Submission

by

THE NEW ZEALAND INITIATIVE

to the New Zealand Treasury

on the

Consultation on the Scope of the Treasury's Long-term Insights Briefing

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1. INTRODUCTION AND SUMMARY

1.1 This submission on the "Consultation on the Scope of the Treasury's Long-term Insights Briefing" is made by The New Zealand Initiative (the Initiative), a Wellington-based think tank supported primarily by major New Zealand businesses. In combination, our members employ more than 150,000 people.

1.2 The Initiative undertakes research that contributes to the development of sound public policies in New Zealand. We advocate for the creation of a competitive, open and dynamic economy and a free, prosperous, fair and cohesive society.

1.3 The views expressed in this submission are those of the author rather than the New Zealand Initiative's members.

1.4 In summary, we submit:

(a) The proposed topic of 'sustainable and resilient fiscal policy over economic cycles' needs a well-being justification. What is the well-being problem that the pursuit of this topic is to throw light on? What is the optimal long-term fiscal policy from a well-being perspective, and is it different?

(b) Treasury's long-term fiscal projections demonstrate the increasing importance of assessing the value of spending programmes in the light of the deadweight costs of higher taxation. The third aspect Treasury needs to be on top of is the path for a prudent level of public debt.

(c) This submission suggests that Treasury could usefully make advances in each of these three respects. In doing so, it should use a comparative institutional economics framework. Better spending disciplines are needed.

(d) The question of optimal fiscal policy activism, counter-cyclical or not, is of some interest, but it is a different question. One starting point would be to commission overseas experts to examine New Zealand's fiscal settings in 2020-2022 in order to advise what lessons they think should be drawn.

2 SOME QUESTIONS ABOUT THE PROPOSED TOPIC

2.1 The proposed topic of 'sustainable and resilient fiscal policy over economic cycles' uses recognisable 'motherhood is good' buzzwords, but it is not evident what the well-being problem is that motivates this topic. Perhaps the problem is that governments tend to have different objectives, or is it that Treasury does not know what to advise concerning optimal inter-temporal fiscal policy?

2.2 If Treasury were to instead explore the topic of optimal inter-temporal fiscal policy from a welfare economics perspective, would that be the same topic or a different topic?

3 ACTUAL FISCAL ISSUES

3.1 Treasury's 40-year fiscal projections show that, under current policy settings, demographics point to the necessity for some combination of significant cuts to existing spending programmes and higher taxes. What combination would Treasury advise?

3.2 Treasury needs to be on top of three aspects: which spending programmes are of least proven value; what are the deadweight costs of higher tax rates on the existing tax base or on extending tax bases; and what is the optimal profile for the public debt through time? Following are some suggested directions for these three aspects:

(a) Quality of government spending: The proposed research topic neglects this issue. Yet there are major grounds for concern about spending quality. Base spending is often 'locked in' without clear objectives or accountability measures. Accountability is minimal because important things are not measured and because there is no clarity as to trade-offs between multiple competing objectives that are claimed for the programme. Many programmes are of a private good nature that lack a public good justification. Treasury could do more work relating spending to outcomes aimed at showing to what degree New Zealand falls inside a best-practice frontier constructed from an international fiscal database.

(b) Deadweight costs of taxes. The mainstream media customarily presents public spending as justified if the marginal benefit to the receiver is positive. Treasury can contribute to a better public understanding of the fact that money can only be spent on one activity by not spending it on a different activity (or by not taking it in the first place). How long has it been since Treasury commissioned heavy-weight assessments of the deadweight costs of taxation?

(c) Prudent levels of public debt: Treasury's recent assessment of what is a prudent public level for the public debt appeared to lack rigour. It is not clear, for example, why a prudent level today should be higher than 2019, rather than lower.

3.2 What lessons can be learned from the 'Keynesian' fiscal responses to Covid-19?

(a) The RBNZ commissioned overseas experts to assess its monetary policy responses to Covid-19. Should Treasury not do the same? Treasury appears to have been slow to realise that the blow-out in spending in 2020 and 2021 was not temporary and to realise that the fiscal problem had become a structural deficit. An external expert could assess that with greater credibility than an in-house defence might achieve.

(b) On the more general point, Treasury could commission assessments from experts with different 'prior' views about the benefits of active counter-cyclical policy in a small open economy. There are issues of (rational) expectations, leakages on imports, difficulties in identifying 'shovel-ready-projects', implementation lags, neutralisation by monetary policy responses and short-term political incentives. Sceptical and supportive expert views could be sought so that their relative merits can be assessed by the informed public.

4 FOCUS AREAS WITHIN THE PROPOSED SCOPE

4.1 With respect to the issues on pages 9 and 10 of the consultation document, improving fiscal transparency and accountability should be a prime Treasury focus. As the control department, it should lead the charge for value-for-money in government spending.

5 GAPS IN THE PROPOSED SCOPE

5.1 The proposed scope appears to lack an institutional economics framework. It may be implicitly assuming that Treasury's role is to advise a benevolent and well-intentioned apolitical government that cares little for its chances of being re-elected. This is not a real-world situation. Advice needs to be institutionally informed.

5.2 In the last 24 years we have had two administrations that inherited forecast fiscal surpluses and bequeathed much higher spending ratios and ending fiscal deficits. It took the administration in the middle nine years to turn those deficits into forecast surpluses. It could take even longer this time. This is a worry.

5.2 An institutional analysis would be asking if there are deficiencies in current fiscal arrangements that unduly allow such swings in fiscal policy. To what degree are current institutional arrangements contributing to poor quality spending and erratic shifts in public debt ratios associated with changes in governments?

5.3 One option, and it is far from being the only option, could be to have a fiscal council that would report directly to Parliament and the public in a way that Treasury cannot. Arguably, the government of the day is insufficiently accountable to parliament and the public for the quality of individual spending programmes.

5.3 The last government also exposed a weakness in the fiscal responsibility provisions of the Public Finance Act. Spending growth was apparently understated by the device of announcing only time-limited funding for programmes that were unlikely to be time-limited. Thought should be put into closing that gap.

6 CONCLUSIONS

6.1 Treasury's long-term fiscal forecasts highlight the critical need to be increasingly tough on government spending programmes that are ill-justified. Deficiencies in current institutional arrangements with respect to value-for-money need to be identified and assessed. Treasury needs to be on top of what advice it should give in those respects.

6.2 The proposed topic lacks a value-for-money focus. Yet government in all its forms is spending around 40% of GDP and tax burdens are high.

6.3 The 'Keynesian' active fiscal policy focus for the proposed topic is of interest, but here an obvious starting point is to commission external experts to assess what lessons might be drawn from the 2020-2022 period.

6.4 We appreciate the opportunity to submit on this consultation and hope that our comments are seen as useful and constructive. We would of course be happy to discuss them further.