The Treasury

Advice on COVID-19 Response Information Release

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Options to Manage Future COVID-19 Costs

Date:	27 August 2021	**Report No:**	T2021/2188
		File Number:	BM-2-1-2022

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	**Note** the content of this report. **Indicate** if you require any further advice on the content of this report.	Tuesday 31 August 2021

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Kamlesh Patel	Principal Accounting Advisor, Fiscal Reporting	[39]	n/a (mob)	✓
Megan Taylor	Manager, Strategic Performance Improvement		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: Options to Manage Future COVID-19 Costs

Purpose of Report

1. Following the recent COVID-19 resurgence it is likely that the COVID-19 Response and Recovery Fund (CRRF) will be fully exhausted in the near-term.

2. The purpose of this report is to outline options to manage future COVID-19 costs. This report specifically focuses on some initial analysis on unused funding allocated from the CRRF that could be potentially returned to manage emerging COVID-19 costs.

3. You recently agreed [T2021/2177] to tighten the criteria to access funding from the CRRF and to managing less immediate costs against Budget allowances. It is worth keeping in mind that advice when considering this report.

Background

4. Overall, the Government has signalled fiscal support totalling $62.1 billion for the response to and recovery from COVID-19. The fiscal support comprises initiatives of $12.1 billion announced on 16 March 2020, that were primarily focussed on supporting the economy, and $50 billion of funding on the establishment of the CRRF on 6 April 2020. The content of this report focusses on analysing funding allocated from the CRRF, rather than the support measures announced on 16 March 2020.

5. The rational for establishing a notional fund (CRRF) to manage the fiscal implications from COVID-19 was to provide a lever for the Government to achieve its fiscal strategy, allow some prioritisation of funding requests and provide transparency in communicating the Government's COVID-19 fiscal support measures.

6. Decisions with fiscal implications that related to the COVID-19 response or recovery have been charged against the CRRF when they are agreed by Cabinet and the fiscal impact of a decision can be reliably measured. It is important to note the balance for specific decisions charged against the CRRF are not subsequently adjusted if there are revisions in their estimated costs, unless additional funding is required. This is consistent with the expectations under the Fiscal Management Approach for operationalising Budget allowances. Although the estimated costs of initiatives charged against the CRRF are not adjusted, the funding available has been adjusted for some unused funding from 2019/20 and the Budget 2021 reprioritisation exercise.

Tracking CRRF Funding

7. For transparency purposes our focus has been on tracking funding decisions that have been charged against the CRRF. The latest list of decisions charged against the CRRF was provided to your Office on Wednesday 25 August.

8. In regards to transparency of legislative approval (appropriations), actual costs and performance reporting of decisions funded from the CRRF we have relied on existing frameworks. This is in line with the overall design of the public finance system which provides for governance and management freedom, alongside accountability and transparency. This existing system makes it difficult to reconcile the actual fiscal impact of decisions to funding provided from the CRRF.

9. To provide information to the public on actual spending on initiatives funded from the CRRF, we have started releasing some information using appropriation data. However, the appropriation data has a number of limitations in reconciling back to the funding charged against the CRRF as:

- some initiatives do not require an appropriation (e.g. tax policy changes),
- some initiatives have been added into existing appropriations, and
- some appropriations related to CRRF initiatives have not been charged against the CRRF (e.g. SBCS loan write-offs).

10. A comprehensive reconciliation between funding allocated (either from Budget allowances or CRRF) and actual spending is complex for a number of reasons (e.g. the flexibility agencies have to move funding around, funding allocated sometimes builds in a risk buffer). While such a reconciliation may be helpful for decision making and transparency, such an exercise would require additional resources for the Treasury and place additional pressure on agencies. If you are interested in a comprehensive reconciliation we can provide further advice on the resourcing required and additional work this would mean for agencies.

11. We consider there to be different ways to understanding the fiscal and economic impact of COVID-19 spending. For example, analysis of actual and forecast financial statements and the fiscal impulse, alongside understanding expenditure related to significant areas of COVID-19 expenditure (e.g. appropriation data). This would not involve a comprehensive reconciliation but would provide useful information for both decision-makers and the public.

Options to Manage Future COVID-19 Costs

12. As at 26 August 2021 $46.5 billion of the CRRF has been allocated, leaving $3.5 billion of unallocated funding. There is still significant uncertainty around the fiscal costs of the current resurgence. If there is a further extension of Alert Level 3 or 4 restrictions, we expect additional CRRF funding to be sought for key business support measures (e.g. wage subsidy scheme). Under a scenario were all of New Zealand is at Alert Level 4 for two weeks, and then Auckland is at Alert Level 4 for two weeks and the rest of the country are at Alert Level 3, business support payments could be around $3.7 - $4.4 billion.

Please note that the figures '$3.7 - $4.4 billion' were an estimate at a certain point in time and are no longer the most up to date figures

13. In addition, we are expecting significant funding requests over the next few months to support the longer-term border and health settings for responding to COVID-19 that could exceed [33] . We understand DPMC has also been doing stocktake of COVID-19 related costs.

14. Considering the potential that additional business support may be needed for the current resurgence and the emerging border and health related pressures we expect that the CRRF could be fully exhausted in the near-term.

15. Our understanding is you are intending to continue to use the CRRF to manage COVID-19 costs. There are a few options available that could help to relieve some of the pressure on the CRRF. You could consider using a combination of below identified options:

- **Option 1** – Return unused funding back into the CRRF (this will have a fiscal impact);

- **Option 2** – Reprioritise funding from the CRRF yet to be spent (this will not have a fiscal impact); and

- **Option 3** – Increase the level of funding in the CRRF (this will have a fiscal impact).

16. The above options are not mutually exclusive, so you could consider a combination of the above. Given the inherent uncertainty of the current resurgence or any future resurgences it is difficult to quantify how much additional headroom may be needed in the CRRF. This uncertainty also makes it hard to predict when the CRRF may be fully exhausted. For example, if Alert Level 3 or 4 restriction continued for a further two weeks this would likely fully exhaust the CRRF.

17. You have agreed that the future scope of the CRRF should be more focussed on managing the immediate cost of resurgences and the public health response. This will help alleviate some of the emerging pressures and could be a helpful way to inform your thinking on setting future buffers. For example, you could ensure a buffer is in place that could absorb the costs of at least two future resurgences with Alert Level 3 or 4 restrictions in place for a month.

18. We understand you are seeking further advice on topping up the CRRF before the end of the 2021 calendar year.

Return unused funding back into the CRRF

19. For a number of initiatives, the funding allocated (based on initial estimated costs) from the CRRF have been greater than the actual and revised future estimated costs. In most cases where the funding allocated for an initiative is not fully utilised, the unused portion has returned back to the centre, therefore resulting in an improvement in the government's fiscal position.

20. We have undertaken some high-level analysis to identify unused funding allocated from the CRRF that could potentially be returned to the CRRF. The analysis has focussed on the most material initiatives funded from CRRF. The selected initiatives for our analysis reflect just over 70% of the funding allocated from the CRRF as at 26 August 2021. As mentioned, due to the challenges of directly linking the funding allocated to their fiscal impacts, we have based our analysis on a number of assumptions. Our analysis, including our assumptions, is attached as Appendix 1.

21. It is worth noting that Cabinet [CAB-20-MIN-0483] previously agreed that $1.0 billion of unused funding, primarily from the 2019/20 fiscal year could be returned to the CRRF. This amount was based on an aggregated view of unused funding rather than looking at individual initiatives. We would recommend a similar approach should be taken if you are considering returning unused funding back into the CRRF.

22. Our analysis has identified that between $3.0 - $3.5 billion of unused funding could be potentially returned to the CRRF. Most of this funding relates to initiatives that were targeted at providing business support. For the initiatives that we analysed that related to the health response and supporting the recovery, our assessment is there is minimal unused funding available. In most cases, any unspent funding in these areas have been transferred into future years.

23. If you are considering returning funding to the CRRF based on our analysis, at this point we would recommend taking a conservative approach (e.g. $3.0 billion), as there is still a chance that the actual costs of the initiatives may increase in the future.

24. As the majority of the unused funding identified has most likely been incorporated into the current fiscal position, if $3.0 - $3.5 billion was returned to the CRRF this would result in an increase in net core Crown debt of just under 1% of GDP by the end of the forecast period.

25. A more comprehensive analysis may identify more unused funding that could be returned to the CRRF. However, we believe it is unlikely that this work would identify much more than what has already been identified from our initial high-level analysis. Our view is based on reviewing the unspent COVID-19 specific appropriations for the 2019/20 and 2020/21 fiscal year. Excluding the business support measures there were minimal unspent appropriations in 2019/20. The majority of unspent COVID-19 specific appropriations for 2020/21 have been transferred into future years.

Reprioritise current and out-year funding from the CRRF

26. A number of initiatives funded from the CRRF have funding remaining in the current year and beyond. To provide additional headroom in the CRRF an option could be to reprioritise allocated funding back into the CRRF. Is it worth noting, in contrast to the option of returning unused funding to the CRRF, reprioritising funding will have no fiscal implications.

27. Given one of the main purposes of the CRRF was to manage the fiscal impacts from COVID-19, this option best achieves this objective.

28. A CRRF reprioritisation exercise was undertaken at Budget 2021 which resulted in around $1.0 billion of funding being added back to the CRRF. Most of the funding identified related to underspends from 2020/21.

29. A significant portion of the future costs funded from the CRRF relate to the government's public health response to COVID-19 (e.g. vaccination, managed isolation and quarantine facilities), business support measures (e.g. wage subsidies scheme) and some wider Government priorities (e.g. Housing affordability, Three Waters reform). Two other areas of outyear spending are Jobs for Nature and the Shovel Ready projects. Both of these programmes are on the list of programmes to be reviewed by the Implementation Unit.

30. Our initial assessment is that there is limited scope for reprioritisation in the above areas, as repurposing this spending would either risk not funding policies that are likely to be required in responding to the current outbreak or require a reassessment of current government priorities. You could relook at policy priorities if you wanted to achieve a high level of funding to be reprioritise back to the CRRF.

31. As part of our advice on Budget 2022 strategy and design, we sought your views on whether to run another CRRF reprioritisation process as part of the Budget. We noted that such an exercise would require additional resources to successfully implement and should be considered against the existing complexity of Budget 2022. Our understanding is your preference is not to run a detailed exercise that scrutinised all CRRF-funded initiatives for Budget 2022.

32. In light of the recent resurgence you may want to reconsider running a CRRF reprioritisation process. We believe that running a CRRF reprioritisation process would be the best way to identify funding that could be reprioritised. However, this would require the involvement of agencies and additional resources within the Treasury. An alternative approach could be to take a more high-level targeted approach at reviewing funding. Our initial view, based on the previous Budget 2021 reprioritisation exercise, is this could potential identify between $500 - $1,000 million of funding that could be reprioritised to the CRRF.

Increase the level of funding in the CRRF

33. Additional funding could be added to the CRRF to provide more headroom to manage emerging pressures. An increase in the funding available in the CRRF will have fiscal implications, for example an increase of $5 billion would increase net core Crown debt by about 1% of GDP by the end of the forecast period.

34. Although this option will have fiscal implications, the Government is in a much stronger fiscal position compared to Budget 2021. Provisional unaudited 30 June 2021 results indicate net core Crown debt could be 3% lower than forecast at Budget 2021.

35. This option would provide the most flexibility in the level of the increase in funding. With our recommendation to tighten the scope of the CRRF this will ensure funding is allocated to manage immediate costs and not crowded out by on-going pressures.

36. We understand you are seeking further advice on topping up the CRRF before the end of the 2021 calendar year.

Evaluation of options

37. There are some key criteria that we think should be taken into considered when evaluating the funding options:

- Fiscal Impacts. How the option impacts on the Government's key fiscal indicators;
- Funding. How much funding can the option make available to manage COVID-19 related costs;
- Transparency. Is the option easy to communicate and understandable by the public; and
- Implementation. How much resource and how quickly can the option be implemented.

Table 1 – Summary of options against key criteria outlined above.

Options	Fiscal Impact	Funding	Transparency	Implementation
1	Would have a fiscal impact on key fiscal indicators.	Around $3.0 - $4.0 billion could be added and still remain within the original funding envelope.	May be difficult to communicate, as no direct link back to individual initiatives.	Simple, if applying a similar approach to the analysis in this report.
2	Would have no fiscal impact on key fiscal indicators.	Around $0.5 - $1.0 billion could be added and still remain within the original funding envelope.	Would be simpler to communicate, as there is a direct link back to initiatives returned	Complex. Would require additional resources and would take a few months to complete the work.
3	Would have a fiscal impact on key fiscal indicators.	Potentially up to $10 billion, however this would result in an increase to the original funding envelope.	Simple to communicate, however will have communication challenges around exceeding the original funding envelope.	Simple.

38. As mentioned, you could consider doing a combination of the above options. Our view is a combination of option 1 and 3 would be the most straight forward progress.

Next Steps

39. We seek your feedback on the options outlined in this report to managing future COVID-19 costs.

40. Depending on your feedback we can provide further advice on the options outlined in this report that you would like to further consider. If you do choose to proceed with any of the options in this report we would recommend you seek approval from Cabinet.

41. Given the complexity in communicating fiscal implications of changes to the CRRF, the Treasury would work with your office on how this can be clearly communicated.

Recommended Action

We recommend that you:

a **note** that a comprehensive reconciliation of CRRF funded decisions to actual fiscal impacts would require additional resources and place pressure on agencies.

b **indicate** if you require further advice on the resource implications involved for a comprehensive reconciliation of CRRF funded decisions to actual fiscal impacts.

Yes/no.

c **note** that the COVID-19 Response and Recovery Fund (CRRF) is likely to be fully exhausted in the near-term.

d **note** that the Treasury has identified three options to provide addition headroom to manage COVID-19 related costs:

- **Option 1** – Return unused funding back into the CRRF
- **Option 2** – Reprioritise funding from the CRRF yet to be spent; and
- **Option 3** – Increase the level of funding in the CRRF (this will have a fiscal impact).

e **note** that Option 1 could potentially return \$3.0 - \$3.5 billion to the CRRF and this would have a fiscal impact of a corresponding amount.

f **note** that Option 2 could potentially return \$0.5 - \$1.0 billion to the CRRF with no fiscal impact.

g **indicate** if you would require any further advice on Option 1 and 2.

Option 1	Option 2
Yes/no.	*Yes/no.*

h note that you have asked for further advice on Option 3 before the end of the 2021 calendar year.

Megan Taylor
Manager, Strategic Performance Improvement

Hon Grant Robertson
Minister of Finance

Appendix 1 – Analysis of COVID-19 Response and Recovery Fund

As there is no reporting that tracks the actual spending of initiatives funded from the COVID-19 Response and Recovery Fund (CRRF) it is difficult to accurately determine the level of unused allocated funding.

To give an indication of the level of unused funding we have performed some high-level analysis which has tracked the funding allocated to actual spending and likely future spending, focussing on the most material initiatives.

The main sources of information for our analysis is the CRRF tracker, agencies 30 June 2020 audited results, agencies 30 June 2021 unaudited results, agencies Budget 2021 5-year fiscal forecasts and in-principle expense letters.

The table below provides a summary of our analysis and an indicative amount of potential unused funds. The table suggests around $4.0 billion of potential unused funds, however from further analysis (outlined in the key points below) we think the upper range is more closer to $3.5 billion.

Table 2 – Analysis of unused funds allocated from the CRRF

		Funding	Actual 2019/20	Actual 2020/21	Likely Future Costs	Total Costs	Potential Unused Funds
		$m	$m	$m	$m	$m	$m
Wage Subsidy Scheme	(a)	16,600	12,095	1,599	2,100	15,794	806
Housing Acceleration Fund	(b)	3,800	-	-	3,800	3,800	-
Shovel Ready Projects	(c)	3,000	-	1,400	1,600	3,000	-
Small Business Cashflow Loan Scheme	(d)	2,811	1,423	186	(904)	705	2,106
Tax loss carry-back	(e)	1,600	83	70	-	153	1,447
Managed Isolation and Quarantine	(f)	1,713	-	781	951	1,732	(19)
COVID-19 Vaccination	(g)	1,787	-	157	1,630	1,787	-
Health Response	(h)	1,582	-	231	1,119	1,350	232
NLTF revenue shortfall	(i)	1,025	125	522	129	776	249
Resurgence Support Payment	(j)	807	-	200	600	800	7
School Lunches programme	(k)	750	-	94	640	734	16
Three Waters Reforms	(l)	710	-	267	443	710	-
Government Housing Building programme	(m)	670	-	58	612	670	-
Business Finance Guarantee Scheme	(n)	538	20	128	-	148	390
Adjustments:							
Back-out WSS from 16 March Package		(5,100)	(5,100)			(5,100)	-
Funding already returned							(1,000)
NLTF funding returned via reprioritisation							(250)
Total		**32,293**	**8,646**	**5,693**	**12,720**	**27,059**	**3,984**

Key points:

(a) **Wage Subsidy Scheme** – the unused funding relates to funding that was expected to be spent in 2019/20 but was not needed and was not transferred into the 2020/21 fiscal year. This unused funding was considered as part of the funding already returned to the CRRF. The amount available for likely future costs will potentially be fully used by the recent resurgence.

(b) **Housing Acceleration Fund** – the spending on the Housing Acceleration Fund does not start until 2021/22, therefore at this stage there is no expected unused funding.

(c) **Shovel Ready Projects** – for our analysis we were only able to track actual and likely future costs for $2.4 billion of the funding provided for shovel ready projects. In the table above we have classified the amount we could not track as likely future costs (some of this would have been spent in 2020/21. From our analysis there was around $300 million of underspends in 2020/21, however this will be transferred into future years.

(d) **Small Business Cashflow Loan Scheme** – the take-up of the scheme has been well below what was initially expected. The recent resurgences could lead to a lift in take-up and potentially result in more defaults, however it is highly unlikely that all the funding that was allocated from the CRRF will be needed.

(e) **Tax losses carry-back** – the actual impact from tax loss carry-back has been significantly lower than initially expected. In the initial estimates, it was expected there would be a positive fiscal impact from this policy beyond the 2020/21. For our analysis, we are assuming that there are no fiscal impacts beyond 2020/21, given the actual amounts claimed are relatively small. There is a possibility that there could be more claims relating to the 2020/21 tax year lodged in the 2021/22 fiscal year. Our sense is the overall impact from this policy will most likely be lower than initially expected. However, it is difficult to quantify at this point in time.

(f) **Managed Isolation and Quarantine** – For our analysis we have focussed on funding provided through Vote Building and Construction. There has been other funding provided from the CRRF for MIQ which has gone into other votes (e.g. Health). There was a small underspend in 2020/21, however this has been transferred into the 2021/22 fiscal year.

(g) **COVID-19 Vaccination** – spending on the vaccination strategy in 2020/21 was around $300 million lower than the amount appropriated. The expenditure is now expected be incurred in the 2021/22 fiscal year.

(h) **Health Response** – For our analysis we have focussed on funding from the CRRF that has gone into the National Response to COVID-19 appropriation in Vote Health. There have been other significant amounts of funding from the CRRF that have been appropriated to Vote Health, however these have gone into existing appropriation which makes it difficult to track spending against. Although our analysis suggests potential unused funding, our understanding is the Ministry of Health has the ability to automatically transfer underspends which is not captured in our analysis.

(i) **NLTF revenue shortfall** – $250 million of funding has already been returned through the Budget 2021 CRRF reprioritisation exercise.

(j) **Resurgence Support Payments** – there was around $200 million of underspends in 2020/21, which has been transferred into 2021/22 to cover the recent resurgence.

(k) **School Lunches Programme** – our analysis shows a small amount of unused funding, however this appears to be due to a fiscally neutral adjustment moving expenditure into another appropriation.

(l) **Three waters reform** – there was a small underspend in 2020/21, however this underspend has been transferred into the 2021/22 fiscal year.

(m) **Government Housing Building Programme** – the funding for this programme was added onto an existing appropriation. The relevant appropriations were not fully used in 2020/21, however this underspend has been transferred into the 2021/22 fiscal year.

(n) **Business Finance Guarantee Scheme** – based on current expected credit loss modelling it is anticipated the cost in relation to the BFGS will be considerably lower than the initial estimate that was charged against the CRRF.