NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

Submission of the
New Zealand Council of Trade Unions
Te Kauae Kaimahi

to the

Finance and Expenditure Committee

on the

Public Finance (Fiscal Responsibility) Amendment Bill

P O Box 6645
Wellington
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1. Introduction

1.1. This submission is made on behalf of the 36 unions affiliated to the New Zealand Council of Trade Unions Te Kauae Kaimahi (CTU). With 350,000 members, the CTU is the one of the largest democratic organisations in New Zealand.

1.2. The CTU acknowledges Te Tiriti o Waitangi as the founding document of Aotearoa New Zealand and formally acknowledges this through Te Rūnanga o Ngā Kaimahi Māori o Aotearoa (Te Rūnanga) the Māori arm of Te Kauae Kaimahi (CTU) which represents approximately 60,000 Māori workers.

1.3. While agreeing that government finances including debt levels should be managed prudently, which in general terms is the objective of the Fiscal Responsibility part of the Public Finance Act ("the Act"), the CTU is also concerned that:

1.3.1. Firstly, governments as elected representatives of the people of New Zealand must have freedom to change policies in the ways they have committed to in elections, as circumstances require between elections, and as lessons are learned about the effects of past policies; and

1.3.2. Secondly, the purpose and impacts of government finances and fiscal policies should not be judged solely by their prudence and contributions to stability of tax rates as set out in the Act. The purpose of government is much wider, including economic, social and environmental objectives.

2. Principles

2.1. The freedom to change policies is fundamental to a working democracy. Electing new governments that are locked by legislation into ways of working that the electorate does not want undermines the reality of democracy and the confidence of people in it. Embedding in law principles which are controversial or are in fact tactical policies rather than generally accepted and lasting principles will not change behaviour, and if it does may lead to poor or even disastrous outcomes.

2.2. The world outside New Zealand has learned much from the events of the Global Financial Crisis (GFC), just as it did from the last major economic crisis, the Great Depression of the 1930s. The role of government and the use and management of government finances is a central aspect of the lessons of the GFC. Unlike the neoliberal philosophy dominant when the principles of the Fiscal Responsibility Act (now part of the Public Finance Act) were embedded in legislation, most economists and policy makers now recognise that the role of government and its ability to raise taxes, borrow and (through a publicly owned central bank) create money is critical for the survival of a capitalist economy. Whether governments around the world took action in the best way will of course be debated for many years to come, but the crucial role of government action is accepted by all but an extremist minority.

2.3. Only the flexibility of the Act, not its principles, allowed the New Zealand government to expand its spending, run large deficits and rapidly increase its debt in the way that was necessary to respond to the GFC and later the devastating earthquakes in Canterbury. In this sense the “success” of the Act can be seen as that it allowed a government to ignore it when necessary. It has been argued that it led to falling public debt levels prior to the crisis, and thus led to a position where New Zealand was much better able to cope with the crisis than many other countries. However that is more likely to be due to the fact that there was a cross-party consensus on the need for low government debt levels. Otherwise a government could and would have changed the Act to suit its views. The National Party, which passed the original Fiscal Responsibility Act, clearly had that view at that time (though previous National governments did not). The Labour Party has historically held that view, arising from experience with international creditors in the 1930s and 1940s.

2.4. So concerns we have about the proposals in this Bill are significantly mitigated by the non-mandatory nature of them.

2.5. Inevitably, policies are compromises between competing objectives such as those laid out in 1.3.2. That is not only a reflection of the political process, but of reality in policy making. Virtually all fiscal and financial policies a government can choose from have side-effects, or impacts on other aspects of our society and environment.

2.6. Treasury has recognised this through its 5-dimensional Living Standards Framework[1], and it deserves congratulations on developing this approach. It recognises that policies have multidimensional impacts and need to be assessed on multiple dimensions. The dimensions of the Treasury framework are Economic Growth, Sustainability for the Future, Increasing Equity, Social Infrastructure, and Reducing Risks. While we would probably choose a somewhat different set and description of dimensions, the principle of multidimensionality is sound. Below, we use the Framework to illustrate the need for multidimensional thinking, rather than necessarily endorsing it in all its detail.

2.7. The existing and proposed principles and fiscal rules show no recognition of their multidimensional impacts. Similarly, Treasury's Regulatory Impact Statement fails to analyse the changes in terms of its own Living Standards Framework.

3. Specifics

3.1. As described above, the "fiscal rules" used to implement "fiscal responsibility" could undermine trust in democracy (part of Social Infrastructure in the Living Standards Framework) unless they are flexible enough to be put aside. If that is the case, their effectiveness is questionable unless future electors and governments believe in the principles independently of the Act – but then it is not the Act that is having effect but their beliefs.

3.2. "Fairness" is included in the proposed s.26G(1)(e) "formulating revenue strategy with regard to efficiency and fairness, including the predictability and

[1] See for example http://www.treasury.govt.nz/abouttreasury/higherlivingstandards.

stability of tax rates", but other aspects of the Living Standards Framework other than Economic Growth are not addressed. For example, taxes such as resource or consumption taxes (or the absence of them) can have impacts on environmental and social sustainability, or on the physical investment needed for physical infrastructure.

3.3. We also note that "efficiency" is not as objective a measure as it may appear. For example, Treasury cost benefit calculation rules[2] load the public sector costings with "deadweight losses" for which there is rarely any method to estimate reliably (if indeed they exist), and require a 10% or private sector discount rates which are much higher than rates reflecting the low rate at which the government can finance its investments. These bias the apparent public sector efficiency to appear lower, encouraging sourcing and provision to be taken away from the public sector.

3.4. The proposed s.26G(1)(f), "formulating fiscal strategy with regard to its interaction with monetary policy", is neutral enough to have little effect. However if its intent is to subordinate fiscal policy to monetary policy, that could significantly limit a government's social and economic options, if the policies followed by the Reserve Bank were in conflict with the government of the day. For example, a government wishing to raise wage rates by various mechanisms could find its wishes neutered or undermined by a Reserve Bank which considers such efforts inflationary.

3.5. The proposed s.26G(1)(g), "formulating fiscal strategy with regard to its likely impact on present and future generations", is sensible as long as "impact" includes a full range of considerations, whether economic, social, environmental or otherwise.

3.6. However we do note the difficulties of assessing the likely impact on future generations. Extrapolation of current policies gives an unrealistic picture of "impact", as future governments are almost certain to change them over a longer time period. It can be used for scare-mongering by unscrupulous or dim-witted parties. Irregular but highly significant events such as economic

[2] See "Cost Benefit Analysis Primer", New Zealand Treasury, Version 1.12, December 2005, p.20, 27.

crises, significant technological changes and earthquakes are difficult to take into account.

3.7. The proposed s.26G(1)(h), “ensuring that the Crown's resources are managed effectively and efficiently”, should also be concerned about whether they are managed in a way that is consistent with the Living Standards Framework. For example, assets such as schools, hospitals, parks, and SOEs have potential to impact most of the Living Standards Framework’s dimensions. Judging whether they are managed “effectively and efficiently” requires explicit analysis being made along the Living Standards Framework dimensions.

3.8. We **recommend** that if these proposals are proceeded with the considerations should explicitly take into account a multidimensional approach along the lines of (but not necessarily identical to) the Living Standards Framework.

3.9. The Fiscal Strategy Report should also report on these or similar dimensions.

3.10. Finally, the Investment Statement (new s.26NA) focuses solely on the value (we must assume the financial value) of the Crown’s assets and omits all mention of aspects such as social value and social returns. The same can be said of environmental value, and other aspects of the Living Standards Framework. Yet most of the government’s physical assets are held primarily for non-financial purposes such as education, health, research, economic development, enhancing the efficiency of the rest of the economy, conservation or recreation.

3.11. To ignore those aspects and focus on financial values reduces these assets to financial ones, and thus makes it easier to justify them being sold on the basis solely of financial considerations. That is misleading and unbalanced.

3.12. We **recommend** that any report on the Crown’s assets should be balanced by including reporting on the way they are achieving their purposes, which are not solely financial.

4. Conclusions

4.1. Fiscal rules are dangerous if too rigid, but seem pointless if they have sensible flexibility. They will only be successful if they are part of a consensus on their objectives – in which case they are not needed.

4.2. We consider that these proposals are at the flexible end of the spectrum so may be more of window dressing than a useful regulatory exercise. However the very act of reporting the measures which are subject to rules draws attention to them and away from other potential indicators which possibly could be more important indicators of sound government. Indeed, the effect of their publication appears to be the main way Treasury sees them working.

4.3. If these proposals are proceeded with, all the rules proposed including reports on them and the proposed Investment Statement should be explicitly subject to assessment under much more balanced and multidimensional criteria along the lines of, but not necessarily identical to, Treasury's Living Standards Framework.