Step 1: Define the problem

With population ageing and other cost pressures likely to push up future demands on government resources, how can we pay for them through time?
Beveridge late 1940s
NZ retirement income debate
Public Finance Act 1989
Fiscal Responsibility Act 1994
Public Finance Act, 2004 & 2013 amendments

Step 1: Define the problem

Treasury’s projections do not include the long-term consequences of the Government’s fiscal strategy (May 2013 FSR)
Rather, they use a “Resume Historic Cost Growth” scenario from the 2015/16 fiscal year (first full fiscal year of new parliamentary term)
Point is to show how expense and revenue categories might grow in the future, using the past as a guide

Bardach’s policy-analysis process

Step 1: Define the problem
Step 2: Assemble some evidence
Step 3: Construct the alternatives
Step 4: Select the criteria
Step 5: Project the outcomes
Step 6: Confront the tradeoffs
Step 7: Decide!
Step 8: Tell your story

PFA requires two longer-term reports:
Fiscal Strategy Report, effects of current decisions to 2020s
Constant fiscal policy. Finance Minister owns FSR
Long-Term Fiscal Statement, effects of current decisions to mid-century
Requirements, loosely specified; projections to capture population change effects. Treasury owns LTFS.

2013 Statement, “Affording Our Future,” used a more experimental process, seeking diverse external perspectives
Used an external panel to test our ideas, approaches, in papers written both inside the Treasury and by outsiders
Held a competition for senior secondary students
Involved university students in a similar process (McGuinness Institute).
Released material to the public once it had been discussed by the panel
Step 1: Define the problem

- Incorporated ideas from the Living Standards Framework to examine tradeoffs between policy options
- Held a conference to expose people to the challenges, ideas and tradeoffs
- Used a telephone survey to find out how the public saw the various tradeoffs behind this work
- Devised a webtool to expose users to the tradeoffs involved to achieve constant debt to GDP
- Had a number of ways of keeping the messages of the Statement in the public eye

Step 2: Assemble some evidence

Pressures are accelerating:

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

Step 2: Assemble some evidence

Effect of removing the 1946-1965 baby boom on dependency ratios

- Ratio to population 15-64

Step 2: Assemble some evidence

Acknowledge huge uncertainty in looking long term

Some misses:

- 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.

1960—50: Kennedy (a two-term president), no internet, no smart phones, no statins, no social movements (-isms)

Now—60: ??Nanotechnology, progress on diabetes, on alzheimer’s, shape of the family, mining of asteriods, new energy/protein sources, bio-IT, beam me up, Scottie??

Step 2: Assemble some evidence

Projected total population probability distribution (millions)

- Typical assumptions (“current policy”):
  - Demographic changes (e.g., population ageing)
  - No change to current legislative settings (e.g., welfare, superannuation)
  - A range of economic variables (e.g., productivity growth)
  - Drivers of government expenses (based on historic growth rates)
  - Tax revenue: Some rise in tax-to-GDP ratio to early 2020s and then hold at 29% (historic average)
  - We start projections from the 2015/16 fiscal year, ie the new Parliament.
Step 2: Assemble some evidence

Resume Historic Cost Growth Scenario (% of GDP)

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<th></th>
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<th>2040</th>
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<td>Revenue less expenses excl interest</td>
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Step 3: Construct the alternatives

Potential solutions or policy options:
- Let present trends continue (and pay the interest bill)
- Higher growth
- More working people
- Higher taxes
- Reduce super
- Reduce health
- Reduce everything other than super and health

Step 4: Select the criteria

Deals primarily with value judgements
Applied a version of Living Standards Framework to policy alternatives (five criteria – the pentagon)
- Sustainability – fiscal, policy consensus, environmental
- Growth – income growth gives choices (some leakage)
- Equity – distribution of income, across generations
- Managing risks – longevity, macroeconomic
- Social infrastructure – preserving social capital (trust), institutions (rule of law, participation in society)

Found these often difficult to apply, but potentially broaden scope of analysis, force examination of tradeoffs
Step 5: Project the outcomes

A review of options in the eight Treasury policy papers pulled out some themes

Supply-side efficiencies:
- Consolidating networks
- Changing use of the workforce
- Making greater use of technology

Demand-side management:
- Targeting of state assistance
- Changing the balance of public-private contributions
- Reducing demand through earlier intervention

Clear policy levers not always identified (eg, contrast between Super and Health or Law and order)

Other messages:
- Suggestions not fully fleshed out
- Current tight fiscal discipline is a building block for the long term
- Current fiscal strategy does not fully address projected pressures in the 2020s and beyond
- Some actions make sense regardless of the long-term outlook
- Evidence suggests relying on supply-side measures alone may not be sufficient
- Don’t overlook the positive side of the story

Step 6: Confront the trade-offs

Tax option: Real fiscal drag
- Sustainability: Closes half the gap
- Growth: Could knock back growth

Super option: Increase age by six months a year from 2019/20
- Sustainability: Closes gap by under 1%age point of GDP
- Equity: Would affect some people, who couldn’t find work, little saved – welfare support?
- Growth: Hard to say, possibly positive (work and saving incentives)

Step 7: Decide!

Voting asymmetry
Self-interest v altruism
Starting sooner v later

Advantages of waiting, disadvantages Is this LT planning accurate enough to be useful?

Step 8: Tell your story

Summary:
- There is no immediate crisis
- Revert to historic spending and revenue patterns and after return to surplus in 2014/15, then expenses will outstrip revenue in the 2020s, leading to persistent deficits
- As a result, need to make policy adjustments, either to spending or to revenue, or mix of both

The sooner we start giving serious consideration to how those policy adjustments will be designed and implemented, the better
- That is because making early, incremental and less socially-disruptive policy responses will diminish the risk of needing to make sharper, more disruptive and potentially less equitable adjustments later on
- Everyone should take an interest in debating this: Can you think of new, creative solutions to the problem? Can your students?
Step 8: Tell your story

Reactions:
- Happy with media response
- Positive report from the Auditor-General, with some recommendations for next time
- Students have had a crack at solutions
- NZIER and OAG have looked at NZ’s fiscal sustainability
- Follow-up engagement, eg, journal articles, speaking opportunities

Some references