

Spending cap proposal the height of foolishness

Bill Rosenberg

THE NATIONAL-ACT confidence and supply agreement promises a cap on government spending. A spending cap has all the attraction of an organised rush of lemmings over a cliff.

If the spending cap had been in place during the global recession starting in 2008, unemployment would have been much higher than it is now. Increased spending paid not only for more unemployment benefits (which are exempted from the cap proposal), but also for the increase in numbers on other benefits, in insulation programmes, infrastructure spending and more. It kept more money in people's pockets, people in jobs, and businesses in business. That is the function of government in a recession. Governments increased expenditure around the world.

Yet the ACT-National agreement limits "core Crown operating spending, excluding finance charges, spending on the unemployment benefit, asset impairments and spending on natural disasters" to grow no faster than population growth plus inflation. Under this, a government could pay people the dole, but it couldn't spend more to keep them in work.

But the foolishness of this proposal goes much further.

Obviously we do want efficient and effective government services, but this proposal will reduce them. Evidence that smaller government expenditure as such is better for growth or innovation or quality of life is simply not there. The level of funding is the stuff of democracy – not arbitrary technocratic limits. A cap would be a windfall for private health and education providers by forcing citizens to pay for services the state is no longer funded to provide.

What if we find that there are services more efficiently provided by the government, or the private sector fails to provide for people's needs? An arbitrary cap



Sign here: Prime Minister John Key signs National's arrangement with ACT's John Banks.
Photo: KENT BLECHYNDEN/FAIRFAX NZ

would have stopped the previous government ensuring we had a functioning railway system, or the current one from paying for high speed internet infrastructure. The private sector has failed to provide these, putting other parts of the economy at risk.

In fact the cap will actually force reduction in many services – and may force future governments to cut New Zealand Superannuation because its costs are rising more quickly than the proposed spending limit. Its costs rise faster than inflation because it is indexed to the average wage, and faster than population growth because the retired population is increasing more quickly than the rest of New Zealand.

It is currently about 12.5 per cent of core Crown expenses; under conservative assumptions, by 2023 it could reach 20 per cent. Under this proposal, even though the economy will have grown in the meantime, that would mean less for other public services such as health and education.

Other government expenditure also grows faster than the proposed cap. Health treatments are one example. The wage and salary bill, which makes up 60 per cent to 80 per cent of most government services is another.

We will see constant crises in other

parts of the Government's budget – and constant patch-ups to fix one area at the expense of another. A Treasury paper issued last year revealed that it had explored a spending cap but the Government rejected it largely because to be sufficiently responsive to changing circumstances such as economic crises it would have to be too complex.

There are plenty of examples of successful countries with much larger government expenditure in proportion to the size of their economies. New Zealand government spending as a percentage of gross domestic product is below the average of similar sized countries in the Organisation for Economic Co-operation and Development, and below higher income countries such as Finland, Denmark, Sweden, Austria and Norway.

In the end it is quality of spending that matters. A paper from the Treasury earlier this year found just that. It also found that most New Zealand public spending is of high quality.

One example of how quality counts: health. According to the OECD, the United States with a largely private health system spent 16 per cent of its GDP on health in 2007.

New Zealand spent just 9.2 per cent, overwhelmingly through government funding. Yet the US has inferior health outcomes in many respects. It has lower life expectancy, for example, and large parts of the population go without insurance coverage.

We are demonstrably better off with that higher government spending.

We should be concerned about build-up of government debt and waste, but there is little evidence that this is a big problem for New Zealand.

Government debt is low compared to other OECD countries. Government expenditure in the year to June 2008 was lower as a proportion of GDP than it was in 1999. Beware of ideology dressed up as simple solutions.

Bill Rosenberg is an economist for the CTU.