THE TREASURY

Kaitohutohu Kaupapa Rawa

Long-Term Fiscal Pressures

Investment Statement Seminar Series – 11 October 2013

Becky Prebble, The Treasury

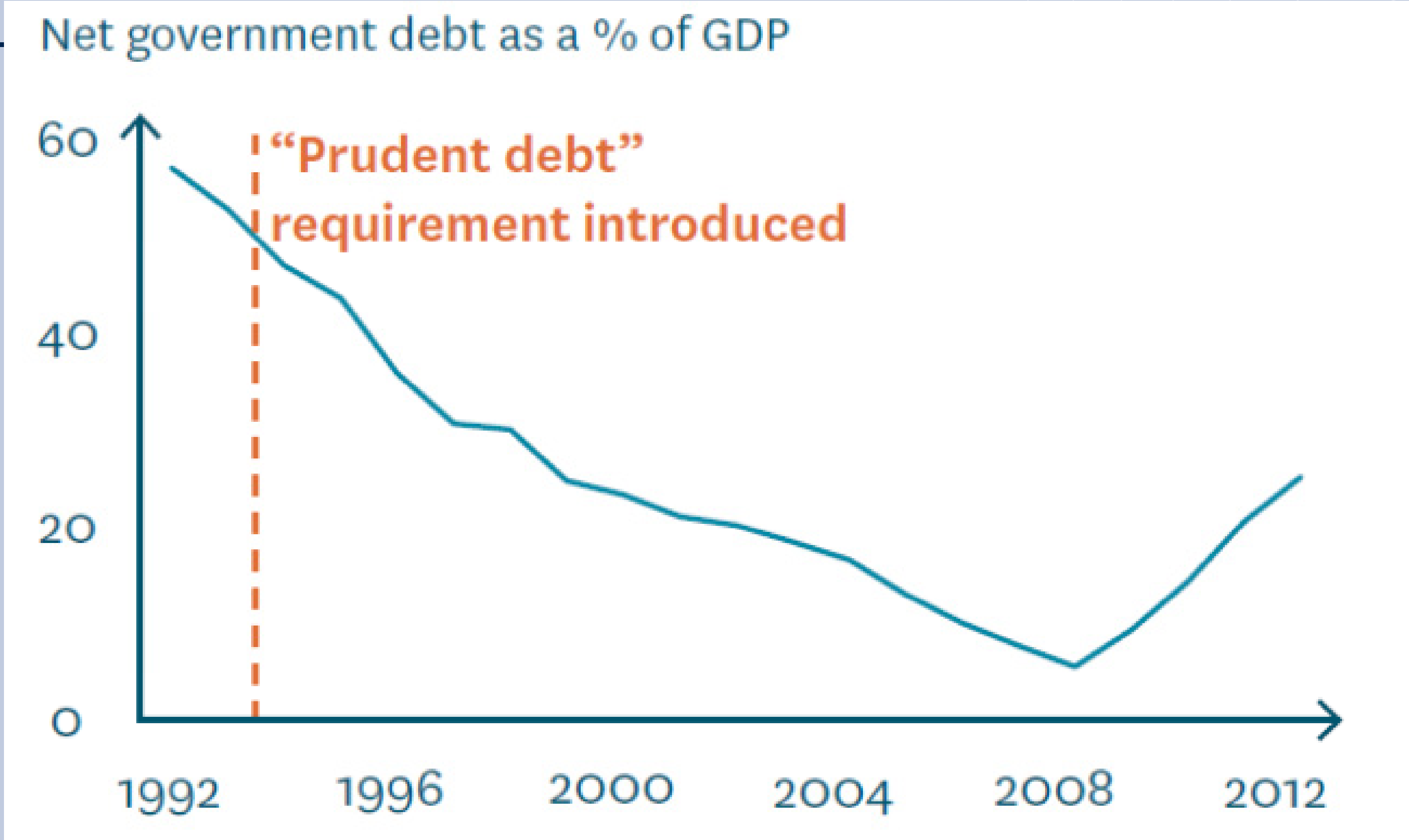
New Zealand's long-term fiscal pressures

- Treasury published a Long-Term Fiscal Statement in July 2013
- Looks at the sustainability of government finances over the next 40 years
- Today: what does that long-term trajectory look like, and what does it mean?

Long-term fiscal pressures and the balance sheet

- Our ability to build a resilient balance sheet is dependent to some extent on our ability to manage other fiscal pressures

The significance of public debt



Looking at long-term trajectories involves thinking about the future

- *Computers in the future may weigh no more than 1.5 tons.* – Popular Mechanics, 1949
- *640K ought to be enough memory for anybody.* – Bill Gates, 1981
- *We don't like their sound, and guitar music is on the way out.* – Decca Recording Co. rejecting the Beatles, 1962.

How the Treasury does its projections

- We assume:
  - Current legislative settings (eg NZ Super, welfare)
  - Historic growth in spending per recipient (eg health)
  - Likely future demand for different services (population ageing is one thing that affects future demand)
  - A constant proportion of tax revenue to GDP, based on recent history.
- We start projections from the 2015/16 fiscal year, ie the new Parliament.

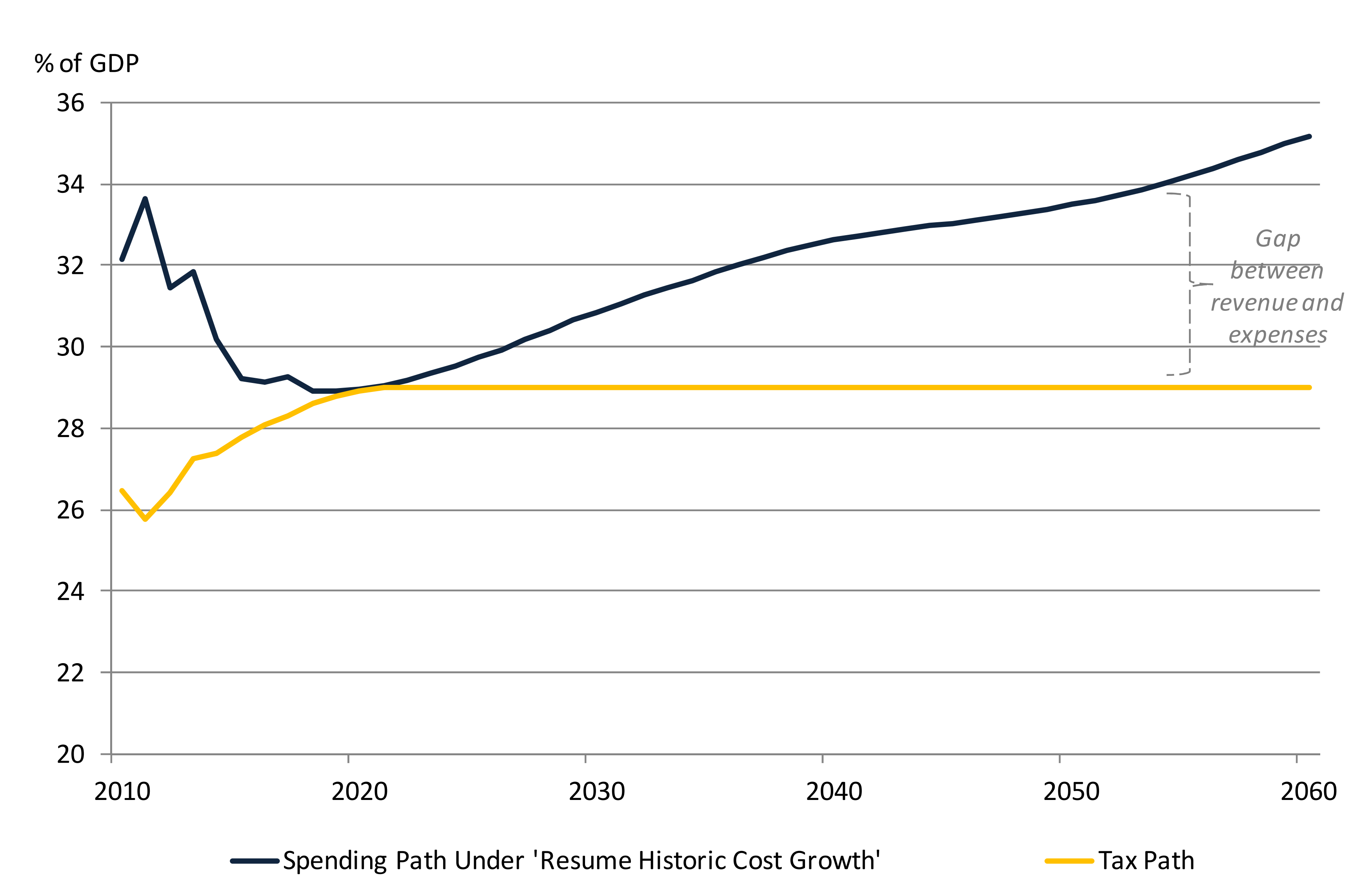
These assumptions produce a “what if” scenario

- NZ Super: 4.4% of GDP in 2010 to 8% of GDP in 2060.
- Public health care: 6.9% of GDP to 11.1% of GDP
- Everything else: largely stays the same or declines

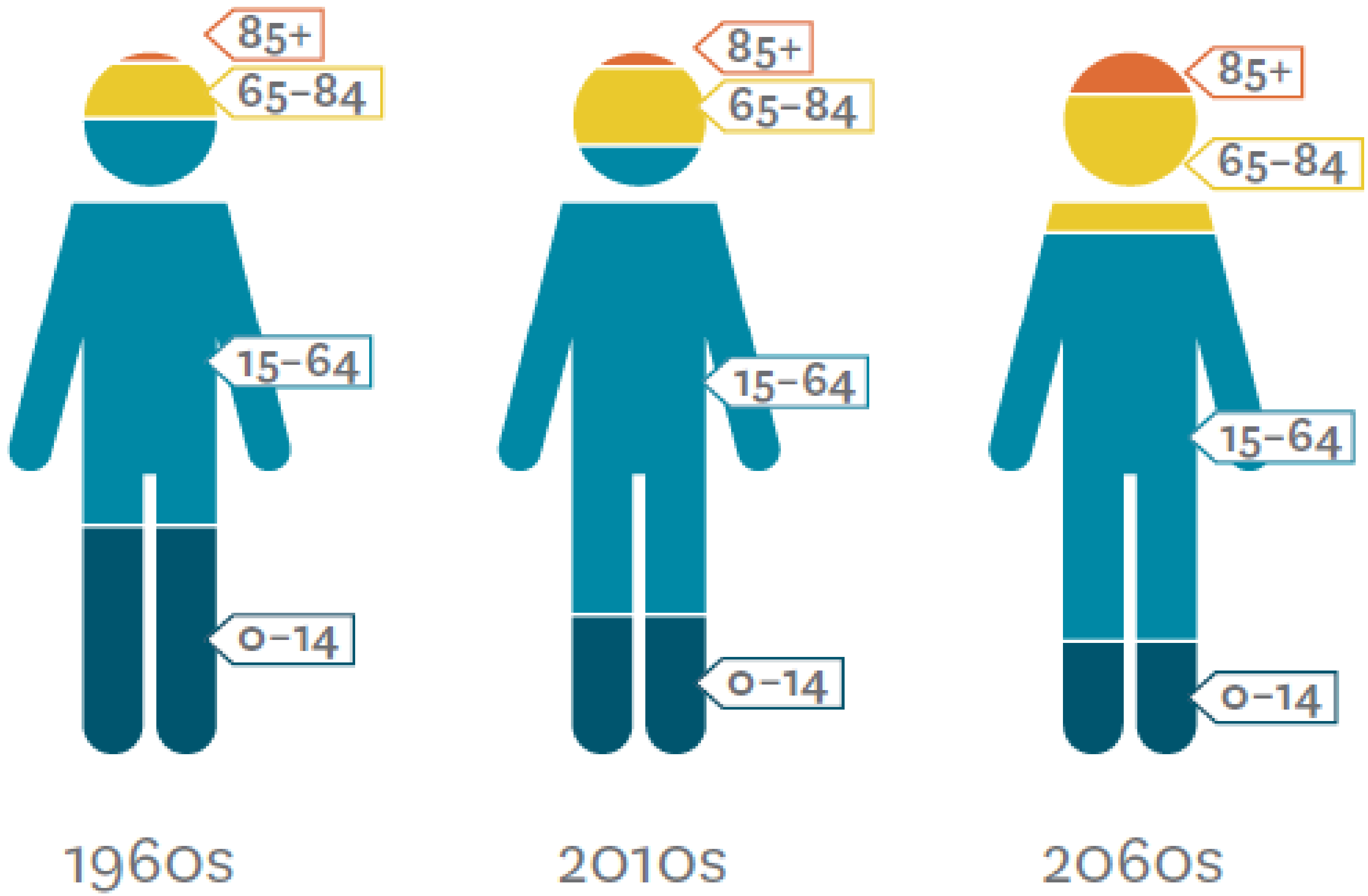
Overall

- We project total government spending to be around 36% of GDP in 2060, not including interest payments on debt.
- If we continue to collect the same amount of tax as we have in the past, our revenue will be around 33% of GDP.
- Result: a gap.

Growing gap between revenue and expenses



Drivers for NZ Super pressures



A startling statistic

- Between February 2012 and February 2013, the number of people receiving NZ Super payments grew by over 27,000, which is close to five times the rate of growth of a decade previously.

Drivers for health spending pressures

- Combination of us getting richer, plus technology change, plus (somewhat) population ageing

Another startling statistic

- Since 1950, New Zealand's real per capita GDP has increased by 144%. In contrast, real per capita government spending on health has increased by 412%

Is there a way to reduce these pressures?

- Higher productivity growth?
- A higher birth rate?
- More skilled migrants?
- More people participating in the paid workforce?

None of these are likely to be significant enough to make a difference.

How big is the issue we face?

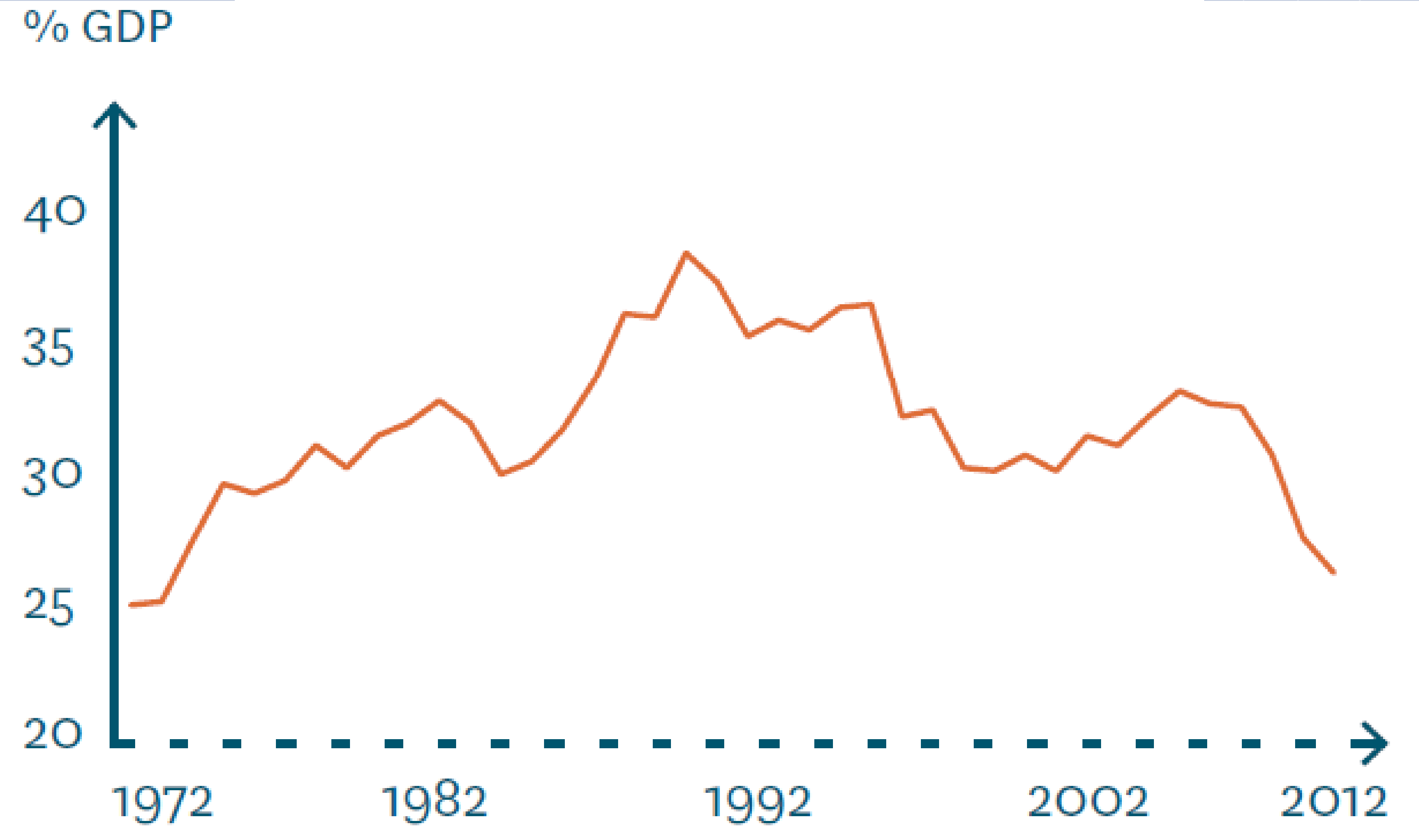
- It could be worse.
- The “what if” scenario we project is not really an option, so we need to make some changes relative to that.
- The earlier we start, the easier it is.

So what could we do?

- Ignore the problem and borrow
- Collect more tax
- Curtail spending growth in health and NZ Super
- Cut spending in other areas – justice, education, welfare, etc.

Should we collect more tax?

Ratio of tax to GDP in history



Options

- Raise rates of an existing tax: personal, corporate, GST
- Let fiscal drag run
- Broaden the capital taxation rules
- Introduce a new tax, eg a land tax

Drawbacks

- But taxes tend to damage economic growth
- And distributional implications
- And sometimes people change their behaviour in response to tax changes

Should we curtail health spending growth?

- Get better at delivering services for less money
- Accept a bigger role for the private sector
- But: would tend to hit lower-income people harder

Should we curtail NZ Super growth?

- Raise age
- Change amount of payments
- Means-test
- Contribute more to the Super Fund
- Switch to compulsory private savings

Could we cut spending elsewhere?

- Probably, but quite hard to think of easy options
- Unlikely that we could do it without trade-offs

To sum up

- We face fiscal challenges
- But they're manageable
- Most options involve trade-offs
- We need to decide what we value most as a society