NEW ZEALAND BUSINESS ROUNDTABLE

Submission on the 2006 Budget Policy Statement

February 2006

Summary

- This submission on the Budget Policy Statement 2006 (BPS) is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests.

- New Zealand is not on track to lift its average living standards relative to Australia or the OECD average. The BPS is based on a projected annual average rate of growth in real GDP of only 2.8 percent during the five years to March 2010. This is far below the annual average rate achieved in the last decade and well below the 4 percent per annum rate of growth that the minister of finance has said would be the test of whether the government's growth strategy was working.

- The BPS does not contain a credible strategy for boosting the rate of economic growth. It declares that the government will focus on lifting the aspirations and abilities of "all" New Zealanders, yet the government is impairing incentives to work through high effective marginal tax rates for many families and presiding over a regulatory juggernaut that is reducing economic flexibility and economic freedom. New Zealand slipped from 5th equal to 9th equal position in the recently released Heritage Foundation/*Wall Street Journal* assessment of economic freedom. Australia is rising on this measure while New Zealand is falling.

- The BPS also aims to enhance fairness, opportunity and security. However, penal effective marginal tax rates reduce opportunities for low to moderate income families to improve their circumstances through their own efforts, and massive increases in subsidies for the educated elite are the antithesis of traditional Labour Party concerns for blue collar workers. New lending on student loans is projected to rise by almost 50 percent to $1.5 billion a year by 2010, while the number of EFTS places is expected to fall by 0.2 percent. Meanwhile far too many New Zealanders lack the literacy skills necessary to participate in higher-level tertiary education. In the absence of a more convincing rationale, the expanded student loans scheme and Working for Families package, in particular, should not proceed.

- The BPS demonstrates that the government still refuses to accept that high taxes and ill-disciplined spending harm prosperity and liberty. According to the Heritage Foundation/*Wall Street Journal* study, 100 countries have a lower fiscal burden than New Zealand, yet core Crown operating spending per capita is projected to rise by nearly 16 percent in the four years to 2010 while prices (GDP deflator) are

projected to rise by less than 6 percent. By 2010, government taxes and levies are projected to be $14,400 per capita, nearly 70 percent higher than the 2000 level of $8,500. The price level (GDP deflator) is projected to rise by only 24 percent between 2000 and 2010. During the five years to 2010, real per capita base core Crown spending is set to increase by 60 percent of the projected rise in real GDP per capita. This represents an enormous propensity to tax and spend the 'growth dividend'. The problem is all the more serious because of concerns about the quality of much of the spending.

- Monetary policy should not be blamed for the squeeze on the exposed sectors that occurs when fiscal policy expands the state sector and other sheltered sectors regardless of the cost to the exposed sectors. Inflation is much more pronounced in non-traded goods – where government spending is concentrated. Monetary policy needs mates, and fiscal policy needs to be one of them.

- The BPS considers that a review of the government's debt target is needed. We concur, but submit that its defence of the current policy of funding capital spending from current account surpluses to stay within an arbitrary debt target is conceptually incoherent and has negative implications for the integrity of the Crown's accounts. To the degree that 'capital' spending is not expected to produce commensurate future benefits, it is a current expense. Debt is a valid means of funding genuine capital spending, particularly where the Crown's assets exceed its liabilities. The best policy from an economic perspective, however, would be to fund justified capital spending at least in part from asset sales. Any debt target should take this into account.

- In our view, there is far too much wasteful spending because of a lack of proper spending disciplines and because taxes are far too high. Governments should not regard revenue increases from economic growth as theirs to spend at will rather than the property of taxpayers. This is one reason why we continue to advocate consideration of a taxpayer bill of rights that would allow taxpayers rather than politicians to determine whether spending and taxes per capita should increase faster than the rate of inflation. We also recommend serious examination of a Regulatory Responsibility Act.

- When the Fiscal Responsibility Act was passed, it was intended that budget policy statements would provide an opportunity for dialogue and engagement between the government, other political parties and outside interests over fiscal and other policies. This has not occurred. We would invite the Finance and Expenditure

Committee to consider how the process could be made more meaningful. One possibility would be for the government to provide a written response to submissions, along the lines of local authority responses to submissions on draft annual plans.

1 Introduction

1.1 This submission on the Budget Policy Statement 2006 (BPS) is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests.

1.2 In this submission, section 2 reviews the BPS's goals, aspirations and means. Section 3 asks whether the fiscal strategy contained in the BPS can be expected to raise or lower economic growth. Section 4 comments on the connection between the government's major spending initiatives and its goals of promoting fairness, opportunity and security. Section 5 discusses the need to improve fiscal arrangements. Our conclusions are presented in section 6.

2 The BPS's goals, aspirations and means

2.1 The BPS states that:

> Our overall objective for the next three years is to continue New Zealand's transformation to a dynamic, knowledge-based economy and society, underpinned by the values of fairness, opportunity and security.[1]

This is a change from the statement in the 2005 BPS that the government aimed to increase sustainable long-term economic growth and ensure that its benefits were spread across society. However, the 2006 BPS seeks to improve economic performance by "strengthening the drivers of long-term sustainable growth to ensure that we are a high skill, high productivity and high wage economy". The 2006 BPS asserts that achieving this goal will involve lifting savings levels; raising productivity through working smarter; improving skills and education; boosting the capacity of firms to innovate, export and add value; and modernising infrastructure.

2.2 The BPS lacks any framework for assessing how best to achieve such outcomes, or even whether they will contribute to economic growth if achieved.[2] The strategy adopted by Labour-led governments since 1999 for lifting New Zealand's sustainable rate of economic growth has never been credible in the

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1 BPS, p 2.

2 As explained in earlier BPS submissions by the NZBR, the key to promoting economic growth is to achieve and sustain a high level of economic freedom. This requires good infrastructure (public goods), security in person and property, modest taxation, light regulation and a high degree of freedom to contract and exchange.

eyes of the business community and is clearly not succeeding. The economic projections in the Half Year Economic and Fiscal Update for 2005 (HEFU 2005) accompanying the BPS are for slower rather than faster economic growth. During the five years ended March 2010, real GDP growth is projected to average 2.8 percent per annum and real GDP per capita growth is projected to average 1.9 percent per annum.[3] Only a few years ago the government regarded a GDP growth rate of 4 percent per annum as a test of whether its policies were working. Yet the BPS shows no awareness of the fact that the continuation of higher taxation and spending policies will be just as likely to thwart its professed growth aspirations in the future. The evident lack of interest in such questions suggests that the government's growth goal is not being taken seriously. Consistent with this interpretation, the BPS proposes no measures of the effectiveness of the proposed spending in relation to the stated goals.

2.3 The projected rates of economic growth are not high enough to narrow the gaps between the living standards of New Zealanders on the one hand and Australians and the OECD average on the other. Instead the gaps seem likely widen. The projected average rate of growth is also much lower than the average rate recorded since 1993. The government is not on track to restore living standards to the top half of the OECD.

2.4 Turning from aspirations to means, the BPS states that the key initiatives in Budget 2006 will be interest-free student loans, an expanded Working for Families package, and lifting the married couple rate for New Zealand Superannuation to 66 percent of the net average ordinary time weekly wage. Other priority areas include additional operating spending on education, skills, productivity, justice, defence, and transport. Based on the figures in table 2.13 of HEFU 2005, election campaign promises since the post-election update have reduced the cumulative adjusted operating balance ('OBERAC') in the four years to 2008-9 by $4.1 billion. The priorities for the 2006 Budget are indicated by the $1.8 billion contribution to this $4.1 billion figure from the reduction in student loan interest, the $1.4 billion contribution from the Working for Families package,

3 Based on the projections on p 11 HEFU.

and a $0.9 billion rise in core Crown functional spending (net of reductions in unallocated future operating spending).[4]

2.5 In addition, the BPS states that capital spending "will be a key feature of Budget 2006".[5] According to table 2.2 in HEFU 2005, the projected cumulative operating surpluses from 2005-6 to 2009-10 will be $24.0 billion. By far the largest capital spending item during this period is NZS Fund contributions, at $12.6 billion. Advances, including on student loans, total $4.8 billion. An additional significant capital item is the planned purchase of $1.2 billion of foreign exchange reserves for the Reserve Bank. None of this spending will create public assets that clearly create wealth compared to privately own assets. Planned capital spending on physical assets and injections to SOEs and Crown entities for hospitals or housing exceeds depreciation by only $3.9 billion.[6] In short, the cumulative surpluses are being largely used to displace private ownership of assets.

2.6 The following table summarises movements in the major aggregates since 2000 relative to GDP. Key features are the sharp increase in revenues relative to spending during the first five years of this period and the planned reversal of this relationship during the next five years. As a result, operating surpluses rose sharply in the first period and will fall in the next. Crown net worth grew very strongly in the first five years (partly because of revaluations), and will continue to grow relative to GDP during the next five years.

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4 Other material items include a cumulative rise in forecast tax revenues of $0.8 billion, a forecast rise of $0.5 billion in finance costs, and in the three years to 2008-09, ongoing reductions in operating expenses on student loans nei of $271 million.

5 BPS p 3.

6 HEFU 2005, table 2.2, p 31. See p 51 for a breakdown of capital spending for 2005-6 and 2006-7. Even the sum of the amounts for the purchase of assets and provision for new capital spending appear to be less than depreciation, as shown on pp 97 and 111.

Key Fiscal Aggregates *Percentages of GDP*				
	2000	**2005**	**2010**[1]	**Overall Change**[2]
Sovereign Power Revenues (Total Crown)	29.7	32.9	32.7	**3.0**
Core Crown Operating Expenses	31.4	30.6	32.4	**0.9**
OBERAC (Total Crown)	0.8	5.9	2.7	**1.9**
Net Worth (Total Crown)	7.8	35.0	39.4	**32.0**
NZS Fund Balance	0.0	5.9	12.5	**12.5**

1 These figures include proceeds from the now-abandoned carbon tax.

2 Percentage points of GDP.

Source HEFU 2005, page 89 for 2005 and 2010 and, for 2000, nominal GDP of $109,951 million applied to data from earlier sources.

2.7 Strong economic growth, and declining unemployment and spending on debt servicing costs mask, in this table, the rapid growth in actual and underlying real government spending and revenue during the decade to 2010. A table in the Annex indicates that underlying real per capita core Crown spending (ie spending other than on finance costs and unemployment benefits, deflated by the GDP deflator) is set to rise during the five years to 2010 by 62 percent of the increase in per capita real GDP. During the first five years of the decade to 2010, real per capita total Crown sovereign power revenue rose by 63 percent of the rise in real GDP per capita. During the decade, the per capita increase in sovereign power revenue and underlying core Crown operating expenses are projected to be 48 percent and 45 percent respectively of the rise in real GDP per capita. These figures demonstrate that the government is appropriating for itself a very large share of the ‘growth dividend’.

3 The BPS's growth strategy

3.1 The BPS does not contain a credible growth strategy. Big increases in operating spending on Working for Families, student loans and retirement incomes do not constitute a growth strategy. Nor are policies that aim to tax or regulate some activities in order to subsidise others, even if the latter are described rhetorically as the 'drivers of economic growth'. If the government wished to encourage well-paid graduates to work harder and smarter, it would be better to lower effective marginal tax rates for all graduates rather than to give interest-free loans to some students and write off interest for some graduates.

3.2 In previous BPS submissions we have explained the importance for economic growth of sustained high levels of economic freedom. New Zealand greatly improved its rankings for economic freedom as a result of the reforms that were implemented 10-15 years ago. Since then governments have lost their way. The 2006 rankings for economic freedom, just published by the Heritage Foundation in conjunction with the *Wall Street Journal*, saw New Zealand fall from 5th equal position in 2005 to 9th equal with Australia. While the decline is largely due to a reduction in New Zealand's score for openness to foreign investment, we note that other policies, such as the large increase in minimum wages and the increase in government spending, are also pointing in the wrong direction.

3.3 While the ratio of government spending to GDP in New Zealand is smaller than in many of the wealthier, relatively stagnant, European countries, fiscal burdens are much larger in New Zealand today than in many other countries. They are also much greater than in New Zealand's past when it was one of the most prosperous countries in the world. According to the Heritage measures, in 2006 New Zealand's fiscal burden was greater than that of 100 other countries. Hong Kong's fiscal burden score was less than half New Zealand's, making it 8th in the world.

3.4 In support of its claim that it has been fiscally prudent, the government has pointed to the fact that core Crown spending has fallen slightly as a percentage of GDP since it assumed office in 1999. However, this outcome is due mainly to growth in GDP (the denominator of the ratio) rather than to spending restraint. Moreover, the claim overlooks the fact that the spending ratio was projected in 1999 to decline even further (as the economy recovered from the effects of the Asian recession) and that it is now set to increase by nearly 2 percentage points by 2010. This increase in planned spending, and the dubious quality of much of it, is likely to have a negative impact on growth. Countries such as Norway, Canada, Belgium, Sweden, the Netherlands and Finland have significantly reduced their public spending in recent years without causing the large fall in community well-being many expect.[7]

3.5 When the government is flush with revenue from increased taxation, the more productive sectors are likely to be relatively squeezed as the state outbids them for people and other resources. One common mechanism for this to occur is for the real exchange rate to rise so that resources can be shifted from the sectors of the economy that are exposed to international competition to the sheltered sectors dominated by public servants, regulators, lawyers, state monopolies and the like. We note, for example, that while employment in agriculture, hunting, fishing and manufacturing fell by 1 percent in the five years to the year ended June 2005, employment in education, health, community services and other services rose by 25.3 percent. Employment in the public service, narrowly defined, rose similarly. Real value added in the primary sector rose by only 0.9 percent in the five years to June 2005. Any priority the government puts on "transforming" New Zealand "to a dynamic, knowledge-based economy" does not justify expanding the uncompetitive state sector at the expense of the exposed sectors of the economy, or the private sector more generally.

3.6 In this context it should be noted that it would be wrong to blame monetary policy for the high real exchange rate. A high real exchange rate arises not because the overall rate of inflation is too high or too low but because inflation in the sheltered sectors is higher than inflation in the exposed sectors – those facing international competition. Inflation is much more pronounced in non-traded goods – where government spending is concentrated. Hence the saying that "monetary policy needs mates". A fiscal policy that was more supportive of monetary policy in current circumstances would see much more constrained spending by the government and lower taxation.

3.7 In addition, the government should reconsider many of the cost-increasing regulations that have been introduced in recent years, such as employment and holidays legislation, restoration of the ACC monopoly, regulation of network industries and business law changes; address longstanding problems with infrastructure and the Resource Management Act; and resume a programme of privatisation to improve efficiency and reduce costs faced by exporters and other industries. Such initiatives, rather than measures that would undermine the

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7 Vito Tanzi, 'The Economic Role of the State in the 21st Century', *Cato Journal*, Fall 2005, p 622.

integrity of monetary policy (such as intervention in the foreign exchange market or the reintroduction of lending controls) are the key to reversing New Zealand's loss of international competitiveness.

3.8 In respect of regulations, it should also be noted that little should be drawn from World Bank research suggesting that New Zealand scores highly as a place to do business. That outcome is a direct and welcome result of earlier economic reforms, but little has been done to build on them for over a decade. The focus should be on further improvements. New Zealand must aim to do better than its competitors for business and investment in order to achieve outstanding performance. The World Bank research relates mainly to developing countries and largely measures factors that are easy to measure (eg how many days or steps it takes to set up a business). The need in New Zealand is to review the issues that are at the heart of our regulatory environment and problems with it such as labour law, the RMA and electricity industry regulation. We continue to believe that a basic reappraisal of New Zealand's regulatory process is required, and commend the concept of a Regulatory Responsibility Act.[8]

3.9 In our view it is clear that the government is putting a higher priority on raising its spending than on raising economic growth. The government does not accept that high marginal tax rates and undisciplined spending are bad for economic growth. Its view is inconsistent with a growing body of international research and the professional advice of organisations such as the OECD and the Treasury.[9] In its briefing to the incoming government, the Treasury wrote:

> Tax policy is a major tool that can assist in promoting economic growth … [T]he most recent evidence suggests that, while [the current regime is] sound, reform of the tax regime could better support economic growth.[10]

This should be the focus of the forthcoming review of business taxation (which is not mentioned in the BPS). The review should be guided by expert opinion. The McLeod Tax Review of 2001 examined the tax system comprehensively and found that it was sound. It advocated moves towards a lower, flatter tax structure for personal and company income. Ideally the top personal and

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8 See Bryce Wilkinson (2001) *Constraining Government Regulation*, New Zealand Business Roundtable, Federated Farmers of New Zealand and the Auckland and Wellington Chambers of Commerce.

9 See, for example, Bryce Wilkinson (2004) *Restraining Leviathan: A Review of the Fiscal Responsibility Act 1994*, New Zealand Business Roundtable, Wellington, section 3.

10 The Treasury (2005) *Sustaining Growth: Briefing to the Incoming Government 2005*, www.treasury.govt.nz, p 18.

company rates should be aligned. Bold moves along these lines would be welcomed. Any proposals to alter tax bases should be subject to the Generic Tax Policy Process through a consultation document. The government should honour its commitment not to introduce new taxes. Tax concessions for particular classes of businesses or major changes to the tax bases (income and GST) are not warranted.

4 The pursuit of fairness, opportunity and security

4.1 Many might prefer to sacrifice some economic growth for greater security, opportunity or fairness. However, the BPS does not explain why greater subsidies for well-paid, indebted graduates are fair to other graduates, or to those who went straight into the workforce without the benefit of a tertiary education. Officials project that new lending on student loans will rise by almost 50 percent to $1.5 billion a year by 2010 while the number of EFTS places is expected to fall by 0.2 percent.[11] Usually fairness is associated with assisting those at the bottom, rather than those in well-off families. The current policy which generates welfare traps (through high effective tax rates) for the working poor and extends privileges for the educated elite is a reversal of Labour's traditional concerns for blue collar workers. If the concern were to improve the access of poorer families to higher education then it would make more sense to target assistance to such families and to raise levels of literacy amongst this group by improving choice and quality in primary and secondary education.

4.2 Security is enhanced by prosperity and a flexible economy, in particular a flexible labour market which makes it easier to obtain a job. Policies that harm economic growth and make the labour market less flexible are likely to reduce opportunity and security. Similarly, policies that put a large proportion of families on very high effective marginal tax rates reduce the opportunity for those families to improve their circumstances by their own efforts.

4.3 As noted in last year's submission, Tyler Cowen, an economist at George Mason University, has explained why governments that sacrifice economic growth to other objectives for long periods can seriously harm the interests of future generations:

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11 HEFU (p 121) projects EFTS places of 243,755 in 2006 and 243,295 in 2010. During the same period new lending rises from $1,098 million to $1,518 million (see p 113).

> The importance of the growth rate increases, the further into the future we look. If a country grows at two percent, as opposed to growing at one percent, the difference in welfare in a single year is relatively small. But over time the difference becomes very large. For instance, had America grown one percentage point less per year, between 1870 and 1990, the America of 1990 would be no richer than the Mexico of 1990. At a growth rate of five percent per annum, it takes just over eighty years for a country to move from a per capita income of $500 to a per capita income of $25,000, defining both in terms of constant real dollars. At a growth rate of one percent, such an improvement takes 393 years.[12]

If the government is to sacrifice some economic growth for greater fairness, opportunity or security, it would be helpful if it acknowledged that trade-off explicitly and demonstrated that the measures proposed contribute to rather than detract from these other goals. In the meantime, we note that New Zealand's score in the United Nation's Human Development Report 2005, which incorporates such indicators, is lower than in its 2004 Report. The score is based on 2003 data, but it is a reminder that many New Zealand indicators are not heading in the right direction.

5 Improving the long-term fiscal objectives

5.1 The BPS acknowledges the need to review the government's long-term fiscal objectives. In particular, the government wishes to 'clarify' the preferred debt target beyond 2015. We agree that there is a problem with the current approach and hope that the following suggestions might be helpful.

5.2 The starting point for determining long-term fiscal objectives should be an assessment of what spending by government will raise rather than lower the welfare of a country's citizens, taking the costs of taxes into account. Since, in general, citizens know more about their own needs than the government, governments should usually leave it to citizens to spend their own money as they see fit. Government spending should be focused on exceptions to this general rule. Economists refer to such exceptions as public goods, with national defence being the standard textbook example.

5.3 Having determined the preferred spending path, the economic goal is to fund it at least cost to citizens. In practice this is likely to be achieved by a broad-

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12 http://www.marginalrevolution.com/marginalrevolution/2004/08/why_the_growth_.html

based, low-rate tax system, unchanged through time, since this structure minimises the deadweight costs of taxes. Because spending will fluctuate through time for many reasons, the budget balance would fluctuate accordingly at the unchanged single rate of tax. Net debt and Crown net worth would fluctuate as a residual. The two key fiscal decisions would be the spending path and the (single) average tax rate of tax.

5.4 The current approach roughly turns this on its head. No rigour is brought to considering whether spending plans produce net benefits for citizens, or even contribute to desired outcomes. Spending plans are increased simply because extra money comes to hand. No serious consideration is being given to designing a tax structure that will minimise the costs to citizens of funding a given spending path. Far from being a residual, the debt target potentially caps total cash spending, given revenues. The revenue policy appears to be to maximise revenue from taxes and levies, within limits set by the political acceptability of new or higher taxes.

5.5 There are major problems with the quality as well as the quantity of government spending. Although the OECD has pointed out that 95 percent of spending is not subject to any review, the government has shown no willingness to undertake a zero-based assessment of the quality of base spending and has largely accepted the status quo and maintained existing programmes. This is a recipe for mediocrity and contrasts with the steps taken by countries like Canada, Ireland and Finland to make more fundamental changes to spending programmes.[13]

5.6 Governments since 1999 have kept current spending within current revenues in order to avoid a repeat of the deficit spending that prevailed from 1973 to 1984. However, the benefits to the community are reduced when the surpluses are used to transfer resources from private hands that could make better use of them into the public sector. Lower surpluses from lower tax revenues would have been more likely to increase community welfare (and economic growth).

5.7 In principle, under the current approach, the current account surplus target is redundant. The limit on total cash spending (current and capital) is set by the debt target, revenues and the government's ideological opposition to asset sales. Such a cash-based system for trying to constrain overall government

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13 Tanzi, *op cit*, p 626.

spending is reminiscent of the anachronistic ‘Table 2’ public accounts in the 1970s that focused only on cash flows and largely blurred the differences between current and capital spending. A clear lesson from that period is that a cash flow focus lacks transparency, invites current account deficits and does not prevent a debt spiral.

5.8 The presentational difficulties that face a minister of finance who is trying to operate a cash flow constraint under an accrual-based accounting system are illustrated by the following paragraph in the BPS:

> Our fiscal strategy involves meeting the cost of much of our capital spending from operating surpluses rather than from borrowing. Some people argue that it is acceptable to borrow to fund capital spending because that is what a household or corporate would do. However, it is dangerous to take these comparisons too far when applied to the government. Many important areas of capital spending do not generate a direct monetary return or contribute directly to raising growth that can be used to offset the cost of extra debt. It might be argued that some of this investment will benefit future generations, so it would be only fair [if] they share some of the cost of paying for it. Ultimately, however, it makes little sense to be increasing the long-run debt burden (as measured by debt-to-GDP) when we are putting money aside in the NZS Fund.[14]

This statement ignores the fact that, conceptually, spending that does not generate future benefits is current operating spending, not capital spending. Under a system of accrual accounts and with the current account in balance over the economic cycle, the issue of funding such spending from debt need not arise. For example, the 'fair value' approach to writing down student loans treats about one-third of new lending on student loans as current year operating spending. Debt is a valid means of funding genuine capital spending, particularly where the Crown's assets exceed its liabilities. The best policy from an economic perspective, however, would be to fund justified capital spending from sales of business assets, at least in part. Any debt target should take this into account.

5.9 One interpretation of the above statement in the BPS is that the government itself is not confident about the future benefits from its capital spending. This possibility raises the question of why it is doing it and whether its accounts are overstating the future benefits. It is important in terms of transparency and accountability that poor quality capital spending should be written down and expensed as it occurs. Otherwise future governments will be able to continue to

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14 BPS, pp 1-2.

defend what is really largely current spending on the basis of spurious claims of future benefits. This discussion underlines the importance of a strong accounting and audit function for the Crown accounts that is independent of the executive.

5.10 We doubt that the review of the gross debt target will solve the problem of the lack of principled, effective constraints on government spending. Our major suggestion, last year and this year, for addressing it is to adopt a taxpayer bill of rights that gives citizens, rather than politicians, the power to decide whether to increase overall real per capita operational spending and taxation. It would similarly limit capital spending by requiring the executive to go to the electorate for approval to increase real debt per capita. Such a bill would reduce the ability of the executive to get what it wants by dominating parliament. The proposal represents a small increase, of a 'strike-down' nature, in direct democracy.

5.11 The proposal is not a panacea. It allows profligate governments to continue to waste money on a large scale because it fails to impose any value-for-money disciplines on existing spending. The quality of base spending can still be very poor. Separate processes to review base spending are needed. Nevertheless, New Zealand has encouraging precedents in recent decades, notably the Fiscal Responsibility Act, for improving New Zealand's fiscal constitution. What is desirable is that such improvements are subject to proper scrutiny and debate before they are implemented. We would be happy to make presentations to any party and in any forum committed to examining the concept of a taxpayer bill of rights constructively.

6 Conclusions

6.1 New Zealand is not on track to lift its average living standards relative to Australia or the OECD average. The BPS is based on a projected annual average rate of growth in real GDP of only 2.8 percent during the five years to March 2010. This is far below the annual average rate achieved in the last decade.

6.2 The BPS does not contain a credible strategy for boosting the rate of economic growth. The government still refuses to accept that high taxes and ill-disciplined spending materially harm prosperity and liberty. Its view is inconsistent with a growing body of international research and the professional advice of organisations such as the OECD and the Treasury.

6.3 The BPS declares that the government will focus on lifting the aspirations and abilities of "all" New Zealanders, yet the government is impairing incentives to work through high effective marginal tax rates for many families and presiding over a regulatory juggernaut that is reducing economic flexibility and economic freedom.

6.4 The BPS also aims to enhance fairness, opportunity and security. However, policies that harm economic growth and make the labour market less flexible are likely to reduce opportunity and security. In particular, we do not see that the major increases in spending planned for Budget 2006 involving the expanded student loans scheme and Working for Families package are justifiable in terms of economic efficiency or equity. On this basis, these initiatives should not proceed.

6.5 There is far too much wasteful spending because spending disciplines are inadequate and because taxes are too high. Much of this spending represents 'fiscal churning' – taxing and spending money on the same group of people – that detracts from the ability of the government to protect those genuinely unable to provide for themselves. A marked reduction in the size of government could be achieved without compromising this group.[15] Instead the government is regarding revenue increases from economic growth as available to spend at will rather than the property of taxpayers. This is one reason why we continue to advocate consideration of a taxpayer bill of rights that would allow taxpayers rather than politicians to determine whether spending and taxes per capita should increase faster than the rate of inflation. We also recommend serious examination of a Regulatory Responsibility Act.

6.6 Finally, we would invite the Committee to consider how the process of consideration of budget policy statements could be made more meaningful.

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15 Tanzi, *op cit*, p 633.

Growth in Real Per Capita Government Revenue and Core Crown Spending, 2000-2010

Years Ended June				Increases $ Per Capita			$ Inc as % $ Inc GDP per cap		
	2000	**2005**	**2010**	**2000-5**	**2005-10**	**2000-10**	**2000-5**	**2005-10**	**2000-10**
Real per Capita Revenue and Spending (1995/96 dollars)									
Total Crown Sovereign Power Revenue	$8,127	$10,195	$11,137	$2,068	$942	$3,010	**63%**	**31%**	**48%**
Core Crown Operating Expenses	$8,603	$9,477	$11,023	$873	$1,547	$2,420	**27%**	**51%**	**38%**
GSF OBERAC adjustment	-$50	$259	$0	$309	-$259	$50	9%	-9%	1%
Core Spending less GSF Adjustment	$8,653	$9,217	$11,023	$564	$1,806	$2,370	17%	60%	38%
Finance Costs	$549	$466	$384	-$83	-$82	-$165	-3%	-3%	-3%
Core Spending less GSF Adjustment and Finance Costs	$8,104	$8,751	$10,639	$647	$1,888	$2,535	20%	62%	40%
Unemployment Benefit/Community Wage	$483	$170	$168	-$312	-$3	-$315	-10%	0%	-5%
Remaining Core Crown Operating Expenses	$7,622	$8,581	$10,471	$959	$1,890	$2,850	**29%**	**62%**	**45%**
REAL GROSS DOMESTIC PRODUCT PER CAPITA (P)	$26,996	$30,268	$33,293	$3,272	$3,025	$6,297	100%	100%	100%

Memorandum Items

				Percent Nominal GDP			Increase in % GDP		
	2000	**2005**	**2010**	**2000**	**2005**	**2010**	**2000-5**	**2005-10**	**2000-10**
Nominal $ million, unless otherwise stated									
Total Crown Sovereign Power Revenue	32,624	49,739	61,411	29.7%	32.9%	32.7%	**3.3%**	**-0.3%**	**3.0%**
Core Crown Operating Expenses	34,536	46,234	60,782	31.4%	30.6%	32.4%	**-0.8%**	**1.7%**	**0.9%**
GSF OBERAC adjustment	-201	1,264	0	-0.2%	0.8%	0.0%	1.0%	-0.8%	0.2%
Core Spending less GSF Adjustment	34,737	44,970	60,782	31.6%	29.8%	32.4%	-1.8%	2.6%	0.8%
Finance Costs	2,205	2,274	2,118	2.0%	1.5%	1.1%	-0.5%	-0.4%	-0.9%
Core Spending less GSF Adjustment and Finance Costs	32,532	42,696	58,664	29.6%	28.3%	31.2%	-1.3%	2.9%	1.6%
Unemployment Benefit/Community Wage	1,937	831	925	1.8%	0.6%	0.5%	-1.2%	-0.1%	-1.3%
Remaining Core Crown Operating Expenses	30,595	41,865	57,739	27.8%	27.7%	30.7%	**-0.1%**	**3.0%**	**2.9%**
Nominal GDP (HEFU)	109,951	150,966	187,853						
Population (millions)	3.849	4.082	4.266						
Real GDP (P) (1995-96 Prices)	103,896	123,567	142,032						
GDP Deflator Base (M Yr 1995-96=1)	1.043	1.195	1.293						

Sources: Statistics New Zealand; Treasury; HEFU, pp 48, 89, 94, 95, 119; OBERAC http://www.treasury.govt.nz/forecasts/hyefu/2005/hyefu05-7.pdf