayer's net income is below 80% of last year's income, the state will compensate for 75% of loss. This would mean that every taxpayer would be guaranteed at least 60% of previous year's income. The replacement rate will depend on earnings. There will be an EMTR of 75% until net income is 80% of previous year.

The difference between these two plans is illustrated graphically below. Reddell's proposal ensures net income is at least 80% of previous year. The alternative policy has a sliding scale of support. This avoids the 100% EMTR. This improves labour supply incentives on both intensive and extensive margin:

- On the extensive margin, which probably has greater importance: replacement cover is now only 60% of previous year's income. Intuitively, it seems unlikely that many workers would be prepared to take a 40% income reduction. And we see similar net replacement rates for unemployment in OECD social security systems. For example, the average net replacement rate for unemployment is 68% for a single person on 67% of average wage in OECD. Very few countries have net replacement rates above 80%.
- On the intensive margin, there is a still a high EMTR of 75% for income below 80% but materially lower than the 100% EMTR in Reddell's proposal.

I think a key issues to explore is how this works for firms, taxpayers in loss and integrity issues and ensuring incentives for exit by non-viable firms.


Net income after guarantee
Post-insurance income (% of previous year)
120
100
80
60
40
20
0
0 4 8 12 16 20 24 28 32 36 40 44 48 52 56 60 64 68 72 76 80 84 88 92 96 100 104 108
Pre-insurance income (% of previous year)
Reddell
Alternative

Assumptions

The following proportion of tax is assumed to attributable to taxpayers with a drop in income of 80%. Weights calibrated to match change in aggregate income.

Farm entrepreneurial income	Non-farm entreneurial income	Salaries and wages	Company profits (in profit)
5%	20%	6%	11%

In addition, assumes government pays out total annual increase in new company losses

Fiscal cost ($b)

Farm entrepreneurial income	Non-farm entreneurial income	Salaries and wages	Company profits (in profit)	Increase in company losses
0.2	3.1	4.9	3.6	13.3

Nominal GDP ($b)	300
Total fiscal cost ($b)	25
Fiscal cost % of GDP	8%

Caveats

Extremely rough

Has not been QA'd

Based on crude assumptions about proportion of taxpayers that would see drop in incomes of 50% plus assumption that change in new company losses would be paid out.

Taxable income $000	Farm income	Non-farm income	Farm + non-farm	Annual COE	Company taxable profits	New company losses
	syfa	**synfa**		**nycea**		
1/01/1987	964	4,248	5,212	26,992		
1/01/1988	1,519	4,985	6,504	30,144		
1/01/1989	1,807	5,423	7,230	31,508		
1/01/1990	2,010	5,945	7,955	32,442		
1/01/1991	1,208	5,995	7,203	32,849		
1/01/1992	1,939	5,957	7,896	32,534		
1/01/1993	1,884	5,776	7,660	33,219	9,957	4,656
1/01/1994	2,372	6,363	8,735	34,766	15,939	3,302
1/01/1995	2,157	7,288	9,445	37,088	17,225	3,978
1/01/1996	2,104	8,195	10,299	39,329	20,314	3,230
1/01/1997	2,028	8,207	10,235	41,970	21,251	3,554
1/01/1998	1,875	8,770	10,645	43,707	17,516	7,582
1/01/1999	1,959	9,299	11,258	44,714	20,608	6,705
1/01/2000	2,629	10,422	13,051	45,817	22,667	5,327
1/01/2001	4,268	9,674	13,942	48,141	24,932	5,960
1/01/2002	4,850	10,244	15,094	51,721	21,719	6,968
1/01/2003	3,039	10,855	13,894	55,130	27,675	5,726
1/01/2004	3,427	12,199	15,626	59,373	29,863	4,748
1/01/2005	3,198	12,604	15,802	64,347	35,909	4,255
1/01/2006	2,311	13,001	15,312	69,696	39,388	6,930
1/01/2007	2,957	14,410	17,367	74,449	41,149	7,347
1/01/2008	5,312	15,371	20,683	80,781	42,599	8,073
1/01/2009	2,288	14,650	16,938	85,104	32,340	13,171
1/01/2010	3,622	14,953	18,575	85,822	33,544	9,673
1/01/2011	5,605	15,655	21,260	88,831	31,002	9,359
1/01/2012	5,789	17,032	22,821	92,305	33,843	9,583
1/01/2013	4,097	16,529	20,626	95,053	37,243	6,760
1/01/2014	8,315	16,947	25,262	98,754	41,741	7,667
1/01/2015	2,736	19,563	22,299	104,376	45,336	8,526
1/01/2016	2,309	20,876	23,185	109,939	46,589	8,206
1/01/2017	5,621	22,725	28,346	115,703	53,322	7,309

1/01/2018	6,587	23,895	30,482	122,690	55,771	7,823
1/01/2019	6,628	24,649	31,277	130,339	57,007	8,027
1/01/2020	6,942	25,545	32,487	136,786	54,382	9,124
1/01/2021	6,708	20,760	27,468	130,519	49,270	22,464
1/01/2022	6,776	25,933	32,709	135,952	60,297	17,193
1/01/2023	6,950	27,930	34,880	144,674	68,699	10,613
1/01/2024	7,453	29,493	36,946	153,221	74,218	9,867

Tax types

	Farm income	Non-farm income	Annual COE	Company taxable profits	New company losses	
2019-20	6,942	25,545	136,786	54,382	9,124	
2020-21	6,708	20,760	130,519	49,270	22,464	
Change	-234	-4,785	-6,267	-5,112	13,340	
	-3.4%	-18.7%	-4.6%	-9.4%	146.2%	
Nominal GDP ($b)	300.0					
80% drop	5%	20%	6%	11%		
20% drop	11%	20%	8%	10%		
2% increase	84%	60%	86%	79%		
-80%	-277.67	-4087.17	-6565.74	-4785.65		
-20%	-152.72	-1021.79	-2188.58	-1087.65		
2%	116.62	306.54	2352.72	859.24		
	-313.77	-4802.43	-6401.60	-5014.06		
	GOOD	GOOD	GOOD	GOOD		
Compensation rate	80%					
Insurance payouts						
75%	208.2513107	3065.380071	4924.307198	3589.240979	13,340	25126.81
0	0	0	0	0		
0	0	0	0	0		
Fiscal cost ($b)	25					
% of GDP	8%					

In this sheet, assume a much more severe economic recessions.

Taxable income falls by		40%					
		Tax types					
		Farm income	Non-farm income	Annual COE	Company taxable profits	New company losses	
2019-20		6,942	25,545	136,786	54,382	9,124	
2020-21		4,165	15,327	82,072	32,629	31,449	
Change		-2,777	-10,218	-54,715	-21,753	22,325	
		-40.0%	-40.0%	-40.0%	-40.0%	244.7%	
Nominal GDP ($b)		180.0					
"Potential" nominal GDP ($b)		300.0					
80% drop		50%	45%	40%	40%		
20% drop		10%	20%	41%	40%		
2% increase		40%	35%	19%	20%		
	-80%	-2776.68	-9196.14	-43771.62	-17402.38		
	-20%	-138.83	-1021.79	-11216.48	-4350.60		
	2%	55.53	178.81	519.79	217.53		
		-2859.98	-10039.12	-54468.31	-21535.45		
		GOOD	GOOD	GOOD	GOOD		
Compensation rate		80%					
Insurance payouts							
	75%	2082.513107	6897.10516	32828.71465	13051.78538	22,325	77185.15
	0	0	0	0	0		
	0	0	0	0	0		
Fiscal cost ($b)		77					
% of actual GDP		43%					
% of "potential" GDP		26%					

Annex: What are the most relevant international interventions and how does that compares with New Zealand's approach so far? (all new content)

Country	Wage subsidy	Support for firms	Tax measures	Support for SMEs	Sector/region	Financial support to households	Sick leave	Public Health
New Zealand	Deleted - Not Relevant to Request					Increase to the rates of all main benefits. Doubling of the Winter Energy Payment. Removal of threshold for the In Work Tax Credit. No stand-down period for unemployment benefit. Mortgage holiday. Residential rent freeze for six months.	Deleted - Not Relevant to Request	
Australia						Two one-off cash payment to welfare recipients. Extending eligibility to income support. New Coronavirus supplement. Early access to Superannuation. Reducing social security deeming rates. Double duration annual leave at half pay.		
United Kingdom						Increasing eligibility and removing stand-down periods for Statutory Sick pay, and Employment Support Allowances. Increase of rate of Universal Credit from 1 April, plus easier claim process (still large delays in the process). Increased rent support available.		
Ireland						Waiving stand-down period for sick pay. Multiple differing financial supports available for those whose income is affected by Covid-19 (some BAU some Covid-19 specific). Enhanced unemployment payment. No increase in rent recommended to landlords. Notice periods extended for renters. Moratorium on utility disconnection.		
Singapore						One-off cash payment to families; additional payments to low-income and unemployed. Flexibility on government loans.		

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France		Extension of benefits.	
Italy		Income-support for workers self-employed and seasonal workers. Select mortgage payment exemptions. Child care support. Parental leave of up to 15 days covering 50% of salaries. Moratorium on debt payments.	
United States		Additional funds to states for unemployment insurance. Paid caregiver leave for up to 10 weeks at 2/3 wage replacement (up to cap). Small employers exempted. One-time cash payments of $1,200 to adults, $500 to children below threshold. More than doubling of UI benefits (increase of $600/week).	

Summary of COVID-19 International Economic Support Measures – as at 9 April

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US

Fiscal & business support measures

- Its fiscal package totals about US$2 trillion (9% of GDP). The main provisions include: business bailouts ($500 billion), funding for hospitals ($150 billion), small business help ($367 billion), unemployment insurance (an increase by $600 a week for four months) and income support ($1,200 per eligible adult with additional payments for children).

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Pages 3 - 10 of this document have been deleted as they are not relevant to this request.

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Economic response to COVID-19 – next steps

Date:	20 April 2020	**Report No:**	T2020/988
		File Number:	MC-1-6

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance** (None)	Discuss with officials.	21 April 2020

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Mario DiMaio	Principal Advisor, COVID-19 Policy and Strategy	s9(2)(k)	✓
Alastair Cameron	Manager, COVID-19 Policy and Strategy		

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: Economic response to COVID-19 – next steps

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While we continue to explore the operational feasibility of shifting to a more generous and wide-ranging approach of an ex-post pandemic insurance, we are not yet in a position to recommend a shift in strategy now. We expect to report later this week on the feasibility of this option.

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Pages 3 - 11 of this document contain some information that has been withheld under s9(2)(f)(iv) and the remainder have been deleted as they are outside the scope of this request.

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33. An alternative to the above package which we have presented to you in recent reports (refer TR2020/935) is the introduction of pandemic insurance. At this point we continue to work through the operational feasibility of this approach. We expect to report to you this week based on further analysis with key operational agencies. Very approximate estimates suggest that an EPI could cost around $30 billion or around 10 percent of current GDP. This could substitute for $12-25 billion of the above policy response.

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Pages 13 - 25 of this document have been remainder have been deleted as they are outside the scope of this request.

TE TAI ŌHANGA
THE TREASURY

Reference: T2020/1012 MC-1-6

Date: 16 April 2020

To: Minister of Finance (Hon Grant Robertson)

Deadline: None
(if any)

Ex-post Pandemic Insurance (EPI) follow-up

Key points

You have sought further advice on how an Ex-post Pandemic Insurance proposal (EPI) would dovetail with other government measures to support firms and employees.

An EPI would replace the need for significant additional cushioning support measures. We understand you have questions about operational feasibility and we have some further work underway to address these questions.

On the issue of compatibility with existing measures, the key messages are:

- An EPI is compatible with all the tax response measures, with the exception of tax loss carry back.
- In large measure, the compatibility of the EPI with existing measures can be dealt with through its design. The relationship with some specific existing measures, such as sector-specific support, would require further consideration.
- Those who gained from the income support package would not see a loss from the EPI, because their incomes will be higher than last year.
- Our initial assessment is that an EPI could theoretically be complementary to the Wage Subsidy Scheme depending how it was designed and administered.
- An EPI would replace any potential redundancy payments and transitional income support measures currently under consideration.
- Interactions with the welfare system would require further operational consideration.
- An EPI would complement Business Finance Guarantee and render further support for economically significant firms unnecessary.
- Interaction with support already provided (i.e., in the transport sector) would need further consideration in design.
- If you are interested in pursuing an EPI, you would need to decide very soon if the loss carry-back changes should be removed or amended from the COVID Bill (intended to be passed in the week commencing 28 April).

Analysis

On 9 April we reported (T2020/935) on the features of a broad response to the cushioning of firms and households incomes from the COIVD-19 shock through the possible development an EPI.

This aide memoire responds to your initial question about the transition and links with measures already announced. Further work on the practical and operational implications would require more design work that could be commissioned.

If there is an interest in developing the approach, then implementation would be better sooner rather than later. In addition, because it would in large part replace new support measures we would need to reset expectations about the development of further income support policy for firms, individual or sectors. This is because it would help to shape firms and individuals expectation of the future and their current economic behaviour.

There are design choices for an EPI, which would determine both policy compatibility and administrative feasibility. For example, a key choice is whether to implement EPI for both firms and households, or just households. If only households, then we could couple an EPI with other business support measures. The motivations for including firms and households are different (productive capacity and alleviation of hardship respectively).

As our report notes a comprehensive EPI would render most additional measures to support incomes of firms, sectors and individuals unnecessary in the cushioning phase. One exception is where we see gaps in the ability of individuals or firms to access liquidity/finance.

The EPI would also not fulfil the role of returning the economy to full employment. Further fiscal and monetary support would be needed to support demand in the economy once restrictions are removed.

The programme would not prevent broader changes in economic conditions and their associated impacts. Firms and individuals in hard hit sectors would still need to make decisions on their ongoing viability and jobs would be lost. Additional sector assistance might be necessary to aid transitions in particular sectors and further measures would be needed around active labour market policies.

In general, support that is already provided to increase incomes would be accommodated by the EPI as follows:

- Where the government has provided income support to those (individuals or firms) whose income has fallen below the threshold (perhaps 80 percent) of last years' income, the call on the government guarantee would be reduced by an equivalent amount.
- Where the government has provided support to individuals or firms where income will not fall below 80 percent of last year's income then this would not represent additional income for the individual/firm and would not reduce the final cost of the guarantee.

Tax measures

The Government's tax policy response to COVID-19 would largely be compatible with EPI, with the exception of the loss carry-back measure. The other tax measures announced either support cash flow or promote investment to support economic recovery, which could complement the EPI.

The loss carry-back rules allow taxpayers to estimate their taxable losses for the 2020/21 income year, offset those estimated losses against previous years' taxable income, and receive an immediate cash refund for overpaid tax in previous years. To reduce the chance of taxpayers deliberately overestimating losses, use-of-money interest (UOMI) is charged where the estimated loss exceeds the actual loss.

Because the EPI would guarantee to all firms and households some proportion of their income in the 2019/20 income year, it would ensure most taxpayers are not in an overall loss position at the end of the 2020/21 year. This would mean taxpayers who had estimated a loss and used the loss carry-back rules would no longer be in a loss position after the EPI payment is taken into account. Such taxpayers would then have to pay back any cash refunded under the tax loss carry-back scheme and would be subject to UOMI on the entire estimated loss. This would create a lot of unnecessary compliance costs for taxpayers and impose a great administrative burden on IR.

Assuming the EPI only guarantees a proportion of the 2019/20 year's income, it would not provide benefits to taxpayers who made a loss in that year. Such taxpayers may still be able to benefit from the loss carry-back rules.

The loss carry-back changes are planned to be included in a bill intended to be passed in the week commencing 28 April, with refunds being paid out within two weeks of estimation of loss (sooner for online applications). If the Government decided to proceed with an EPI, it would also need to decide very soon if the loss carry-back changes should be removed from the COVID Bill or amended to be more compatible with the EPI.

We note that while the EPI is intended to be temporary, the Government has signalled it plans to consult on and enact a permanent loss carry back measure in late 2020. If this measure goes ahead, taxpayers will still be able to carry back losses in later years.

Table 1: Compatibility of tax measures with an EPI

Tax loss carry-back scheme	**Not compatible – policy would need to be reconsidered**
Restoring depreciation deductions on non-residential buildings	Compatible
Increasing the provisional tax threshold from $2,500 to $5,000	Compatible
Increasing the low-value asset write-off threshold to $5,000 for 17 March 2020 till 16 March 2021 and $1,000 from 17 March 2021	Compatible – but may increase integrity risks under the EPI
Bringing forward the application date for the broader refundability rules for the research and development tax credit	Compatible

Enabling Inland Revenue to remit use of money interest (UOMI) if a taxpayer's ability to make a payment on time was significantly adversely affected by COVID-19	Compatible
Greater flexibility for taxpayers in respect of statutory tax deadlines	Compatible
Changes to the tax loss continuity rules	Compatible – the EPI may affect some of the costings

Wage subsidy and welfare support measures

Those who gained from the income support package would not see a loss from the EPI; some beneficiaries and/or superannuitants will see a rise in income.

Our initial assessment is that an EPI could theoretically be complementary to Wage Subsidy Scheme (WSS) depending how it was administered. The extent of the support from the EPI would depend on extent to which wages have fallen below 80 percent of last year's income – which would depend on how and individuals' hours and wage had been adjusted during the year. Table 2 provides a stylised example.

The fiscal costs of EPI and WSS would partially overlap. For example for furloughed workers the WSS would reduce the call on the income guarantee by the same amount as the WSS payment.

Table 2: Stylised example of interaction

Situation for worker normally on $1000/week, but now…	Support from wage subsidy	Support from EPI topping up to 80%
Working 0 – 80%	$585/week to employer to pass on to employee	Top up of $115/week to employee (to get to $800/week)
Working 80-100%	$585/week to employer to pass on to employee	No top up

The interactions with the welfare system would require further operational consideration. The operational issues for an EPI include whether support would be treated as income for the purposes of supplementary assistance, abatement, and child support obligations. We have not had an opportunity to test this with MSD. Technical details and operational design may change the implementation timeframes significantly.

An EPI would replace any potential redundancy payments and transitional income support measures currently under consideration. If it was decided to go ahead with these measures alongside an EPI, then further thought would also be needed on how an EPI would interact/relate to a redundancy payment. A decision to progress an EPI would ideally be made sooner as it would provide significantly higher levels of support to those most affected and render a redundancy type program unnecessary.

Business finance measures

The Government and the financial sector have put in place measures that seek to extend additional credit to those firms and households facing immediate cash needs. The Government has agreed to provide up to $5 billion in guarantees and banks have provided for payment holidays for households and firms.

The finance measures would remain important. An EPI would substantially reduce the risk for the Crown from its guarantee product. Firms and households would need to borrow against these measures. s9(2)(f)(iv) [redacted] We would need a discussion with banks about how they would treat the EPI and the extent to which they would extend credit in the basis of this guarantee.

An EPI, depending on the design and whether it was extended to larger firms, would render support to economically significant larger firms unnecessary.

Firm and sector support

The government has deployed a number of sector and firms specific interventions, for example in the transport sector and media sector. The interaction with and EPI would require further assessment of the nature and form of that support.

Mario DiMaio, Principal Advisor, Covid-19 Strategy and Policy, s9(2)(k) [redacted]
Alastair Cameron, Manager, Covid-19 Strategy and Policy, s9(2)(g)(ii) [redacted]

Ex post pandemic insurance (EPI) scheme
Scoping note

Project goals

- Confirm objectives and strategic fit of an EPI scheme
- Form view on administrative feasibility of an EPI scheme
- Develop clear recommendation for MOF on whether to proceed with policy development

Scope

1. Goals and strategic fit
    a. Define the potential objectives of an EPI scheme
    b. Develop a clear articulation of how an EPI scheme would fit into and support the Government's broader response/recovery efforts.

2. 'Straw man' policy design
    a. Identify key policy design choices
    b. Develop a strawman proposal of sufficient depth to test with Inland Revenue

3. Administrative feasibility
    a. Engage with Inland Revenue [+ MSD & ACC?] to form a view on the administrative feasibility of an EPI scheme
    b. Surface any issues arising from interaction with welfare/transfer system

Out of scope

The project will not consider the following issues:

- Detailed policy design
- Incentive issues associated with the policy
- Integrity issues associated with the policy

Outputs

1. Short internal notes
    a. Goals and strategic fit (Tsy responsibility)
    b. Strawman policy design (joint Tsy/IR)
    c. Assessment of administrative feasibility (IR responsibility)

2. Treasury Report to MOF
    a. Assessment of coherence of EPI with broader government goals and decisions
    b. Assessment of administrative feasibility
    c. Recommendation to proceed/not proceed with policy design

Timeframes [TBC]

Milestone	Date
Stand up project • Agree scope internally and with IR • Confirm IR admin contacts	**Thurs 16 April**

• Confirm depth of information necessary to inform admin assessment • Agree timing of interaction with IR admin/operational staff	
Goals and strategic fit • Complete note on goals and strategic fit • Circulate to IR (PAS)	**Fri 17 April** [Thurs night if possible]
Straw man • Complete note on strawman policy design • Circulate to IR (Admin)	**Mon 20 April**
Feedback from IR	**Weds 22 April (noon)**
Report to MOF	**Thurs 23 April**

Resourcing

Area	Level	Person
Project lead	PA	Jess
Goals and strategic fit	PA	Bevan – with contributions from Mario, Steve C, Murray, Phil W, Trish, Matt N (Paul Q in the loop)
Straw man	PA / SA – with contributions from IR (PAS)	Bevan – with contributions from Paul Q, Ben, Phil W, Trish, Matt N, Richard (?)
Admin feasibility	SA in linking role with IR (Admin)	Paul - with Clara, Ben (Caleb to be informed b/c of vote overlap); Kath, Ron and Geoffrey
Reporting	SA drafting with PA oversight	Ben – with oversight from Bevan/Paul Q (depending on capacity)
MSD/welfare liaison	Jordan's team	TBC
ACC liaison	TBC after discussion with Matt	TBC

Stakeholders

Team	People
COVID Policy & Strategy	Mark, Alastair, Mario, Matt C
WOT	Jordan, Laura
IR (PAS)	Emma, Phil, Matt N, Trish
IR (Admin)	[Kath?]

[what level of involvement will Caralee want to have? – check with Mark]

An ex post pandemic insurance scheme
Goals and strategic fit

Purpose

An ex post pandemic insurance (EPI) scheme would commit the Government to guarantee a proportion (say 60-80%) of last year's income for individuals and/or firms. This note sets out the goals of an EPI scheme and explains how such a scheme could fit within the Government's broader COVID response/recovery strategy.

Goals

An EPI scheme is a tool to manage the income shock associated with the pandemic. We are going to assume that it applies to individuals and firms. The goals for individuals and firms will be different.

EPI for Individuals

- **Income support objectives.** Alleviate hardship caused by the income shock.
- **Fairness objectives.** Share the economic burden of the pandemic as widely as possible.
- **Growth and recovery objectives.** Support demand in the economy by underpinning a more stable consumption path through the shock and recovery phases (i.e. consumption smoothing).

EPI for firms

- **Growth and recovery objectives.** Maintain the productive capacity of firms through the income shock, with a view to supporting a more rapid recovery as the outbreak eases.
- **Labour market objectives.** Support workforce attachment to firms, with a view to mitigating the labour market impacts of the shock.

Strategic fit

An EPI scheme that covered both individuals and firms would replace most of the additional income support and business assistance measures that are currently under consideration.

- **Income support.** An EPI scheme could potentially be complementary to the wage subsidy scheme, and would have no impact on the benefits already provided to individuals under the income support package. An EPI scheme would replace further income support measures that are currently under development, but interactions with the welfare system would require further consideration.

- **Business assistance measures (loans and grants).** An EPI scheme would complement the Business Finance Guarantee scheme and remove the need for further assistance to economically significant firms. Interaction with bespoke support already provided (e.g. to the transport sector) would require further consideration.

- **Tax measures.** An EPI scheme would be compatible with all tax measures taken to date, with the exception of the tax loss carry back proposal. It would remove the need for further measures to reduce cashflow pressures on taxpayers, but there would still be a role for measures to enhance flexibility and reduce compliance costs.

- **Stimulus and recovery.** An EPI scheme is not a stimulus measure. There will still be a need for a separate set of stimulus measures to kick start the economy as the outbreak eases.

BRIEFING FOR EPIDEMIC RESPONSE COMMITTEE

Komiti Ārai Mate Urutā

21 April 2020

Pages 1 - 69 of this document have been deleted as they are not relevant to this request.

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Australia and the United States have recently announced they will give cash directly to households in response to COVID-19. Will the government be doing the same?

The Treasury is considering a number of measures to support the economy after public health containment measures ease. Cash payments are one of the options under consideration.

During the lockdown the main focus is on more targeted support for households such as through the wage subsidy scheme, increase to benefits and mortgage holidays.

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Pages 71 - 153 of this document have been deleted as they are not relevant to this request.

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Ex Post Pandemic Insurance - Administrative Implications

Date:	22 April 2020	**Report No:**	T2020/1182
		File Number:	SH-13-5 (Tax Strategy)

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Discuss** next steps on this proposal at the meeting with officials on Thursday 23 April	Thursday 23 April

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Ben Ching	Analyst, Tax Strategy	s9(2)(k)	N/A (mob)	
Alastair Cameron	Manager, Covid Policy and Strategy		N/A (mob)	
Jessica Rowe	Acting Manager, Tax Strategy		N/A (mob)	✓

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: Ex Post Pandemic Insurance – Administrative Implications

Purpose of Report

1. This report responds to your request for an assessment of the administrative feasibility of an ex post pandemic insurance (EPI) scheme (T2020/935 and T2020/1012 refer).

The goals of ex post pandemic insurance

2. An EPI scheme would commit the Government to guarantee a proportion (say 80%) of last year's income for individuals and/or firms. As an alternative, it could guarantee some portion of firm's expenses, upon proof that the firm has lost a set percentage of revenue. If successful, an EPI scheme would allow the Government to mitigate the initial income shock to individuals and firms, and then spread the costs of the pandemic across the economy and through time in a fairer and less disruptive manner. Additionally, an EPI scheme could help maintain public support for ongoing public health measures.

The administrative feasibility of ex post pandemic insurance

Inland Revenue

3. Treasury officials have discussed the administrative feasibility of a 'straw man' EPI proposal with Inland Revenue. A description of the straw man proposal is annexed to this report. Inland Revenue's initial administrative assessment is that both 'in-year' and 'year-end' delivery is possible, however:

   a **The year-end option** is preferable from an integrity and administrative complexity perspective. Implementation of a year-end EPI would take about 6 months. Inland Revenue would need this time to build and prepare the necessary customer support functions to handle a large number of EPI claims. This option would involve payments made at the end of the tax year, which for most taxpayers would be 31 March 2021. Businesses and individuals would then need to rely on bank finance to receive timely cash-flow support, but could use the EPI scheme to support their loan applications.

   b **The in-year option** would provide cash to people more quickly, but involves a trade-off between speed, simplicity, and integrity risk. Broad-based payments based on set criteria could be set up relatively quickly. This would require a taxpayer to estimate their income for the current year compared to last year; and for firm's to estimate their expenses. This will present two risks:

      i Taxpayers may be overpaid during the course of the year, in which case they will owe money to the Government at the end of the year (and some taxpayers may be unable to pay the debt); and

      ii Some taxpayers may be able to manipulate the tax system to over-claim.

4. It may be possible to develop integrity measures to manage these risks, but this will increase complexity and reduce the ability of the Government to deliver timely support. Some integrity risks may be unmanageable. Given the time available, Inland Revenue

has not been able to assess the level of these risks. If Ministers wish to proceed with further work on the in-year EPI, we are able to provide further advice on this next week.

5. Inland Revenue's ability to administer an EPI will be reduced if it is called upon to deliver other measures to support individuals, firms and/or households in the interim.

Ministry of Social Development

6. Treasury officials have also raised the EPI proposal with MSD. It is unlikely that MSD would be able to deliver EPI, given the scale of existing and proposed demands on its administrative capacity. Also, many of MSD's payments are assessed on a weekly basis so annual income information is not collected or assessed for all clients, and MSD only holds income information about its clients. MSD also does not hold income information about firms. The Treasury does not see MSD as a viable option for the delivery of an EPI Scheme.

Accident Compensation Corporation

7. Treasury officials engaged with ACC recently to discuss operational support in delivering support to Small and Medium-sized Enterprises (SME). ACC have indicated to Treasury that it has the capacity and capability to deliver a simple scheme via its current infrastructure, assuming that businesses' details were provided to ACC and this did not require a front-end process to validate or assess applications. Any expectations for validation would be a significant deviation from the core business of ACC and outside of its expertise.

8. s9(2)(h) [redacted]

9. ACC's capacity to deliver both support to SMEs and an EPI scheme is untested. Delivery of both would create significant challenge for an organisation where this form of activity is outside of its core business and would likely seriously delay the delivery of both schemes. If Ministers were interested in pursuing the offer from ACC to support the delivery of support, it is recommended that one scheme is chosen to prioritise the utilisation of ACC resource, which will be the subject of further advice.

Next steps

10. A decision to progress an EPI scheme would require a significant commitment of resources on the part of both Treasury and Inland Revenue. It would therefore constrain the ability of both agencies to deliver more targeted forms of support to firms, individuals and/or households.

11. You are meeting with officials are on Thursday 23 April to discuss options for providing further support to firms, individuals and households. We suggest that you consider the merits of an EPI scheme against these other options at the discussion on Thursday. We will provide you with a final organisational view on the merits of progressing an EPI at that meeting.

Recommended Action

We recommend that you:

Discuss the next steps on the ex post pandemic insurance proposal at your meeting with officials on Thursday 23 April.

Jessica Rowe
Acting Manager, Tax Strategy

Hon Grant Robertson
Minister of Finance

Annex: Straw man proposals

Ex post pandemic insurance for individuals

Objectives

- Supporting living standards.
- Maintaining demand in the economy.
- Maintaining support for the public health response strategy.

Key design parameters

Entitlement	An insurance mechanism that guarantees and pays up to [80%] of an individual's previous year's income.
Individuals covered	All natural persons, but excludes sole traders, self-employed and partners in partnerships (as they are covered by the firm EPI described below).
Administration	'Push' model – entitlements calculated by IR and cash pushed out to recipients without the need for application or verification.
Timing of payment	Following options considered: • 'Front-loaded' (payments during the tax year). • 'Back-loaded' (payments at the end of the tax year).

Ex post pandemic insurance for firms

Objectives

- Preserving the productive capacity of affected firms.
- Maintaining attachment between firms and their workers.
- Maintaining support for the public health response strategy.

Key design parameters

Entitlement	An insurance mechanism that guarantees and pays up to [80%] of a firm's current fixed operating costs (e.g. rent, utilities, interest), adjusted by the firm's percentage reduction in turnover.
Firms covered	Firm must have filed a tax return for the previous income year *or* must be GST registered.
Administration	'Pull' model – self-selection and self-assessment by firms, with application to Inland Revenue and subsequent payment.
Timing of payment	Following options considered: • 'Front-loaded' (payments during the tax year). • 'Back-loaded' (payments at the end of the tax year).

EPIDEMIC RESPONSE COMMITTEE PACK

Komiti Ārai Mate Urutā

<u>Version for the Finance and Expenditure Committee Hearing on 29 April 2020</u>

Pages 2 - 187 of this document have been deleted as they are not relevant to this request.

	Sector/Region Specific Support	NZ$600 million support for the aviation sector and a NZ$900 million debt funding agreement with Air New Zealand to ensure continued freight operations, domestic flights, and limited international flights. NZ$27 million for social sector services and community groups to continue to provide essential support to their members and users. NZ$50 million to support media.	AUS$1 billion to support communities most significantly affected by COVID-19, including regions reliant on industries such as tourism, agriculture, and education. AUS$715 million to support the airline industry in Australia by reimbursing aviation fuel taxes, easing Airservices Australia charges, and providing a rebate for domestic aviation security. This package starts from 1 February and is valid for eight months until 30 September 2020. Victoria: AUS$1.7 billion (0.1% of GSP) stimulus, including support for firms in the worst affected sectors, payroll tax refunds, and a fund to provide employment for dismissed workers. New South Wales: Around AUS$3 billion (0.2% of GSP), including stimulus for new capital projects and payroll tax relief. Queensland: AUS$4 billion (0.2% of GSP) stimulus package including the establishment of a loan facility for impacted businesses, payroll tax relief, and discounted utility bills for households. Western Australia: AUS$607 million (0.03% of GSP) package, including payroll tax relief for firms and a freeze on household fees and charges. Tasmania: AUS$985 million (0.05% of GSP) of measures that include payments to households, health spending, interest free loans to small businesses, and payroll tax waivers for businesses in sectors most heavily impacted and targeted industry assistance. South Australia: AUS$1 billion (0.05% of GSP) in measures. These include a fund to provide employment opportunities, payroll tax relief, land tax relief, a one-off boost of AUS$500 for households who are receiving welfare support, and a waiver of liquor licence fees for 2020-21 for hospitality forced to close. Australian Capital Territory: AUS$137 million stimulus package targeting vulnerable households through cash payments and small business through the provision of credit, as well as a fund for contractors to undertake

Question time information 30 April 2020

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Pages 2 - 9 of this document have been deleted as they are not relevant to this request.

	Financial Support to Households Deleted - Not Relevant to Request	Deleted - Not Relevant to Request	Deleted - Not Relevant to Request Two AUS$750 cash payments to income support recipients and eligible concession card holders, including veterans. Individuals who receive the Coronavirus supplement payment will not receive the second cash payment. First payment made from 31 March and second from 13 July. Deleted - Not Relevant to Request

From: Mario DiMaio [TSY]
Sent: Thursday, 23 April 2020 11:30 AM
To: Bryan Chapple [TSY]; Caralee McLiesh [TSY]
Cc: Alastair Cameron [TSY]; Bryan Chapple [TSY]; Tim Ng [TSY]; Mark Vink [TSY]; Hugo Van Dyke [TSY]; Andrew Hagan [TSY]; Struan Little [TSY]; Aleisha Christison [TSY]; Keiran Kennedy [TSY]; Mickey Stott [TSY]; Cara Palmer-Oldcorn [TSY]; Jessica Rowe [TSY]; Geraldine Treacher [TSY]; Andrew Rutledge [TSY]; James Beard [TSY]; Bevan Lye [TSY]; Ben Ching [TSY]
Subject: GG advice on Ex-post insurance

Dear Bryan and Caralee

- You are due to give verbal advice to the MOF on the EPI
- It was agreed this is the decision point – either the package in the TR or the EPI.
- Mark convened the Governance group to discuss our advice to the Minster on this proposal (not all members participated)
- While there were some different views was not broad enough support from the Governance group to recommend this approach. This was for three reasons:
  - Risk that political economy would still lead to a range of overlapping and bespoke solutions
  - Equity issues
  - Since this a 'single solution' if it doesn't work well it poses risks.

Key points for the Minister

- Advice has confirmed that the EPI is operationally feasible. The EPI would largely substitute for the package you have now.
- There are some obvious benefits – including the replacement of the need to developed bespoke and more targeted interventions, the very broad based support it would provide.
- But its also expensive and untested.
- We don't think you should switch strategies now.

HI Colleagues

Key question: Should Treasury recommend the government guaranteeing individuals and firms [70/80] of last year's income. Ex-post Pandemic insurance]

My suggestions is that we go round the table and take view starting with DS/Directors. I will collate the views and we will send up to Bryan Caralee for a decision.

Here are the key points from the analysis:

- The management of the economic response is exploding in scale and complexity.
- The EPI in principle provide the broadest tool for income support in the near-term
- Objectives of an EPI have merit
- There are some weaknesses in incentives and integrity that need to be addressed in design; These weakness need to be compared warts and all
- The should be seen largely as a substitute for other interventions
- Fiscal cost: Anywhere between 10 and 20 percent
- Admin: Is feasible form IR but… would need to replace existing programs given demand on their limited capacity

An EPI would ould only recommend work on an EPI if we are prepared to recommend (and think it is feasible to recommend) that work is paused on the subsidy & grant while we work up an EPI design

-

From: Alastair Cameron [TSY] <Alastair.Cameron@treasury.govt.nz>
Sent: Wednesday, 22 April 2020 7:06 PM
To: Bryan Chapple [TSY] <Bryan.Chapple@treasury.govt.nz>; Tim Ng [TSY] <tim.ng@treasury.govt.nz>; Mark Vink [TSY] <Mark.Vink@treasury.govt.nz>; Hugo Van Dyke [TSY] <Hugo.VanDyke@treasury.govt.nz>; Andrew Hagan [TSY] <Andrew.Hagan@treasury.govt.nz>; Struan Little [TSY] <Struan.Little@treasury.govt.nz>; Aleisha Christison [TSY] <Aleisha.Christison@treasury.govt.nz>; Keiran Kennedy [TSY] <Keiran.Kennedy@treasury.govt.nz>; Mickey Stott [TSY] <Mickey.Stott@treasury.govt.nz>; Cara Palmer-Oldcorn [TSY] <Cara.Palmer-Oldcorn@treasury.govt.nz>; Mario DiMaio [TSY] <Mario.DiMaio@treasury.govt.nz>; Jessica Rowe [TSY] <Jessica.Rowe@treasury.govt.nz>; Geraldine Treacher [TSY] <Geraldine.Treacher@treasury.govt.nz>; Andrew Rutledge [TSY] <Andrew.Rutledge@treasury.govt.nz>; James Beard [TSY] <James.Beard@treasury.govt.nz>; Bevan Lye [TSY] <Bevan.Lye@treasury.govt.nz>; Ben Ching [TSY] <Ben.Ching@treasury.govt.nz>
Subject: For action - GG discussion on Ex-post insurance

Hi all,

The purpose of this email and tomorrow's 10.30am meeting is to develop a view on whether we should advise the Minister to pursue the Ex-post Insurance option on which we've previously provided advice.

We have a meeting with the Minister at midday tomorrow (Thursday), and we expect he may ask us the question.

Apologies for the short timeframes. Also, we couldn't find a time when everyone could meet, so some round-robining my email might also be required. Mario will lead then when he's back on board in the morning.

In the meantime, please find attached the last report on the administrative implications of an EPI that went to the Minister this evening.

Also attached for completeness are our two previous reports outlining the option in some detail and responding to the Minister's initial question about how an EPI would operate with other elements of the Government's COVID response.

Ngā mihi,
Alastair

Alastair Cameron (he/him) **| Manager | Te Tai Ōhanga – The Treasury**
COVID Strategy and Policy
s9(2)(g)(ii) Email/IM: alastair.cameron@treasury.govt.nz
Visit us online at https://treasury.govt.nz/ and follow us on Twitter, LinkedIn and Instagram

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