ISSUEANALYSIS

The Decade-long Binge: How Government Squandered Ten Years of Economic Prosperity

Luke Malpass

EXECUTIVE SUMMARY No. 128 • 17 November 2011

Politicians in New Zealand are wedded to the idea of the activist state, but despite huge spending increases life is not much better for most people. Over the last decade, government has provided more social services but at such great cost that we have to question whether the marginal improvements in social outcomes justify the cost, whether there are other ways to bring about the same results, and whether such spending is fiscally responsible in the long term.

Government spending has almost doubled in nominal terms to $70.5 billion from 2000–01 to 2010–11. Adjusting for inflation, this is an increase of 57% in real terms. Most of this money was spent on social welfare and introducing costly and ineffective new policies.

From 2000–10:

- Health spending increased from $6.6 billion to $13.5 billion.
- Education spending increased from $6.1 billion to $11.7 billion.
- Social security and welfare spending increased from $13.2 billion to $21.2 billion.

Despite the quantum of spending increases, there is evidence of only marginal improvement in social indicators even though it is easier to disprove than prove causation.

Moreover, these spending increases have seen New Zealand slide into deficit very easily with reduced tax revenue. In fact, the global financial crisis was not to blame for the great increase in recent spending, although the political response prolonged the spending.

This report should prompt all those involved in New Zealand public policy to reconsider the profound attachment to the state as a substantial facilitator and provider of services. In light of the negligent results of government spending, new alternatives need to be considered.

This report updates research undertaken by The Centre for Independent Studies in 2007 and confirms a decade-long binge of government spending. It confirms that from 2000–10:

- Core government spending increased from 29% to 35% of the economy, while total government spending is a staggering 49.9% of the economy in 2011.
- The amount of cash churn, whereby people paying tax are getting it back in services and payments, has increased drastically.
- Some of the clear spending items have been public sector pay rates, numbers of public servants, and a stubborn incidence of long-term welfare dependency.
- A recession in the tradeable sector of the economy meant that government spending not only increased in dollar figures but also relative to the size of the economy.
- By comparison, the biggest spending government in Australian history still has a far lower level of government expenditure to GDP, partly because of far greater provision of private providers in health and education.

Luke Malpass is a Policy Analyst with the New Zealand policy unit at The Centre for Independent Studies. He has worked on a range of New Zealand public policy issues, including KiwiRail, electoral systems, and alcohol regulation.

Thanks to Peter Saunders, Oliver Hartwich, and other anonymous reviewers for their comments. Any mistakes remain my own.

THE CENTRE FOR INDEPENDENT STUDIES
www.cis.org.nz

Is life much better than it was a decade ago? This is the question that governments should constantly ask themselves. Social indicators are not a perfect science and there are lags, but if policies are going to be put in place that help some facet of life, their success or otherwise needs to be measured and weighed. Unfortunately, on the evidence available, New Zealand's prosperity since 2000 represents a decade that wasted the proceeds of a painful reform process, while simultaneously wasting the proceeds of the economic boom of the 2000s.

Introduction

In 2007, The Centre for Independent Studies published a report by policy analyst Phil Rennie, *New Zealand's Spending Binge*[1] (the 2007 report), in which he made the following two points among others:

- In 2006–07, spending was $20 billion higher than in 2000, a 32% increase in real terms.
- Government spending made up 40% of GDP, compared with 35% in Australia.

Rennie argued that:

- If the extra $20 billion was used to fund tax cuts, nearly all income tax could be abolished.
- There was little specific information on what this extra spending had achieved.
- The available social indicators showed negligible improvement.
- There was little relationship between higher spending and better social outcomes.
- Middle-class welfare was responsible for much of this ineffectual spending, primarily through churning (taxpayers get back the money they pay as tax in the form of benefits and deductions). Much 'new' spending was in fact displaced spending that would have invariably occurred in private hands. Therefore, the increased spending may have actually reduced public welfare.
- Many people could afford their own social services if taxes had been lower, allowing for more savings, competition, innovation and personal responsibility. It would also have reduced the size of the bureaucracy.
- Australia outperformed New Zealand on most social indicators by targeting its spending, and relying on private health, education and superannuation.
- Diminishing returns from spending coincided with the rising costs of taxation. This meant that New Zealand could have achieved better social and economic outcomes with less taxation and spending.

Four years later

Much has happened since the 2007 report was published. New Zealand has a different government with a new agenda and there have been changes to the tax system, particularly in GST and personal income tax.[2] Although New Zealand has weathered the global financial crisis reasonably well, a near decade of surpluses turned to deficits very quickly, requiring quick adjustments to rectify the situation. This was compounded by the economic impact of the Christchurch earthquake and the impending global financial recession. This report seeks to update the 2007 report in a wider context and examine whether the Key government's rhetoric about 'cutting one's cloth' to current economic circumstances really stands up to scrutiny.[3] This report takes the same basic indicators and broadens the trends where suitable for the decade 2000–10.

In the latest government accounts, government spending (core Crown expenses) was $34.5 billion for 2000, $54 billion for 2007, and $70.5 billion for 2010—33.8% of GDP for 2010 and 34.9% of GDP for 2011.[4] But these figures are only core Crown expenditures. Including capital outlays, local government, spending by State Owned Enterprises (SOEs), Crown entities, and local government, the OECD claimed that this figure was about 40% of the GDP in 2005. With the purchase of KiwiRail, extension of social schemes, and spending increases across the board, that figure is now 44.2% of GDP.[5]

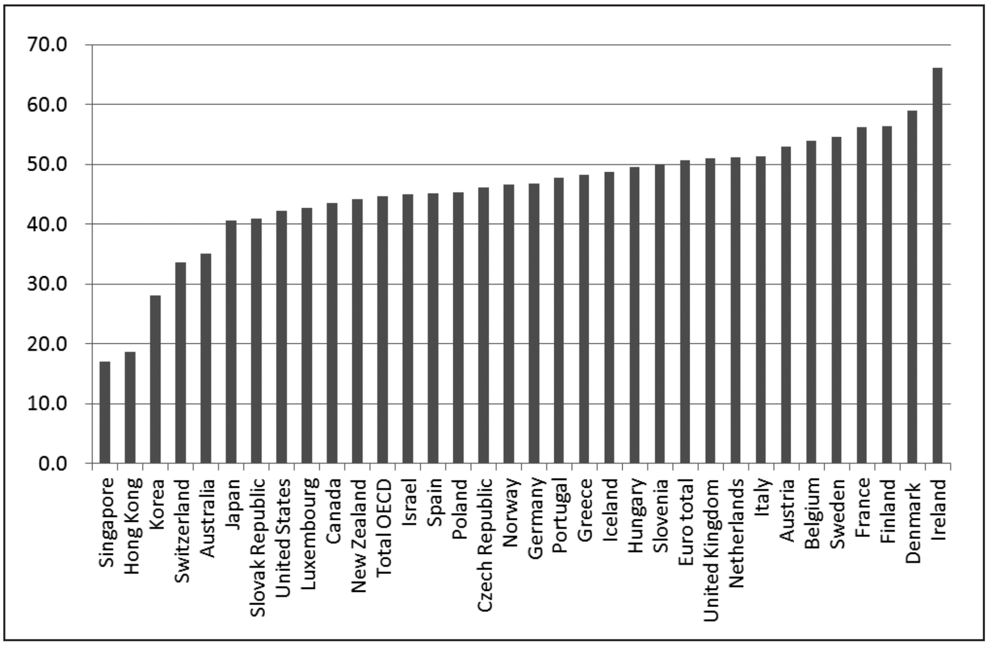
This report seeks to update the 2007 report in a wider context and examine whether the Key government's rhetoric about 'cutting one's cloth' to current economic circumstances really stands up to scrutiny.

Global context

According to the 2007 report, government spending for the decade 2000–10 'will have increased from $34.5 billion to $60.6 billion.' Rennie's prediction was too low. The figure for 2000–01 to 2010–11 is a $34.5 billion increase to $70.5 billion—a staggering two-fold increase in just 10 years.

Although government spending of 45% is around the OECD average, it hides the clear split between higher spending European nations and the lower spending but more prosperous nations such as Australia, Singapore and Hong Kong. New Zealand still remains wedged between the two groups, but its spending is trending inexorably upward towards the European nations.

Figure 1: Spending as a percentage of GDP across the OECD, Hong Kong and Singapore (2010)



Sources: OECD. For Hong Kong and Singapore, 2010 Heritage Foundation/Wall Street Journal Index of Economic Freedom.

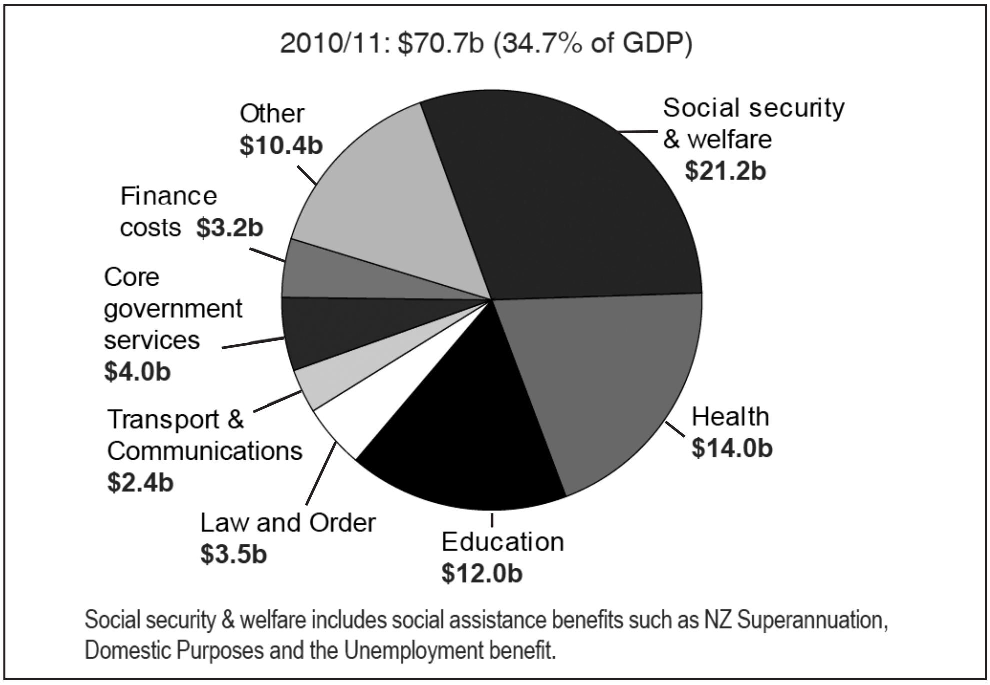
Overall social spending (education, health, welfare and superannuation) makes up about 70% of all government spending, and has been the biggest area of increase over the past decade.

New Zealand is already facing substantial fiscal pressures over the next few decades. An ageing population is going to place pressure upon superannuation and health spending. There have been a number of contributions to the debate, including the retirement commissioner arguing that, at the very least, the retirement age needs to be raised to help cope with these pressures.[6]

What are we spending on?

Overall social spending (education, health, welfare and superannuation) makes up about 70% of all government spending, and has been the biggest area of increase over the past decade. Even after the change of government and its rhetorical age of austerity, these three areas have been to some extent ring-fenced from funding reductions.

Figure 2: Breakdown of government spending (2010–11)



Source: Treasury, *Key Facts for Taxpayers 2010*.[7]

The biggest increases from 2000 to 2010 have come in health, education and family tax credits. In particular:

- Core health spending increased from $6.6 billion to $13.1 billion.
- Education spending increased from $6.1 billion to $11.7 billion.
- Social security and welfare spending increased from $13.2 billion to $21.1 billion. The big percentage increases were the In Work Tax Credit ($70 million to $595 million) and the Family Tax Credit ($1.3 billion to $2.2 billion). These increases were a result of the Working for Families income support scheme introduced by the Clark Labour government. Since 2000, New Zealand Superannuation claimants have increased from 449,000[8] to 540,000,[9] an increase of 90,000. This is set at 66% of after tax average weekly earnings. This liability alone has increased by $2 billion since 2000.
- The indexing of benefits to the Consumer Price Index is one reason for the recent rise in costs at the margin.

Social security and welfare spending has increased from $13.2 billion to $21.1 billion in the past decade.

Other difficulties have also occurred. Whereas in 2000, cost of servicing debt and social welfare spending was comparatively low, the global financial crisis and local recession (as well as recent disasters such as the Christchurch earthquake) have meant rising unemployment, falling growth, and deficit spending. However, although welfare rolls have predictably grown since 2007–08 due to straitened economic circumstances, the increase in spending as a share of GDP for benefits has only increased from 1.8% to 2.1%. This is virtually back at the 2005–06 level of 2.1%. However, in the same period, welfare spending on pensions and superannuation has increased from 3.4% to 3.8% of GDP. So although there has been an effect due to the downturn, as far as automatic stabilisers are concerned it has not been large—around 0.5% of GDP since 2005–06.[10]

Up until 2006, government had effectively run a decade of surpluses. In 2010–11, prior to the first Christchurch earthquake, the nation was expected to operate on a deficit of around 5.5%.[11] This deficit is now a staggering $18.4 billion (9% of GDP) due to the earthquake, but would still be more than $9 billion without it.

Measuring results of extra spending

How the results of spending are measured is a contentious subject. This has central bearing on the key questions that must be asked about the incredibly increased spending since 2000. If you throw a lot of money at any issue, there will be *some* improvement. The crucial question is of inputs, outputs and outcomes: *how much improvement* and whether it was worth the vast increase in spending.

Outputs and outcomes tell us the efficiency and effectiveness of publicly delivered programs. Outcomes are notoriously difficult to measure but very important. The achievement of a particular program or scheme can be best measured by working out its overall outcomes.

Although how well government measures its outputs is often critiqued, we can make some reasonable conclusions based on the information available on the main indicators.

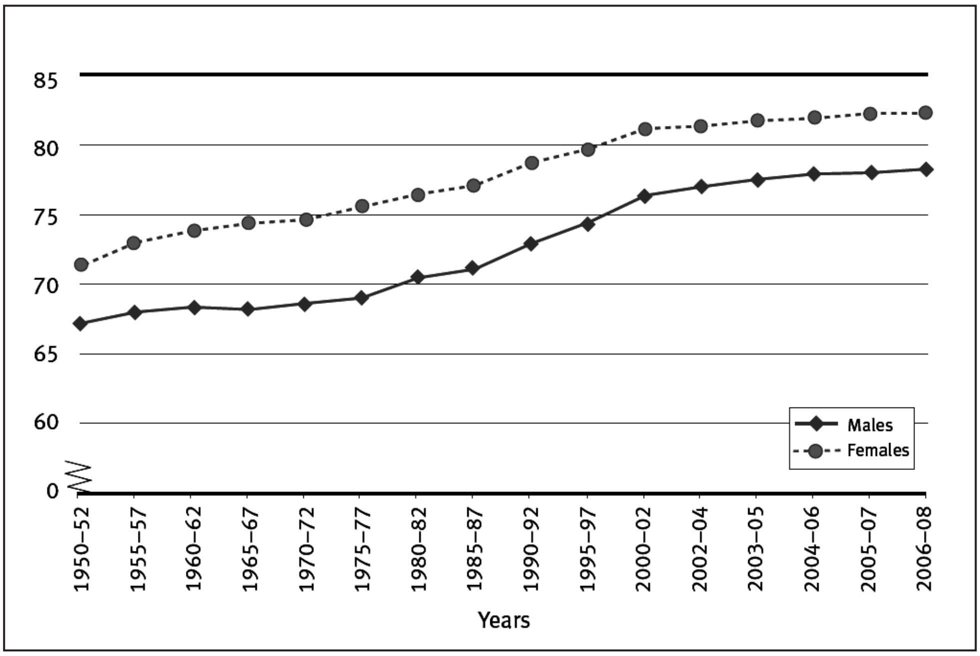
Health outcomes

The crucial question is of inputs, outputs and outcomes: *how much improvement* and whether it was worth the vast increase in spending.

Since 2000, health spending has increased by **58%** from **$6.6 billion** to **$13.5 billion**.[12]

One of the basic measures of health is life expectancy and is used by the Ministry of Health in its *Statement of Intent 2011-2014*.[13] A decade of extra spending is a reasonable time to expect results in longevity. Since 1950, New Zealand had been making large gains in life expectancy (Figure 3) but these gains have levelled off since 2000 to show only a slight increase. This shows a disconnect between the quantum of extra funding and increase in life expectancy. During the 1970s and 1980s, an increase in spending was accompanied by a rise in longevity. This increase was small compared to other OECD countries with more modest health spending increases but which leapt ahead by comparison.

Figure 3: Life expectancy at birth by gender (1950–52 to 2006–08)

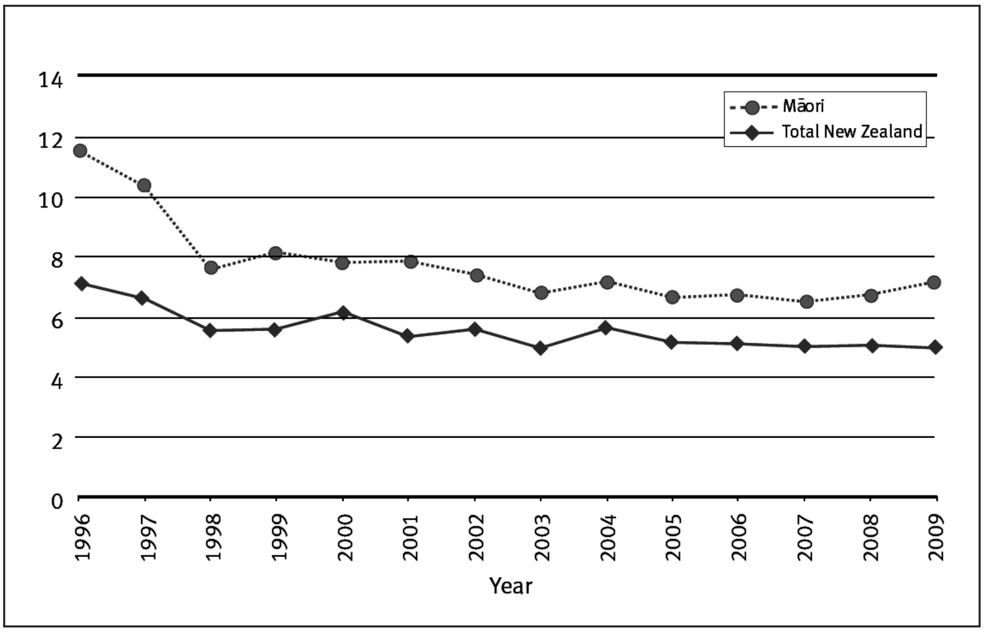


Source: Ministry of Health, *Annual Report 2010*.[14]

New Zealand's life expectancy improved the most in the 1990s—at a much faster rate than the worldwide average.[15] This increase was despite the instability within the public health sector and only modest increases in expenditure. It was also the period in which the funder/provider split was introduced to create accurate price signals within the health sector. Since 2001, district health boards have governed hospital districts.[16]

Infant mortality is another key indicator used around the world. There has been an overall reduction in rates since 1999, with the overall mortality rate reducing from 5.5 deaths per thousand to 4.9, and the Maori mortality rate reducing from 8.1 to 7.2. In 1969, the respective rates were 17.6 and 23 per thousand. However, since 2002, infant mortality rates for both Maori and the overall population have remained largely unchanged.[17]

Figure 4: Infant mortality per thousand live births (Maori and total population) (1996–2009)



Source: Ministry of Health, *Annual Report 2010*.[18]

Mortality rates have declined since 2000, particularly for those aged over 45.

For the most part, outputs from hospitals have also been disappointing. In 2005, a report by the Treasury concluded that from 2000–01 to 2003–04, 'hospital efficiency would appear to have fallen by 7.7% over the last three years.' This is in contrast to a 1.1% improvement in efficiency from 1997 to 2000.

Since the election of a new government in 2008, the following indicators have changed:

- The number of elective surgery operations (one of the government's top priorities) has increased. The number of surgeries increased from just under 130,000 in 2008–09 to 138,450 in 2009–10.[19] The number of operations between 2000 and 2006 had declined.[20]
- Hospital readmission rates are recognised as a key indicator of quality care. According to the Ministry of Health, '[u]nplanned acute readmissions may imply a failure in patient management, such as discharge too early or inadequate support at home or in follow up care.'[21] Readmission rates to 2009 have increased slightly every year since 2004.
- Mortality rates have declined since 2000, particularly for those aged over 45.[22]

- Average length of stay in hospital—a measure of efficiency—has been improving since 2008, albeit modestly. Total average length of stay per patient decreased from 4.56 days to 4.31 days. However, with readmissions increasing in roughly the same time period, the overall efficiency improvement is ambiguous.
- Patient satisfaction has remained largely unchanged across the country.

Of course measuring efficiency and patient care in this way is difficult—there needs to be a balance between patient care and efficient admission/discharge practices.

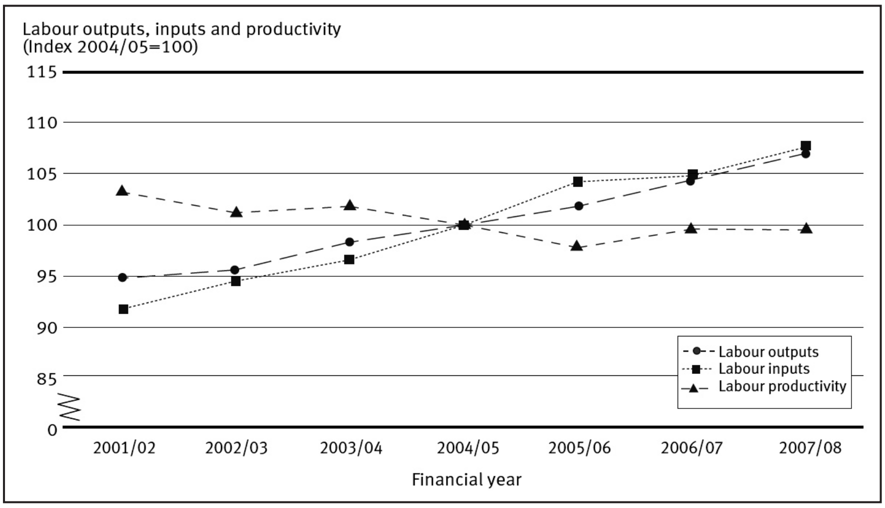
Drivers of labour costs have been a key reason for the increase in the cost of health. The Ministry of Health's 2010 Annual Report notes that between 2001–02 and 2007–08:

An ageing population is going to place pressure upon superannuation and health spending.

> Medical and nursing costs per output increased by 50% ... when adjusted for Consumer Price Index, medical and nursing costs per output increased 27.3% in real 2007/8 dollars during this period, or 4.1% per year on average. During this period there were significant wage settlements for senior doctors, resident medical officers and nurses employed at DHBs. These costs partly reflect the fact that New Zealand competes in an international market for doctors and nurses.[23]

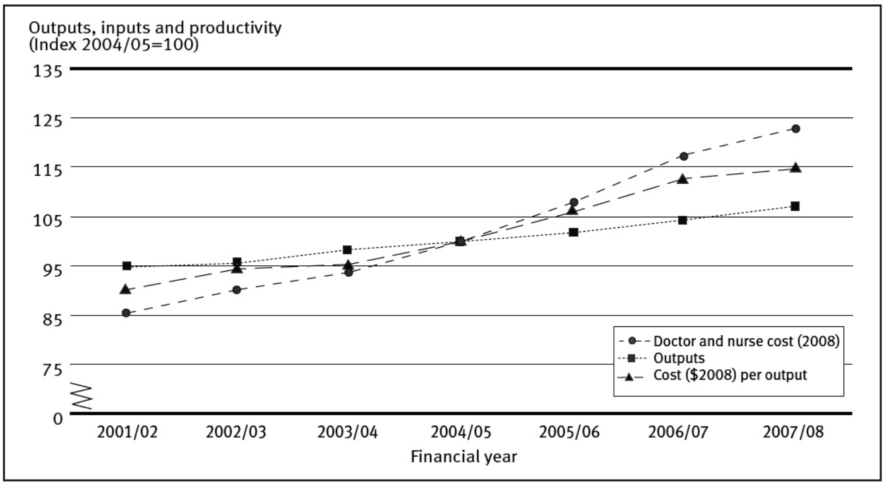
This is reflective of union power of doctors and nurses unions.

Figure 5A: Doctor and nurse productivity in DHB provider arms (medical and surgical) (2001–02 to 2007–08)



Source: Ministry of Health, *Annual Report 2010.*

Figure 5B: Doctor and nurse efficiency and costs (2008 dollars) in DHB provider arms (medical and surgical) (2001–02 to 2007–08)



Source: Ministry of Health, *Annual Report 2010.*

Since the election of the National-led government in 2008, certain sectors have shown consistent improvement with the new policy priorities. The most obvious of these is elective surgery, which has improved since the government instituted a new hospital targets regime, but this improvement has not been much since 2000, a period over which funding increased by 70%.

Treasury estimates that 60% of the increase in costs, at least to the mid-2000s, was due to increased staff costs. In a tight market for medical staff (doctors particularly), this is not surprising but does not explain the decline in efficiency.[24] According to the 2010 Annual Health Report, medical and nursing costs between 2001–02 and 2007–08 increased by 50% per output.[25] This is a massive increase in cost per output.

One of the most recent reports of hospital productivity performance was conducted by Mani Maniparathy for the New Zealand Business Roundtable. Although acknowledging the patchy nature of data secured from the Ministry of Health, Maniparathy found that between 1998–99 and 2005–06, personnel costs in hospitals increased by 18%, while overall personnel productivity dropped by 8%, and productivity for medical and nursing staff fell by 15% and 11% respectively.[26] This is obviously one large driver of increased costs.

The good news is that efficiency and value for money have improved overall since around 2007. Day care procedures (number of day surgeries) have increased and average length of stay has decreased. However, while labour productivity improved between 2005 and 2007, it has levelled off since then.

Despite recent improvements at the margins, overall health indicators have not improved greatly.

Despite recent improvements at the margins, overall health indicators have not improved greatly. There has been a poor return for a huge investment. This may indicate limits of the human body or a slowdown in medical breakthroughs, but it still seems a remarkable plateau.

The above indicators suggest that overall health productivity is improving at a stubbornly low rate with some exceptions. According to the Ministry of Health's Statement of Intent 2010, there was no change in productivity from 2006–07 to 2007–08.[27] The results of continued increases in spending have clearly shown diminishing returns. It is worthwhile repeating what Treasury said in 2005:

> It is difficult to tell what improvements in health outcomes or services have been achieved for the additional expenditure on health, and whether New Zealanders are getting value for money.[28]

Education outcomes

Since 2000, spending on education (primary, secondary and tertiary) has increased by **36%** from **$6.1 billion**[29] to **$11.7 billion** in real terms. Again the indicators show little change for money spent.

The Ministry of Education and the OECD both use the Programme for International Student Assessment (PISA) as the leading indicator for education outcomes. This test measures literacy levels for 15-year-olds in reading, maths and science every three years on a world scale. New Zealand has an internationally impressive public education system—consistently scoring in the top few PISA ranked countries. However, two out of three scores have declined slightly, but not statistically significantly, in 2000–09.

Table 1: PISA Literacy scores for New Zealand (2000–09)

	Reading	Science	Maths
2000	*529*	528	524
2003	*522*	521	*525*
2006	*521*	*530*	*522*
2009	*521*	*532*	*519*

Sources: Ministry of Education and OECD.[30]
Note: Due to differences in testing methodology, italicised figures can only be compared with other italicised figures.

The good news is that New Zealand performs very well internationally, particularly in science. However, scores have either declined or remained largely unchanged.

The good news is that in all of these figures, New Zealand performs very well internationally, particularly in science, where the scores of 15-year-olds are bested only by Finland. High achieving students fare particularly well in New Zealand compared to other countries. However, scores here have either declined or remained largely unchanged.

Another main assessment of this type is the National Educational Monitoring Project (NEMP) for Year 4 and Year 8 students, which measures cross-curriculum achievement. NEMP requires rolling assessments, so not everything is assessed every year. However in 2009, there was negligible difference in maths in both years 4 and 8 from 2005 to 2009 and a slight improvement over the longer term in Year 4 students from 1997 to 2009. There was no improvement in Year 8 students.[31] In science, last assessed in 2007, there was no overall change in performance; however, the report did note 'some concern for year 4 students'[32] as trend numbers over some subject areas were down. In reading, there has been an overall improvement from 1996 to 2008, particularly in Year 4 reading; however, as the NEMP report notes: 'the improvement occurred mainly between 1996 and 2000, with little change since then.'[33]

The other main indicator of education outcomes are the qualifications achieved by students. However, with grade inflation, this measure is not necessarily reliable. The number of school leavers gaining NCEA level 3 or above (University Entrance) is now 45.8%[34] compared to 32.8% in 2005 and 27% in 2000. Since 2004, there has been a 43% increase in school leavers with a University Entrance qualification.[35] It should be noted that a new national qualifications framework, the National Certificate of Education Achievement (NCEA) introduced from 2002–04,[36] increased the number of school leavers with qualifications (the national scaling of marks was no longer being used under NCEA). The increase in numbers reflects a different qualification system, with no bearing on students leaving school being better educated.

Social outcomes

According to former Prime Minister Helen Clark, New Zealand was 'a badly divided and disillusioned nation'[37] and 'The balance in our country wasn't right ... Our society with its history of caring about its members had become a harder, meaner place, with significant numbers of excluded people.'[38] Prime Minister John Key has moderated this line of reasoning but accepts its general premise in promising not to cut core funding but to reduce the relative rate of increases.

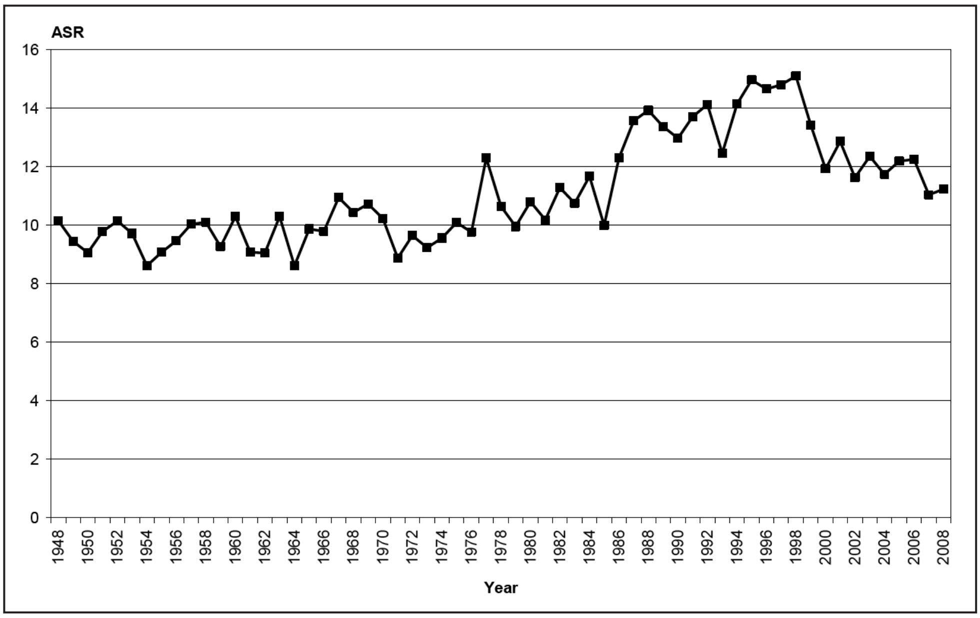
But has this extra social spending over the last decade created a less mean and hardened country, which Clark was concerned about? The fairest way to find out is to once again measure the government's performance against some of its own indicators.

The Ministry of Social Development publishes a *Social Report* every year. The 2007 CIS report used the 2006 *Social Report* to measure social outcomes in the following indicators—suicide rates, crime, poverty, and income inequality; this report uses the 2010 *Social Report* to measure the same indicators.

Suicide

Suicide rates are an important indicator of mental health, depression, social connectedness, and the general well-being of a society. The suicide rate in New Zealand reached an all-time high in 1998 before stabilising between 11 and 13 suicides per hundred thousand people. The Ministry of Health notes that despite the overall decline since 1998, there are quite substantial year on year variations.[39] Longer term, the rate of suicide is back to where it was in 1985–86.

Figure 6: Age standardised suicide rate per 100,000 population (1948–2008)



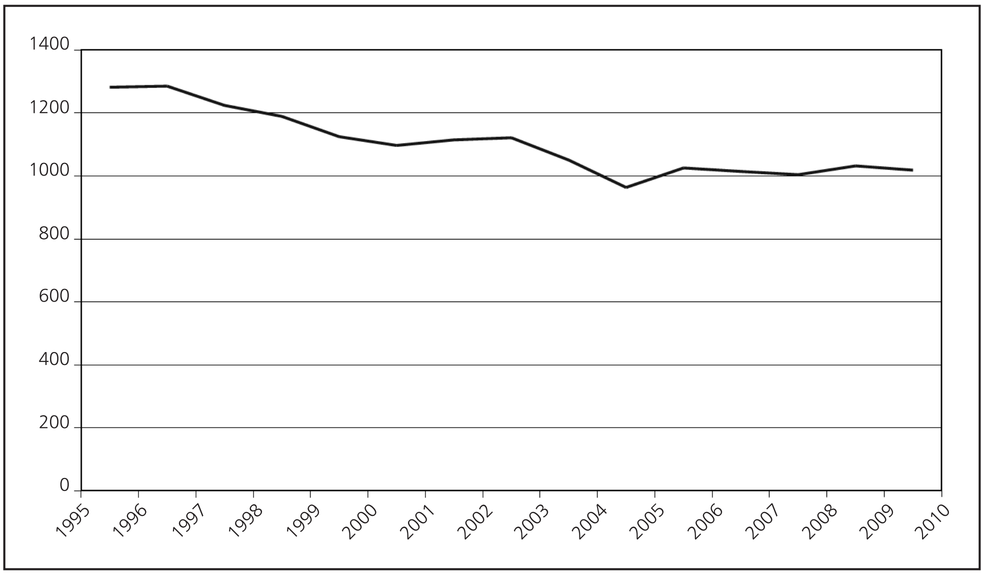
Source: Ministry of Health.[40]

Since 2003–04 the crime rate has plateaued, and there has been no overall improvement since 2007.

Crime rates

Crime is an important indicator of personal safety, the effectiveness of law enforcement, and the general health of a society. Since 1970, the number of reported crimes has doubled, with the peak reached in 1992. However, since then there has been a steady decline—on a population basis, reported crime is down by 22%.

Figure 7: Overall recorded offences per 10,000 population (1995–2009)



Source: New Zealand Police Crime Statistics for year ending 30 June 2010.[41]

Once again there is little relationship between government spending and the indicator: since 2003–04 the crime rate has plateaued, and since the 2007 report there has been no overall improvement.

Poverty

Reducing poverty has been a major goal of successive governments. Under the Clark government, a key method of achieving this was by increasing expenditure. Spending on education, health, Maori development, and economic development increased greatly since 2000 but has somewhat slowed under the Key government.

According to the Ministry of Social Development, between 2000 and 2004, '… the average living standards of the low income population dropped slightly.'[42] In the 2008 *New Zealand Living Standards Report*, the relativities of low income groups remained roughly the same as in 2004.[43] However, there have been some changes. In particular:

- The proportion of New Zealand children in poverty edged back towards 2000 levels, dropping from 26% to 19%[44] (18% in 2000).
- The proportion of Pacific Island families in hardship dropped over the intervening period.
- The overall proportion of the population in hardship dropped slightly from 14.9% to 12.9%, a change likely to be statically significant.[45]

The proportion of New Zealand children in poverty edged back towards 2000 levels, dropping from 26% to 19% (18% in 2000).

Income inequality

Reducing income inequality was a key priority of the Clark government. The Key government is instead opting for policies that encourage economic growth. In 2009, the disposable income of a household was 2.5 times larger at the 80th percentile than that at the 20th percentile.[46] This compares to a score of 2.8 times in 2004 and 2.7 in 2001. In the period 2004–09, low to medium incomes grew at a faster rate than incomes above the median. This was the only period in the past 25 years in which this has occurred.

The OECD research echoes this finding. The GINI coefficient measures income inequality, with a score of 100 indicating perfect inequality and a score of zero indicating perfect equality. From 2004 to 2009, New Zealand's score went from 34 to 33.[47]

This is a change from the 2007 report, which indicated that inequality had remained unchanged. This possibly reflects two developments: the Working for Families' tax credits and migration of higher income New Zealanders abroad.

State of the nation

New Zealand's lack of progress on any of the social indicators is reflected in our United Nations Human Development Index (HDI) rating, which is a measure of life expectancy, literacy, education and GDP per capita for countries worldwide.

From 2000 to 2004, New Zealand's score moved from 0.917 to 0.936, an increase of 2%, while our world ranking has remained unchanged at third from 2005 to 2010.[48] In 2010, New Zealand's score dropped to 0.907[49]—below 2000 levels.

Remarkably, our performance on many of these indicators was better in the five years before 2000, and has stagnated since then. These meagre outcomes were the result of a 39% increase in spending, in real terms, since 2000. Public expenditure levels were much lower before 2000. New Zealand's HDI had its fastest rate of increase in the early 1990s before declining in recent years.

These indicators are of course only that—indicative. They are not definitive or completely up to date. Data collection takes time, and the data collected changes over time in line with government expectations, priorities and advances in statistical methods.

Table 2: Change in indicators since 2000

Indicator	2007 report	2011 report
Life Expectancy	Negligible	Negligible
Infant Mortality	Negligible	Negligible
Hospital operations	Negligible	Negligible
Education literacy	Negligible	Negligible
School leavers qualifications	Increase	Increase
Suicide Rate	Negligible	Decrease
Crime	Decrease	Negligible
Violent crime	Increase	Increase
Incidence of hardship	Negligible	Negligible
Income Inequality	Negligible	Decrease
Human development index	Negligible	Negligible
Government spending	**+32%**	**+57%**

The global financial crisis and recession

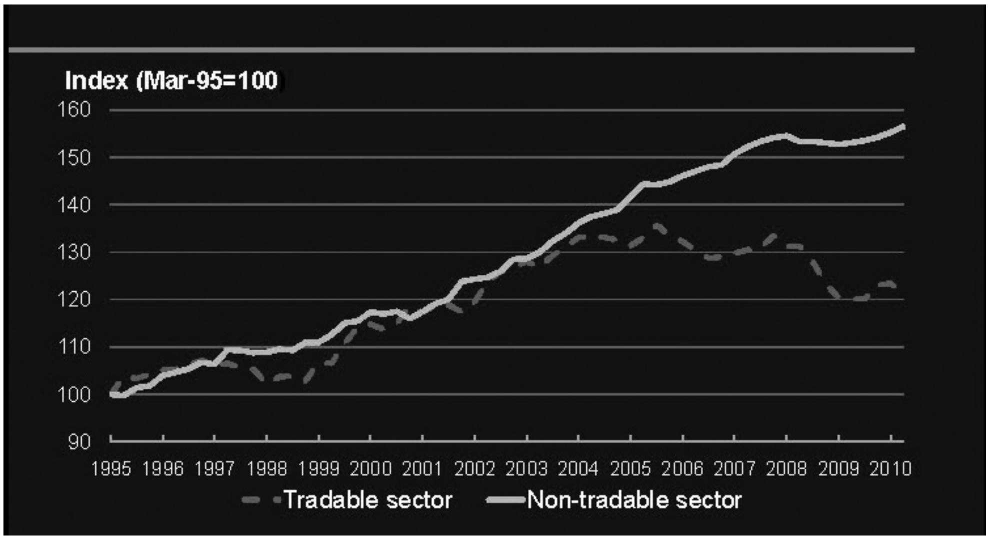
Tax revenue and total government revenue have dropped since their peak in 2008.

One argument about government spending is that the accounts have bulged to reflect the reality of a global financial crisis and economic downturn. Does the downturn in economic activity and upturn in unemployment account for the increase in spending? And if not, what else could account for this?

Reduced government revenue: Tax revenue and total government revenue have dropped since their peak in 2008: tax revenue dropped from $56.7 billion in 2008 to $51.5 billion in 2011.[50] Although this drop and subsequent flatlining do not explain the great increase in spending, they do explain the increase in the deficit. Overall government revenue has been broadly steady since 2008, slightly increasing in nominal terms from $81.4 billion to $81.5 billion. As a percentage of GDP, it also dropped from 44.1% in 2008 to 40.7% in 2011.

Growth in the tradeable good sectors (government sector versus real economy): The tradeable vs non-tradeable goods sectors is a very important indicator for New Zealand, whose main source of revenue is commodity export. It basically shows the output of the government sector versus the non-government sector. It is important because although growth in the non-tradeable output is not necessarily a sign of unwarranted government growth, it does need a growing tradeable sector to pay for it. On this measure, New Zealand's recent performance is woeful. The growth in the non-tradeable part of the economy has continued unabated, while the tradeable sector of the economy has declined since 2004. This divergence in growth is unsustainable.

Figure 8: Tradeables and non-tradeables output (1995–2010)



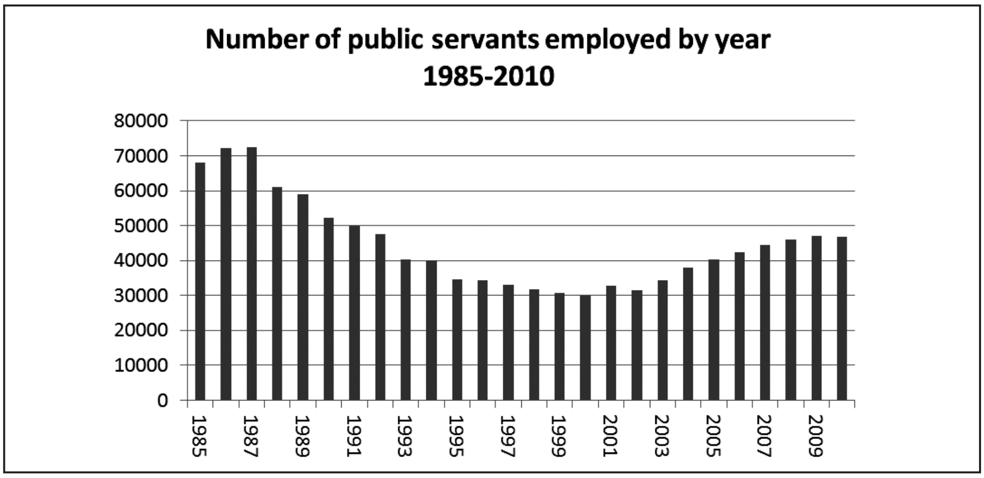
Sources: Treasury and Statistics NZ.

Growth in public service

Since 2000, there has been a substantial increase in the growth of the public service. Extra public servants create extra unseen costs by creating new laws, taxes, levies and compliance cost of new regulations for businesses.

Since 2000, there has been a substantial increase in the growth of the public service. More bureaucrats not only entail more salaries and benefits but more office space, equipment and work. In Wellington, it has been well documented how the increase in bureaucratic office requirements over the past decade has driven up office lease prices. Further, public servants are obviously employed to advise on policies, regulations and laws. Extra public servants create extra unseen costs by creating new laws, taxes, levies and compliance cost of new regulations for businesses. The growth in the public service was an ongoing trend before the global financial crisis and recession in New Zealand (Figure 9).

Figure 9: Growth in public service

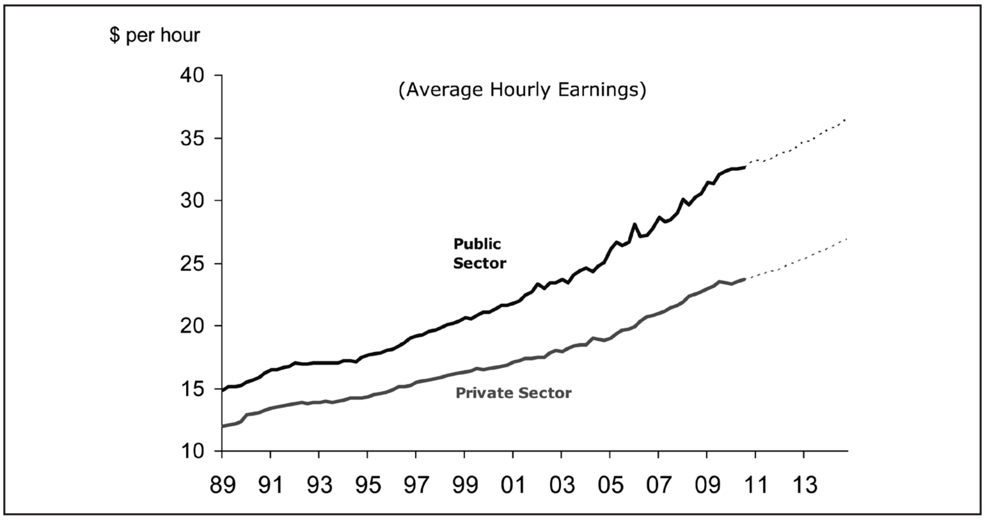


Source: State Services Commission.[51]

Public sector pay rates

According to Statistics New Zealand and ANZ, since around the beginning of the 2000s, public sector pay rates—which had been comparable to those in the private sector—increased at a greater rate than in the private sector. This trend had nothing to do with the global financial crisis or recession but was well in train beforehand.

Figure 10: Public vs private sector pay rates (1989–2010)



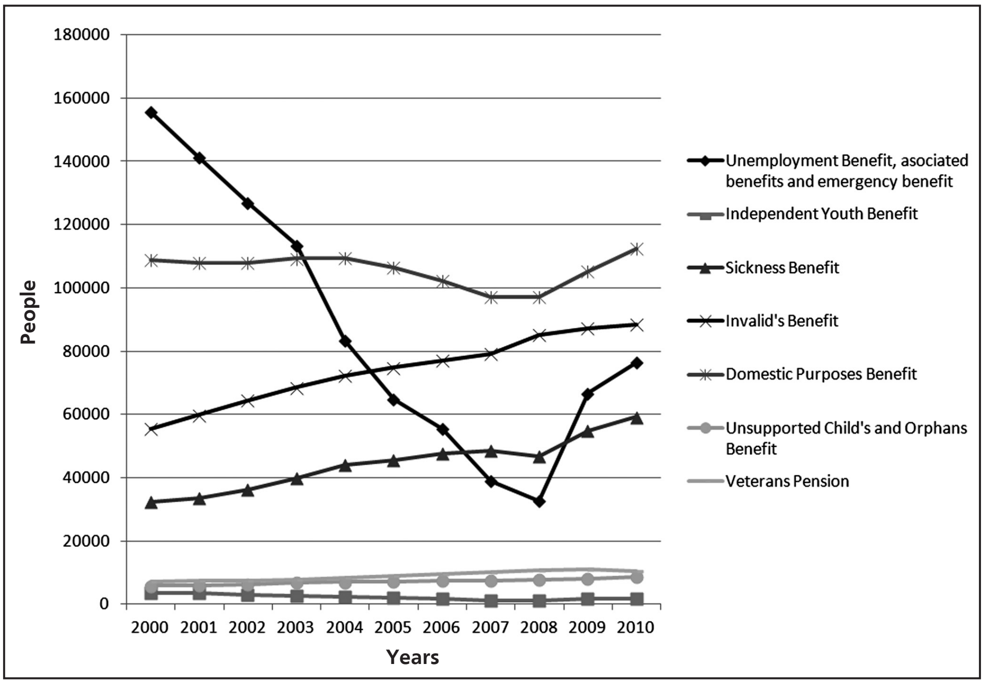
Sources: Treasury, Statistics NZ, and ANZ Bank.

Benefit rolls

Obviously, some of the increase in costs is going to be in the form of swollen benefit payments due to the recession, but how much is it exactly? As can been seen by the figures below, the number of people receiving unemployment benefit has increased in the past couple of years after a very impressive low of 32,683 in 2008. The figure now is still about half the 150,000 who were on the rolls in 2000. However, overall dependency on the state, particularly for longer term benefits, has been increasing inexorably. In particular, Sickness and Invalid's benefits have been steadily increasing over the past decade; the Domestic Purpose Benefit (DPB) dropped a little in 2007 and 2008, but has more or less been static; and superannuation has continued to rise as more baby boomers reach the age of 65 and receive 66% of average weekly earnings as superannuation.

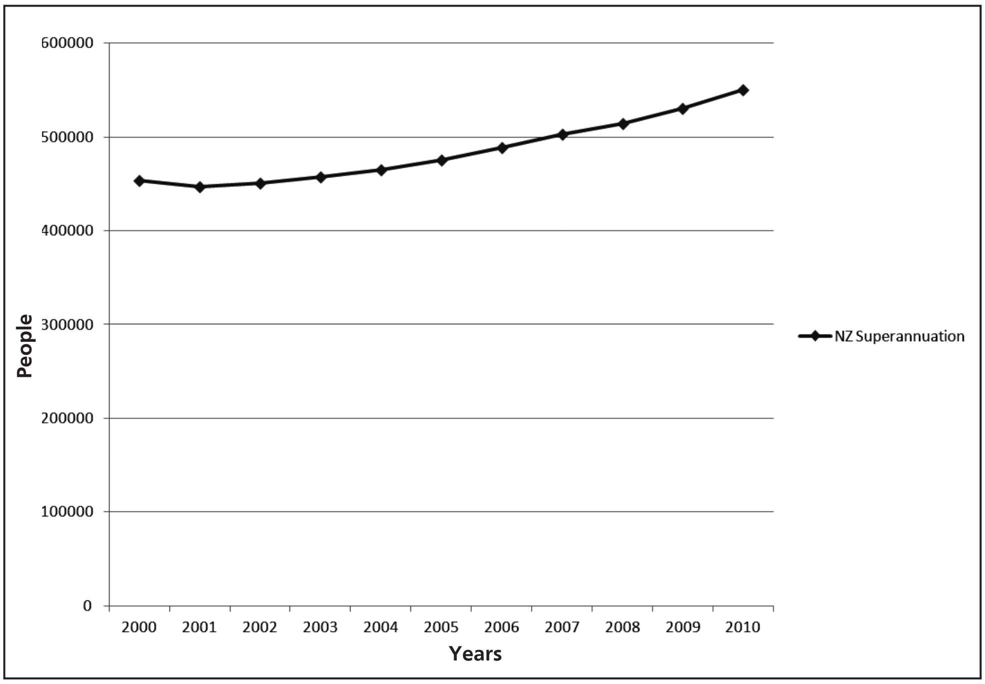
This trend had nothing to do with the global financial crisis or recession but was well in train beforehand.

Figure 11A: Benefit roll numbers



Source: Statistics NZ.

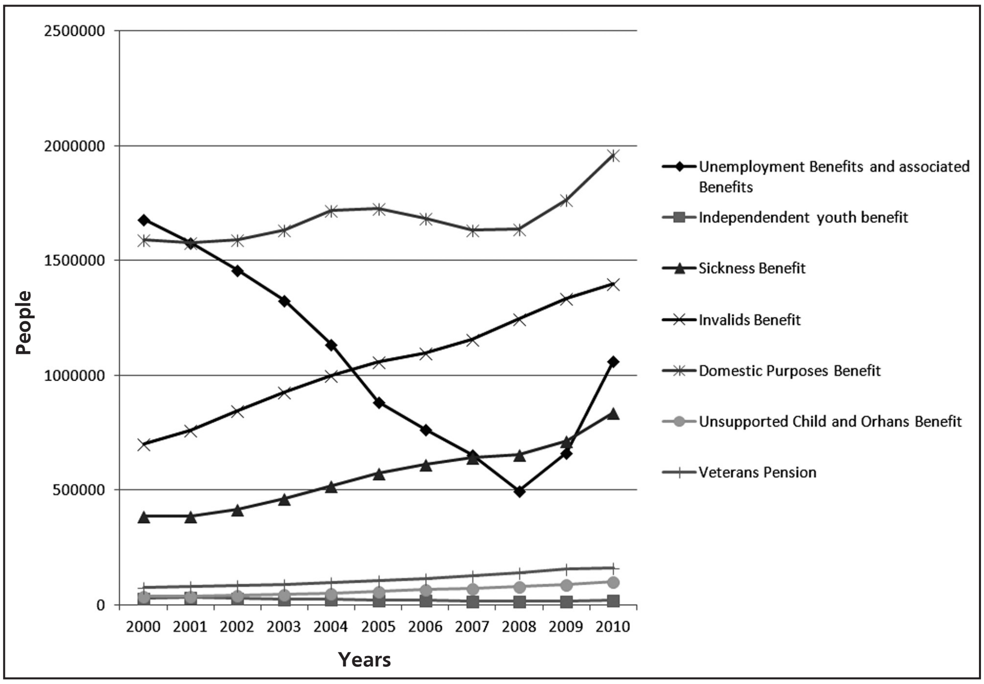
Figure 11B: Benefit roll numbers



Source: Statistics NZ.

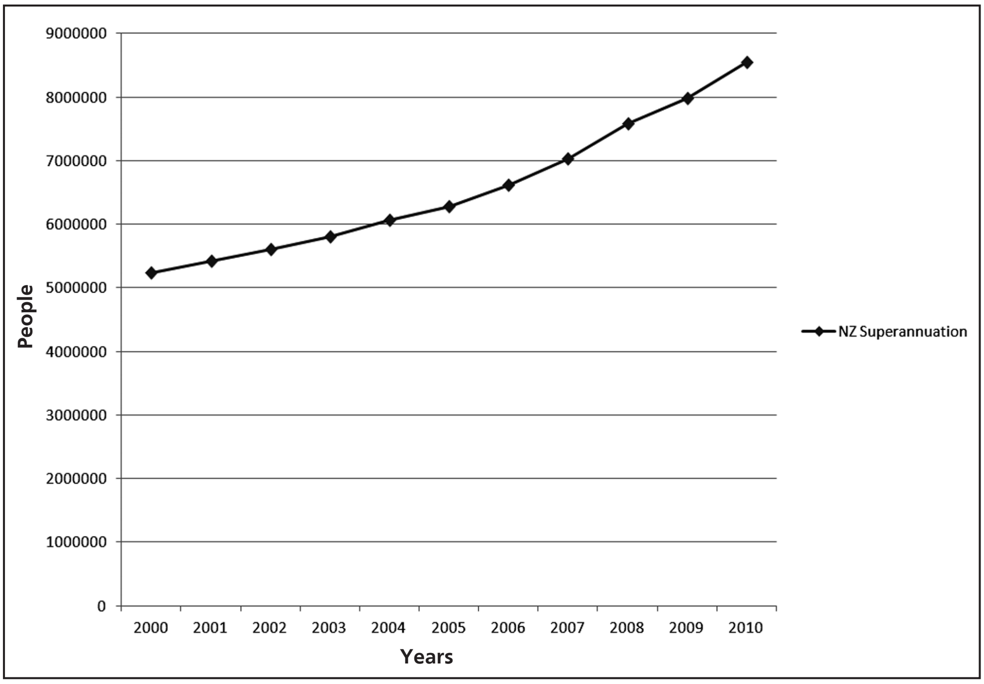
New Zealand did not have to resort to knee-jerk stimulus packages because government had already been stimulating the economy with large spending increases and growth in government employment.

Figure 12A: Benefit expenditure numbers



Source: Statistics NZ.

Figure 12B: Benefit expenditure numbers



Source: Statistics NZ.

Failure of public spending around the world

Public spending is a very different creature to what it was in 2007. Since the global financial crisis, many economies have opted for economic stimulus packages, tossing hard won fiscal management aside as panic set in and governments sought to stimulate demand within economies. New Zealand did not have to resort to such knee-jerk stimulus packages because government had already been stimulating the economy with large spending increases and growth in government employment.

These stimulatory fiscal policies did work to the extent that although New Zealand's trading sector had been in recession since 2005, the whole economy did not experience it until much later in 2008. Aside from this, the overall outcome of substantially increased spending for unchanged social outcomes is not unique to New Zealand. Indeed, the New Zealand experience largely matches the thesis of economists Victor Tanzi and Ludger Schuknecht. In their book on the economic progress of industrialised countries, *Public Spending in the 20th Century* (2000), the authors argued that beyond a certain level, government spending results in rapidly diminished returns in social outcomes (30% to 35% of GDP). At the time of the 2007 CIS report, New Zealand was at 40% and is now about 39% core expenditure and 45% overall.

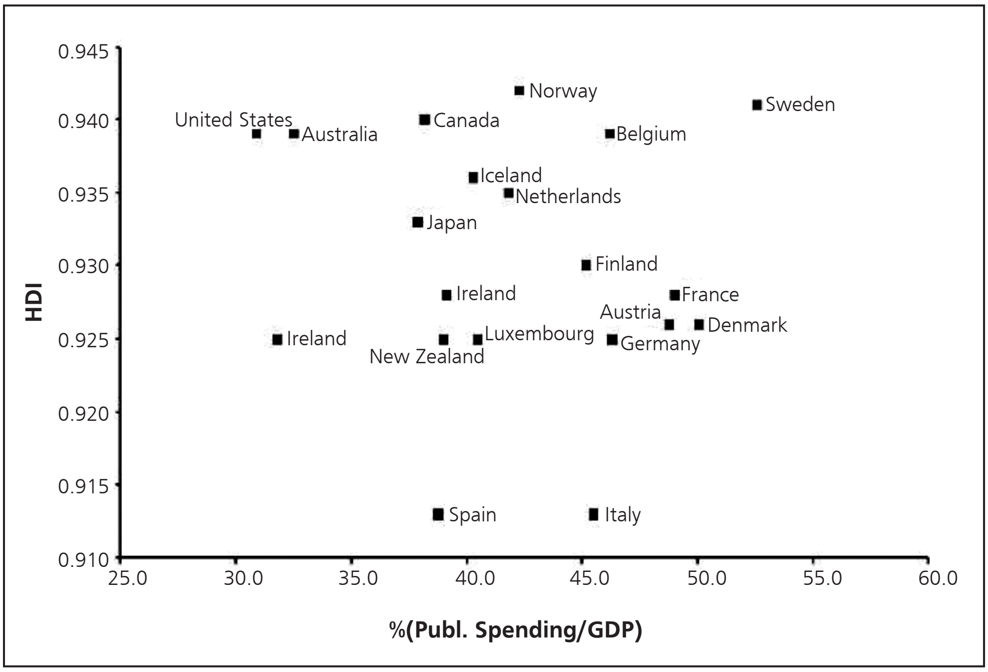
The overall outcome of substantially increased spending for unchanged social outcomes is not unique to New Zealand.

Victor Tanzi and Ludger Schuknecht found that until 1960, more government spending greatly improved living standards and social outcomes, but gains have been modest since then in a broad range of social indicators. The size of the government in different countries made little difference.[52]

Further support for this theory is found in newly industrialised countries such as Chile, South Korea, Hong Kong and Singapore. Their social outcomes have rapidly caught up with the Western world but achieved with much lower levels of public spending.

What this suggests is that sometimes less is more—with the right policies, governments can achieve the same social gains with far less public spending, and the tax that usually implies. The problem is that over the past decade, the NZ government has used favourable economic conditions to raise expenditure but without significantly raising taxes.

Figure 13: Public spending vs human development index



Source: *Cato Journal* (Fall 2005).[53]

Why hasn't the spending achieved more?

With the right policies, governments can achieve the same social gains with far less public spending, and the tax that usually implies.

Why has the effectiveness of this spending declined in New Zealand and around the world? A major explanation is churning or middle-class welfare—government spending is recycled back to those who paid the tax in the first place.

Originally, government spending came out of necessity. Health care, unemployment insurance, and education were beyond the realistic reach of most families in the 1930s, so government intervention was seen as justified and worthwhile. The first Labour Prime Minister, Michael Joseph Savage, described this as 'applied Christianity.'

However, social policy began to change in the 1970s. Services were expanded and made available to more and more recipients. Instead of providing services that wouldn't otherwise exist, government began taking over what was previously the responsibility of individuals. In New Zealand, this meant generous family support payments, a generous universal pension (originally set at 85% of the average wage!), and greatly increased health and education spending.

The inevitable problem with expanding universal social services is that they benefit the upper and middle classes. In effect, a large amount of tax money is now recycled (or churned) straight back to the taxpayer in the form of social services.

Working out exactly how many households benefit from spending is a difficult task. In New Zealand, there is not much up-to-date data on this. It was last attempted by Statistics New Zealand in 1997–98 and analysed by Michael Cox in a book called *Middle Class Welfare* (2001). Cox concluded that the wealthiest 40% of households received 23% of all social expenditure. In particular, Cox found that these households received 45% of all education spending and 34% of all health spending.[54]

These figures, as with the ones in this report, are only indicative—the actual amount of churn is likely to be far higher. A major limitation is that these figures are static and measure a snapshot in time, whereas churning also takes place over the course of a lifetime, making it likely to be much higher. Many people are only on low incomes for a very short period of time (for example, students and the temporarily unemployed) and will eventually pay more tax. The figures are also rather dated. All expenditure has increased over this time, particularly in health and education; spending in these two sectors tends to benefit all households. Since those figures, interest-free student loans and a generous Working for Families family tax credit scheme have come into being. Interest-free student loans in particular overwhelmingly benefit the middle classes.

The Working for Families scheme in particular delivers tax credits to about 360,000 working families and who pay tax—these families then apply to get back the money they paid as tax from the Inland Revenue Department. Families, many of whom earn up to $100,000 or more and pay the top personal income tax rate, are now included in the scheme. This is perhaps the most obvious example of churning.

More public expenditure may not increase public welfare—and may even reduce it.

Therefore, much public spending today is not 'new' spending; rather, it replaces spending that would have happened anyway by individuals themselves in response to their own private circumstances. It follows that more public expenditure may not increase public welfare—and may even reduce it.

It also means that people could more easily fund their own social services if taxes were not so high.

Why is churning so bad?

Why is public spending of cash likely to be less efficient than letting individuals spend it themselves? The 2007 report listed the seven main factors that help explain poor results from public spending:

Administrative costs. Transferring money on this scale is like using a leaky bucket because it requires a large bureaucracy to collect the tax and then distribute it. To cope with this extra spending, the number of people in the public service has had to increase by over 30% since 1999.[55]

The economic cost of high taxation. Taxation affects the behaviour of individuals and alters their decisions on matters like employment and investment. These deadweight losses are a major handbrake on economic growth.[56]

Lack of knowledge. No matter how hard they try, a public monopoly will never understand the specific needs and requirements of an individual better than the person themselves. Given the equivalent resources, most individuals could buy cheaper and better services tailored to their needs.

Crowding out the private sector. Government spending and regulation make it difficult (or impossible) for the private sector to get involved in many areas and find new solutions to problems. According to the Treasury, agencies 'tend to be risk averse and ... are inherently less inclined to innovate than private companies constantly required to respond to latest market developments.'[57]

Lack of competition. People can't switch to an alternative health or education system or re-arrange their spending if they are unsatisfied with the performance.

Lack of personal responsibility. In health, for example, the emerging challenges are illnesses such as obesity and diabetes, which are strongly linked to lifestyle/diet, smoking and lack of exercise. Governments do attempt to influence behaviour with marketing campaigns, taxes, incentives and restrictions but only with limited success.

Equity. Churned spending does nothing for the poor and disadvantaged in society. By definition it goes straight back to the person who paid the tax.

Australia: The lucky country (or just well managed)?

Comparisons with Australia are often not all that helpful, and New Zealanders often consider adopting poor Australian policy ideas, or do not understand what they are advocating.[58] Government spending in Australia has risen greatly in recent years, but there is still a far greater involvement of the private sector in social policy and provision than in New Zealand.

Australia has smaller government than New Zealand and spends around 35% of GDP compared to 45% in New Zealand. It is a much richer country with better social outcomes. Interestingly, there is rising recognition in Australia that the highly targeted social spending is delivering high levels of economic freedom and low levels of tax as well as excellent scores on overall measures of equality.[59]

Much is made of the higher incomes in Australia; the average salary in Australia is now over a third higher than in New Zealand.[60] Australians outperform us on a range of social indicators, including life expectancy, infant mortality, income inequality, and suicide rates.

Australia doesn't necessarily have less social spending, but its private provision is more prevalent and actively encouraged by federal government policy under successive governments. In health, 32.3% of spending comes from the private sector compared to 19.5% in New Zealand.[61] In education, the corresponding figures are 26% for Australia and 17% for New Zealand.[62]

Government spending in Australia has risen greatly in recent years, but there is still a far greater involvement of the private sector in social policy and provision than in New Zealand.

Conclusion

Although trying to measure the effectiveness of spending is difficult, and choice of indicators is always subjective, and even if values have slightly increased or decreased, there is still no proof that it is the direct result of government spending.

Sadly, since the 2007 CIS report on this range of social indicators, New Zealand's performance has basically stood still while spending has doubled. There remains a commitment in spirit from the current National-led government about spending restraint, but that restraint seems constrained to only limiting the growth in spending to a minimum while spending more on health and education.

And though it is easier to disprove than prove causation, even with limited and patchy statistics there appears to be little relationship between the increased spending and better social welfare generally. Given the quantum of the last decade's spending increases, there are obviously some improvements but they seem to be located firmly at the margins.

The cost of providing substantial apparatus of government has increased, while any benefits, especially in social outcomes, are diminishing. The key difference between today and 2007, when the last report was published, is the economic situation. Indeed, the major difference has been in terms of government revenue. While unemployment has risen slightly, and this has made a difference at the margins, a static economy has meant that as spending has increased at trend, the share of government spending to GDP has increased greatly. Government spending continues to crowd out private investment, and government continues to do things people could do for themselves. New Zealanders are getting a poor return on investment in public service, which is suffocating the economy.

New Zealand politicians seem strangely wedded to the concept of an activist state, and wear rose-tinted glasses when examining what it can achieve. Too often, the argument is not over whether the state should do something but the extent—government involvement is taken for granted. The political imperative to 'do something' and hubris about the abilities of the state have led New Zealand to this impasse.

The proper role of government is rarely debated in New Zealand, and attempts to do so are often derided as ideological or 'Friedmanite.'[63] Indeed, even asking for cost-benefit analysis of policies is sometimes seen as uncaring by 'putting dollars before people.' Policymakers need to consider that, as difficult as it may be, sometimes the best option is to not do anything. We should continually be considering not just what the state *should* do but what it *can* actually achieve and what it might actually *make worse*.

Endnotes

1 Phil Rennie. *New Zealand's Spending Binge*, Issue Analysis 83 (Sydney: The Centre for Independent Studies, 2007).
2 For snapshot information of tax changes see Treasury, *Budget 2010: Key Facts for Taxpayers* (20 May 2010).
3 One News, 'NZ must face economic reality, says Key' (11 March 2011).
4 All comparative budgetary figures taken from Treasury, *Half Year Fiscal and Economic Update* (14 December 2010), 109.
5 OECD Economic Outlook 88 (Paris: OECD, 2010). See Annex Table 25: Total Government Outlays.
6 Retirement Commission, 'Something will have to change to keep NZ Super in the future,' media release (7 December 2010).
7 Treasury, *Budget 2010: Key Facts for Taxpayers*, as above.
8 Treasury, *Budget 2002*, Annex table. See tables B1–B4.
9 Treasury, *Half Year Fiscal and Economic Update*, as above, 113—115.
10 Ministry of Social Development, *The Statistical Report for the Year ended June 2010* (Wellington: 2011), 17.
11 Treasury, *Budget Policy Statement 2011* (Wellington: 14 December 2010).
12 Treasury, *Half Year Fiscal and Economic Update*, as above, 109.
13 Ministry of Health, *Statement of Intent 2011-14* (Wellington: 2010), 36.
14 Ministry of Health, *Annual Report 2010* (Wellington: 2010), 116.
15 See Ministry of Social Development, *The Social Report 2006* (Wellington: 2006).
16 Ministry of Health, *District Health Boards* website.
17 Ministry of Health, *Annual Report 2010*, as above, 117.
18 As above.
19 Tony Ryall, Minister of Health, 'Elective surgery numbers continue to rise,' press release (20 August 2010); Ministry of Health, *Annual Report 2010*, as above, 139.
20 Phil Rennie, *New Zealand's Spending Binge*, as above, 6.
21 Ministry of Health, *Annual Report 2010*, as above, 127.
22 As above, 126.
23 As above, 147.
24 Treasury, *Treasury Report: Value for Money in Health—DHB Sector*.
25 Ministry of Health, *Annual Report 2010*, as above, 147.
26 Mani Maniparathy, *Productivity Performance of New Zealand Public Hospitals 1998/99 to 2005/06* (Wellington: New Zealand Business Roundtable, 2008).
27 Ministry of Health, *Statement of Intent 2011-14*, as above, 36, 40.
28 Treasury, *Briefing to the Incoming Government 2005—Sustaining Growth*, 39.
29 Treasury, *Budget Economic and Fiscal Update 2000* (Wellington: June 2000), 33.
30 Ministry of Education, *Education Counts* website (PISA: 2000, 2003, 2006 and 2009).
31 NEMP (National Educational Measurement Programme), *Report 48 Aspects of Technology* (2009), Summary, 3.
32 NEMP (National Educational Measurement Programme), *Report 44 Science* (2007) Summary, 5.
33 NEMP (National Educational Measurement Programme), *Report Reading and Speaking* (2008).

34 Ministry of Education, *Education Counts* website. Note: The figure used here is the trend figure used by the ministry. There is a slightly newer calculation used which changes the figure slightly. For more information, see the *Education Counts* website.
35 As above.
36 NZQA Website, *History of NCEA*.
37 Helen Clark, Address to 2002 Labour Party Congress (2002).
38 Helen Clark, Keynote address to Labour Party Conference (2001).
39 Ministry of Health, *Suicide Facts: Deaths and Intentional Self Harm Hospitalisations 2008*, 2.
40 As above.
41 New Zealand Police, *New Zealand Crime Statistics 2009/10* (Wellington: 2010), 12.
42 Ministry of Social Development, *New Zealand Living Standards 2004*, 131.
43 Ministry of Social Development, *New Zealand Living Standards 2008*.
44 As above, 66.
45 As above, 57.
46 Ministry of Social Development, *Social Report 2010*, 64.
47 As above.
48 United Nations Development Agency, Human Development Index (UNDP, 2010), 12.
49 United Nations Development Agency, *Human Development Index and its Components* (UNDP 2010), 143.
50 Treasury, *Financial Statements of the Government of New Zealand for the year ended 30 June 2011*, Table 3: Statement of Revenue.
51 State Services Commission, *Human Capability Survey: Public Service Trend Report 2010* (Wellington: 2010).
52 Social indicators used include life expectancy, infant mortality, literacy, school enrolment, income inequality, suicide, emigration, and prison population.
53 Vito Tanzi, 'The Economic Role of the State in the 21st Century,' *Cato Journal* 25:3 (Fall 2005), 624.
54 Michael Cox, *Middle Class Welfare* (Wellington, New Zealand Business Roundtable, 2001), 128.
55 Treasury, *Briefing to the Incoming Government 2005*, as above, 36.
56 See Phil Rennie, *Why Tax Cuts Are Good for Growth*, Issue Analysis 74 (Sydney: The Centre for Independent Studies, 2006).
57 John Whitehead, Secretary to the Treasury, *The Imperative for Performance in the Public sector*, Speech to Public Sector Governance Seminar (September 2006).
58 An example of this is car insurance. In New Zealand, it is often argued that Australians have compulsory third-party car insurance. While there is such a scheme in NSW (CTP green sticker), it only covers injury liability, which is covered by Accident Compensation Corporation (ACC) in New Zealand. It is not in fact insuring against liability for damaging someone else car, which is precisely what is being argued for.
59 David Alexander, 'Free and Fair—How Australia's Low-Tax Egalitarianism Confounds the World,' *Policy* 26:4 (Summer 2010), 3–14A.
60 Ministry of Social Development, *Economic Development Indicators 2011*, 131.
61 OECD, *Health Statistics 2010* (Paris: OECD, 2010).
62 OECD, *Education at a Glance 2006* (Paris: OECD, 2006).
63 Catherine Delahunty MP, 'Friedmanite fringe now influencing govt welfare policy,' media release (14 April 2010).

THE CENTRE FOR INDEPENDENT STUDIES

Issue Analysis (ISSN:1440 6306) is a regular series published by The Centre for Independent Studies, evaluating public issues and Government policies and offering proposals for reform. Views expressed are those of the authors and do not necessarily reflect the views of the Centre's staff, advisors, directors or officers. Issue Analysis papers (including back issues) can be purchased from CIS or can be downloaded free from **www.cis.org.nz**.

The Centre for Independent Studies
| PO Box 5529, Lambton Quay, Wellington 6145 New Zealand | p: +64 4 499 5861 | f: +64 4 499 5940 | cis@cis.org.nz
| PO Box 92, St Leonards, NSW 1590 Australia | p: +61 2 9438 4377 | f: +61 2 9439 7310 | cis@cis.org.au