

The Treasury

Advice on COVID-19 Response - Tranche Two Information Release

September 2022

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Treasury Report: Implications of forthcoming fortnightly RSP payments: considerations ahead of Cabinet discussion on 21 October

| | | | |
|--------------|-----------------|---------------------|-----------------|
| Date: | 20 October 2021 | Report No: | T2021/2654 |
| | | File Number: | SH-1-6-1-3-3-22 |

Action sought

| | Action sought | Deadline |
|---|--|-----------------|
| Hon Grant Robertson Minister of Finance | Note the contents and agree the recommendations of this report | 21 October 2021 |

Contact for telephone discussion (if required)

| Name | Position | Telephone | 1st Contact |
|---------------|---|-----------|-------------|
| Tayla Forward | Analyst, Regions, Enterprise and Economic Development | [39] | [35] ✓ |
| Jean Le Roux | Manager, Regions, Enterprise and Economic Development | | |

Minister's Office actions (if required)

| |
|--|
| Return the signed report to Treasury. |
|--|

Note any feedback on the quality of the report

Treasury Report: Implications of forthcoming fortnightly RSP payments: considerations ahead of Cabinet discussion on 21 October

Recommended Action

We recommend that you:

- a. **note** that the content of this report has implications for the Cabinet paper *Economic support available under the COVID-19 Protection Framework*, which you intend to present on 21 October, and officials are providing a corresponding set of alternate recommendations;
- b. **note** the estimated cost of the proposed approach to RSP payments starting from 12 November is \$220 – 440 million per fortnight;
- c. **note** the total combined cost of the RSP and the Wage Subsidy under the proposed approach is estimated at \$470 – 940 million per fortnight on an ongoing basis until the implementation of the new COVID Protection Framework;
- d. **note** that providing the proposed level of support for a prolonged period could, prove to be disproportionate to the ongoing non-wage costs and economic impacts faced by firms; set precedent for the scale of future support; introduce regional inequities and complexities in support; and represent a fiscal risk;
- e. **note** that an increase in the revenue drop threshold would better target the most affected locations and industries and those likely to experience more significant ongoing impacts on activity in coming months (the Auckland region and hospitality sector in particular);
- f. **note** the appropriateness and effectiveness of the proposed parameter settings for the RSP “exit payment” is altered by the proposed approach to frequent and generous RSP payments throughout the transition period;
- g. **agree** that payments made on 12 November, 26 November, and 10 December (if no part of New Zealand is operating under the COVID Protection Framework at these times) are set at the usual rate with revenue drop unchanged,

OR

- h. **agree** that if payments made on 12 November, 26 November, and 10 December (if no part of New Zealand is operating under the COVID Protection Framework at these times) are made at double the usual rate, in line with the approach you have proposed, the revenue drop threshold should be increased to 40%;
- i. **agree** that forthcoming announcements on the economic support to be made available from 10 December until the implementation of the new public health framework remain high-level and do not make commitments to parameter settings;
- j. **agree** to defer announcement of the proposed RSP “exit payment” until officials are able to consider the interaction of this support with ongoing RSP payments throughout the transition between public health frameworks;

OR

- k. **agree** the announcement of the proposed RSP “exit payment” will not commit to a particular payment rate, and officials will provide further advice on the appropriate parameter settings in coming weeks.

Jean Le Roux
Manager, Regions, Enterprise and Economic Development

Hon Grant Robertson
Minister of Finance

Treasury Report: Implications of forthcoming fortnightly RSP payments: considerations ahead of Cabinet discussion on 21 October

Purpose of Report

1. This note provides an overview of the costs and implications associated with the proposal to provide eligible businesses the Resurgence Support Payment on a fortnightly basis under increased payment settings, as well as a comparison with a more targeted approach. It advises on some adaptations to your proposed communications on the future of COVID-19 economic support, to support Cabinet's discussion on 21 October.

Context

2. On 22 October you plan to confirm that the fourth instalment under the RSPAUG21 will be available at the usual payment rate on 29 October, and announce that thereafter the RSP will be provided as a fortnightly payment at double the current base rate and FTE rate¹, until the new COVID Protection Framework is implemented².
3. We expect it to be communicated that the Framework will be implemented upon the achievement of 90% vaccination of eligible populations in DHBs in Auckland and the rest of New Zealand. Based on Cabinet's consideration of the paper COVID-19: Confirming a Strategy for a Highly Vaccinated New Zealand (CAB-21-MIN-0421 refers) on 18 October, we understand the timing of the shift in framework could vary between regions as they meet this vaccination threshold, meaning this would be a sequenced implementation and rather than a national one. The implication is that two public health frameworks may operate simultaneously for different parts of the country.
4. Under scenarios for the economic impacts of public health restrictions that we have modelled, **we estimate the cost of the proposed approach to RSP payments starting from 12 November at \$220 – 440 million per fortnight.**
5. This figure does not include the proposed one-off RSP payment targeted towards Auckland firms upon the transition to the Red level under the new public health framework. We suggest the parameter settings for this payment (referred to alternately as the "exit payment" or the Business Emergence Payment in previous advice) be reconsidered in light of the proposed approach to fortnightly RSP payments. In particular, the payment rate for this disbursement would likely need to be higher than that provided on a regular basis throughout the transitional phase.
6. It also does not include the costs associated with potential future payments of the Wage Subsidy from 29 October, estimated at \$250 – 550 million per payment, making for a fortnightly cost of \$470 – 940 million for COVID-19 economic support on an ongoing basis until the implementation of the new COVID Protection Framework. More costing information is presented in Annex 1.

¹ The low-revenue rule which caps payments at four times the actual decline in revenue would also be doubled, and the 50 FTE rule would remain in place.

² Note that 10 December is the last opportunity to provide a payment prior to the Christmas/New Year period due to Inland Revenue's shutdown period.

7. We understand that the shift in public health framework is anticipated for late November or early December at the earliest, based on the current trajectory of vaccination rates. However, there is potential for this to shift to come later, if vaccination rates prove to be slower than anticipated.

There are risks associated with committing to ongoing generous fortnightly payments now

8. The duration of the transition period between the public health frameworks remains uncertain. Providing the proposed level of support for a prolonged period could:
 - a prove to be too generous in relation to the costs faced by firms and potential pent-up demand effects (which we recognise will vary according to sectors); whilst also supporting potentially unviable businesses and undermining adjustment;
 - b raise expectations of a similar regularity and scale of support for a prolonged period both prior to a 90% target being hit and at any time Red or Amber settings are in place in the future;
 - c introduce significant regional inequities and complexities in support, depending on the sequence of regional transitions to the new Protection Framework; and
 - d represent a significant fiscal risk if vaccination rates prove to be slow and the transition period between frameworks is prolonged.
9. These risks are explored in further detail below.

Proportionality

10. The aggregate ongoing non-wage costs³ faced by affected businesses under relevant scenarios⁴ are estimated at \$150 – 250 million per week. This means, in aggregate, fortnightly payments of the RSP at double the current rate would cover around 70% of the ongoing non-wage costs faced by businesses.
11. The aggregate economic impact of the restrictions estimated at \$80 – 250 million per week. The RSP therefore represents 70% to 140% coverage of the estimated economic cost of the restrictions.
12. Treasury is of the view that is not necessary or desirable for government to meet the ongoing costs faced by impacted firms fully, given:
 - a in most industries, we expect strong recoveries in economic activity as restrictions progressively lift;
 - b most businesses are also not experiencing a 100% revenue drop and will have some inwards cashflow with which to address ongoing costs;
 - c businesses are expected to undertake actions to relieve some of the cashflow pressure they face, to the extent they are able to;

³ "Ongoing costs" refers to those cash pressures faced by businesses regardless of their activity (and consequently their revenue) level. This differs from "economic costs" referred to in the following paragraph, which capture the GDP impact of restrictions.

⁴ Treasury has not produced estimates of the difference in economic impact between stage 1, 2, and 3 of Alert Level 3, as Auckland is progressing through now. Here we have assumed that the Alert Level 3 settings have an economic impact at most equivalent to Level 3 as it has been in previous resurgence events, and at least equivalent to a Level 2.5. We assume the rest of New Zealand remains under the standard Alert Level 2 restrictions.

- d some cost items may be reducible or deferrable under Alert Level restrictions, if sufficient certainty around restrictions can be provided; and
- e most businesses are expected to have sufficient reserves and access to resources to weather a period of reduced business activity.

Table 1: Comparing fiscal cost of further RSP payments to economic and ongoing costs per fortnight

Auckland at AL3, regions outside of Auckland at AL2

| | Estimated fiscal cost | Estimated economic cost associated with restrictions |
|--|------------------------------|--|
| Fortnightly RSP payment at double rate | \$220 - 440 million | \$160 - 500 million <i>Fiscal cost = 70 - 140% of economic cost</i> |
| Total RSP and Wage Subsidy | \$470 – 940 million | <i>Fiscal cost = 180 - 290% of economic cost</i> |

Expectations

13. Doubling the payment rate for future payments will need to be carefully communicated in order not to raise expectations that this becomes the usual approach until the new COVID Protection Framework is introduced. This is particularly a risk if the 90% vaccine target is not reached in line with current expectations.
14. Doubling the payment while keeping the current revenue drop also means a non-negligible number of businesses currently under AL2 will not only keep benefiting from the RSP but will receive more under it, generating expectations that this type of support will continue as they transition to Amber (when this is not the case). Ensuring the businesses which benefit from the support are those which are most likely to transition to Red under the new Protection Framework would mitigate this risk.
15. Finally, there is also a risk that businesses expect an increase in the support made available to them in the event that the public health situation deteriorates during the transition period (e.g. North Island outside Auckland and Waikato have to come back to Alert Level 3 or 4). That expectation would come in addition of what is an already raised level of support while the circumstances have not changed.

Inequity and complexity

16. There is significant operational complexity in managing the possibility of the new COVID Protection Framework and the current Alert Level framework being in place simultaneously in different parts of the country, which officials need to consider carefully in order to avoid introducing significant inequities in support, administrative complexity for Inland Revenue, and confusion for the business community.
17. The potential staging of regional shifts to the new Protection Framework introduces the possibility Auckland moves to Red restrictions while other regions remain at the current Alert Level 2 settings, potentially for some time. ^[4]

18. The implication would be that businesses under Red conditions may be excluded from further payments on the fortnightly cycle, but eligible for a one-off “exit-payment”, and businesses under Alert Level 2 or 3 would continue to be eligible for the fortnightly payment, despite their restrictions being less severe, representing a significant inequity directly counter to objectives around targeting and proportionality of support.
19. This inequity has the potential to undermine incentives in the transition between frameworks, and therefore undermine the public health response.

Macroeconomic risk

20. Treasury advice to date has emphasised that the primary objectives of economic support should continue to be supporting the public health response and reducing social disruption and the risk of long-term economic scarring from the outbreak. We see no need for additional fiscal support to stimulate demand to support the economic recovery post-lockdown.
21. The proposed increase in fiscal response would likely be going further than required to mitigate scarring effects in the economy, and rather would have a stimulatory effect on demand which, in the current supply-constrained environment, would have ongoing macroeconomic consequences, such as putting upward pressure on inflation and interest rates.

Recommendations

22. In light of the above and in line with our position to date, we recommend that payments made on 12 November, 26 November and 10 December (if no part of New Zealand is operating under the COVID Protection Framework at these times) are set at the usual rate. However, we recognise this is not your preference.
23. Therefore, we suggest the doubling in rate is associated with an increase in the revenue drop threshold to 40%, to better target the most affected locations and industries and those likely to experience more significant ongoing impacts on activity in coming months (the Auckland region and hospitality sector in particular), which is a key objective in this phase of the response. This would also set expectations that there will be less support provided to business which are most likely to transition to Amber under the new framework.
24. We also suggest that forthcoming announcements on the economic support to be made available from 10 December until the implementation of the new public health framework remain high-level, retaining optionality to review the parameters of the RSP during the transition period to the COVID Protection Framework and shift towards a more targeted approach whilst also managing business’ expectations of the support available under prolonged Red restrictions.
25. In particular, we suggest the announcement of the proposed RSP “exit payment” be deferred, recognising that the recommended parameter settings for this form of support are dependent on the frequency and generosity of the regular RSP payments made throughout the transition period.
26. However, we understand that it is your preference to announce the payment, and that it should be more generous than the RSP payment rate chosen for the transition period. Therefore, subject to your response to this paper we will provide further advice on the appropriate costings for the payment.

27. We consider that shifting to a more targeted approach may reduce future macro-fiscal risk (as spending would be targeted towards the mitigation of possible scarring effects, rather than having a stimulatory effect on demand); be more proportionate to the economic impact and ongoing costs being faced by businesses; and better signal the need for businesses to adapt towards COVID-resilient operations.

Annex: Supplementary cost information

Table 1: Indicative support to hospitality and Auckland businesses under different revenue drop thresholds

Auckland at Alert Level 3, regions outside of Auckland at Alert Level 2

| Revenue drop threshold | Fiscal cost* (\$ million) | Businesses covered | Proportion of total support directed to hospitality industry, in dollar terms (number of businesses) | Proportion of total support directed to Auckland, in dollar terms (number of businesses) |
|------------------------|---------------------------|--------------------|--|--|
| 30 | 220 - 440 | 65,000 | 23% (10,000 businesses) | 65% (40,000 businesses) |
| 40 | 60 - 160 | 25,000 | 35% (5,500 businesses) | 75% (17,000 businesses) |

*At double current payment rate – \$3,000 + \$800*FTE

A more targeted approach to future payments during the period of transition between frameworks could result in fiscal savings of **\$160 - 280 million per fortnight**.

Table 2: Further costing detail

| Payment beginning | RSP | WSS | Latest forecast cost (\$m) | RSP Latest forecast (\$m) ⁵ | WSS cost | Total (\$m) |
|---|-----|-----|--------------------------------------|--|----------|--------------------|
| <i>Previous payments under AUG21</i> | | | | | | |
| 20/8/21 | | ✓ | | 1,326 | | 1,326 |
| 24/8/21 | ✓ | | 700 | | | 700 |
| 3/9/21 | | ✓ | | 937 | | 937 |
| 17/9/21 | ✓ | ✓ | 430 | 616 | | 1,046 |
| 1/10/21 | | ✓ | | | | |
| 8/10/21 | ✓ | | 220 | 480 | | 700 |
| 15/10/21 | | ✓ | | 300-550 (including Waikato AL3) | | 300-550 |
| Total 20 August – 15 October | | | | | | 4,920-5260 |
| <i>Agreed by Cabinet, announced</i> | | | | | | |
| 29/10/21 | ✓ | ✓ | \$200-\$220m (including Waikato AL3) | 250-500 | | 450-720 |
| <i>Not yet agreed by Cabinet or announced; RSP issued at double rates</i> | | | | | | |
| 12/11/21 | ✓ | ✓ | 220-440 | 250-500 | | 470-940 |
| 26/11/21 | ✓ | ✓ | 220-440 | 250-500 | | 470-940 |
| 10/12/21 | ✓ | ✓ | 220-440 | 250-500 | | 470-940 |
| Total 29 October – 10 December | | | | | | 1,860-3,540 |
| Expected total since 20 August | | | | | | 6,780-8800 |

⁵ The forecast cost for the WSS under Alert Level 3/2 has been revised down slightly since the 11 October Cabinet paper based on demand for payment 4.