

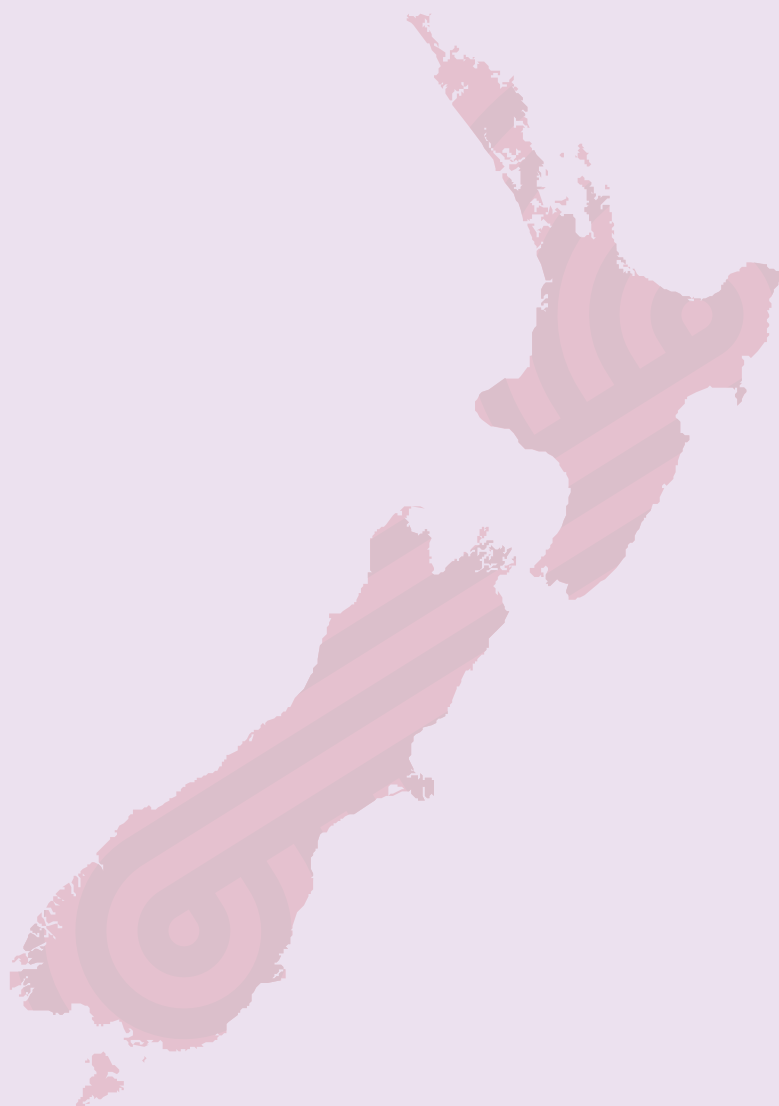
March 2024

Investing in a growing population



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Executive summary



The coalition Government has emphasised its commitment to “fiscal responsibility”. As part of these claims, it is cutting public investment by \$2.4 billion over the next four years to fund tax cuts, even though we face mounting deficits in Aotearoa New Zealand’s public infrastructure and services.

It is well-documented that these deficits have been caused by decades of underinvestment. Our public infrastructure and services have failed to keep up with a growing population and growing service needs.

New Zealand has recently been experiencing record levels of population growth – far faster than forecast. Over the past decade, Treasury has frequently underestimated our actual population growth.

This report examines the possible real terms gap in public investment. This could occur over the next four years, if population continues to grow faster than forecast by Treasury, and government investment does not adjust.

We can calculate this figure by measuring the real per capita level of investment that the Government would need to make to maintain the per capita track set out in HYEPU 2023.

If population grows at the same rate that it did from 2013–20 (1.96% per annum), then the total public investment gap will be \$10.1 billion, almost five times larger than the Government’s announced cuts.

If population continues to grow at the current rate of 2.8% per year, then the total public investment gap will be \$22.1 billion, more than 10 times larger than the Government’s announced cuts.

This would worsen New Zealand’s infrastructure deficit and put pressure on already stretched public services.

Migrants moving here are not to blame for any of this, and our economy is stronger because of immigration. Many of our essential public services would struggle to function if migrants did not come to New Zealand.

It is time we moved away from the narrow conception of fiscal responsibility, which over-emphasises low government debt and annual operating surpluses. Fiscal responsibility should also mean sufficient levels of investment in our public infrastructure and services, so that we can accommodate a growing population and support a high standard of living for all.

Context



The coalition Government has emphasised its commitment to “fiscal responsibility”. Its concept of fiscal responsibility focuses on reducing New Zealand’s – already very low – level of government debt and returning annual operating surpluses. These goals are being used to justify planned reductions in public investment.

The Government plans to cut \$2.4 billion in public investment over the next four years (or \$2.2 billion in 2023 dollars). These cuts are additional to those that were announced under the previous Government, as well as the expected reductions in spending on contractors and consultants. Together, this amounts to around \$6 billion in cuts across four years.

Yet, while the Government claims that this is fiscally responsible, these cuts are being made to fund unnecessary tax cuts. They also come at a time when New Zealand’s public infrastructure and many of our public services are already under immense pressure.

According to the Infrastructure Commission, we have accumulated a \$100 billion infrastructure gap and this is set to double over the next 30 years if we maintain current levels of investment.¹ We are now experiencing the consequences of this underinvestment in our failing water system, our overcapacity hospitals, and our broken railway system.

We have also underinvested in many of our critical public services, which struggle to maintain existing levels of service, often due to understaffing. Everyday examples of this can be found in our schools, our aged-care homes, and our environmental protection agencies, to name a few.

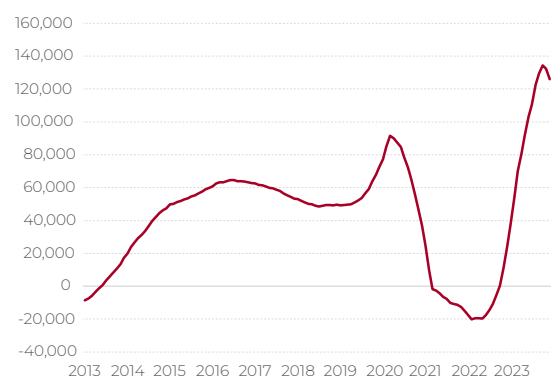
Demand for public infrastructure and services will continue to rise as New Zealand’s population increases. More people will mean greater demand for health services,

which in turn will require more hospitals, doctors, nurses, midwives, and support staff. It will mean greater demand for education, which will require more schools, together with more teachers. It will mean a higher volume of demand for everything from the provision of passports to the court system. If these services don’t grow in line with our population, then all New Zealanders will experience degraded public services, longer queues, and poorer outcomes.

Recently, our population has been growing very rapidly, largely because of high levels of immigration. Annual net immigration was estimated to be 126,000 people in the year to December 2023. From December 2022 to December 2023, it is estimated that New Zealand’s population grew by 2.8%.

This isn’t a new phenomenon. Migration-driven population growth was also very strong in the years preceding COVID-19. From 2013–20, the population grew at an average rate of 1.96% per annum – an extra 650,000 people. The period of essentially flat population growth during the pandemic was therefore unusual; the history of the past decade is largely one of rapid population growth coupled with significant and on-going underinvestment in public infrastructure and services.

Figure 1: Net annual immigration, 2013–23.

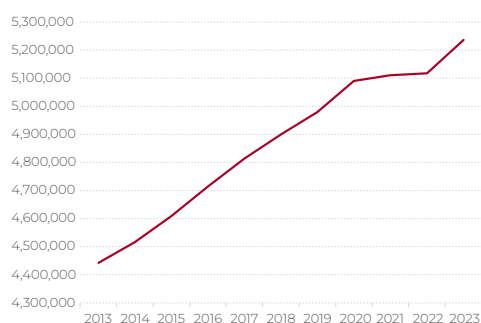


Source: Stats NZ.

¹ [Sense Partners](#), “New Zealand’s Infrastructure Challenge: Quantifying the Gap and Path to Close It”, Report for the Infrastructure Commission, 2021.



Figure 2: Estimated resident population, 2013–23 (June years).



Source: Stats NZ.

This systemic underinvestment is a consequence of both a lack of political will from successive governments and the Treasury’s fiscal management approach, which is a “fixed nominal baseline and allowance” system. Put simply, this means that the budget for government expenditure grows by a fixed amount each year (what is usually called “the allowance”). This is set ahead of the Budget each year. All new spending must be contained within this amount. There are no automatic adjustments to deal with inflation, cost adjustments, or population growth (outside of welfare and superannuation payments).

From a spending control perspective, this puts a tight leash on costs. But it also makes it very easy to underinvest in areas where spending might have to increase over time. For example, if we have a rising population, we will generally have a rising school roll. If we don’t put more money in to deal with that, it means we will be making real-terms cuts to investment in education as the same number of dollars has to spread over a larger number of children. This is also true of health and any number of other public services.

If population grows quickly (as it is right now), the fixed nominal baseline approach can have a perverse effect. The economy grows and Crown revenue rises as new wages and spending generate taxes. Holding expenditure constant will make the Treasury accounts look better, as that money can be used to reduce debt as a percentage of GDP and to improve the operating balance. But that benefit is time-limited, as expenditures will eventually need to rise to cope with the needs of the rising population.

Population growth scenarios



Every year, the Treasury forecasts future population change. This is a core part of its overall economic forecasts, which are used to inform the Government's budgeting decisions. The Treasury's latest forecast, released in its Half-Year Economic and Fiscal Update (HYEFU) in December 2023, has the population increasing 2.2% in the year to June 2024, with the rate of change slowing thereafter, coming down to 1.2% in the year to June 2028 (see Table 1 in the Appendix). Over the forecast period of June 2024 to June 2028, this would see the population grow by 5.4%, or 289,000 people.

In this scenario, during the first year of the forecast period the Government will need to ensure that our public infrastructure and services can meet the extra demand that comes with an additional 85,600 people. Across the entire forecast period, the population growth experienced in the first year alone will require the provision of an extra 342,500 'yearly units of demand' for public infrastructure and services ('yearly units of demand' is the term we use to describe the basket of public infrastructure and services that each New Zealand resident uses each year).

When we account for the extra people that will be living in New Zealand over the forecast period, according to Treasury, the Government will need to ensure that our public infrastructure and services can meet approximately 754,000 more yearly units of demand.

Yet despite this significant forecast increase in population, the Government is set upon cutting public investment to fund its tax cuts. As discussed above, the Government is planning on an extra \$2.4 billion in cuts to public investment over the next four years (or \$2.2 billion in 2023 dollars).

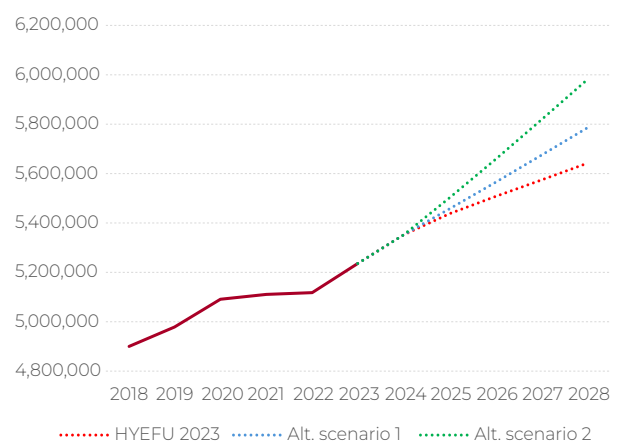
In itself, this is concerning, given the pressure that New Zealand's public infrastructure and services are already under. The Government is asking an already stressed system to do more with less.

But if the population grows faster than the Treasury has forecast, then the public investment gap will be even larger. This is indeed quite likely, given the pattern of the previous decade and the Treasury's tendency to underestimate actual population growth in its forecasts.

Therefore, a fiscally responsible government should consider the Treasury's forecasts as a lower-range estimate and would be wise to prepare for potentially much higher population growth.

To get a sense of what the potential fiscal costs of faster-than-forecast population growth would be, we have looked at two other population growth scenarios that we consider possible.

Figure 3: Three population growth scenarios, 2024–28.



Source: Stats NZ; Treasury.

Alternative scenario 1: Population grows at the same rate as 2013–20

In the first alternative scenario, we assume that New Zealand's population increases at the same rate that it did in the pre-COVID period, when it averaged 1.96% per year. Across the pre-COVID period New Zealand's population consistently grew faster than anticipated by Treasury at economic updates.

If New Zealand was to experience this rate of growth over the years 2024–28, our population would increase 8.1%, or 432,000 people.



Compared to the Treasury's HYEFU forecast, this would see an additional 143,000 people living in New Zealand by June 2028. When measured cumulatively, this would equate to a further 316,000 yearly units of demand for public infrastructure and services across the forecast period (on top of the HYEFU forecast).

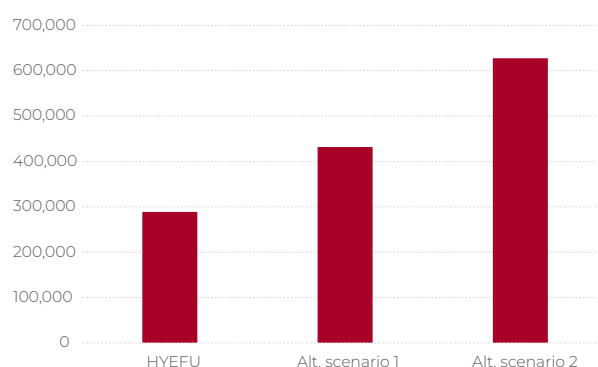
Alternative scenario 2: Population continues to grow at its current rate

In the second alternative scenario, we assume that New Zealand's population continues to increase at the current rate of 2.8% per year (the estimated growth rate from December 2022 to December 2023). We consider this a high-end estimate of potential population change.

In this scenario, New Zealand's population would grow 11.7%, or 627,000 people, from 2024 to 2028. Compared to the Treasury's forecast, this would see a further 338,000 people living in New Zealand by June 2028. When measured cumulatively, this would equate to an additional 793,000 yearly units of demand for public infrastructure and services across the forecast period (on top of the HYEFU forecast).

Judging by the pre-COVID experience of higher-than-forecast population growth, and the current rapid level of growth, it is reasonable to expect that actual population growth over the next four years will be somewhere between the Treasury's HYEFU estimate and the upper-bound estimate of alternative scenario 2.

Figure 4: Total population growth under the three scenarios, June 2024 – June 2028.



Source: Stats NZ; Treasury.

The fiscal impact of higher-than-expected population growth



In both alternative population-growth scenarios, demand for public infrastructure and services will rise significantly more than it will under the Treasury’s forecast. The implications of this in terms of real government investment per head of population are significant.

Under alternative scenario 1, the size of the public investment gap would be \$7.95 billion. Adding in the Government cuts lifts this to \$10.1 billion, almost five times larger. Under alternative scenario 2, the public investment gap would be \$19.9 billion, or \$22.1 billion with cuts—more than 10 times larger.

We can calculate this figure by measuring the real per capita level of investment that the Government would need to make to maintain the per capita track set out in HYEFU.

Across the past thirty years, real investment per capita has grown 1.37% every year, on average. Real growth reflects the fact that the public sector tends to grow as the economy grows. If we strip away the COVID-19 period, and simply count the period 1994–2019, then real investment increased an average of 1.16% per year.

Any change from this would represent a real period of change for the public service. The 2023 HYEFU already sets out an essentially flat real-terms period for investment on a per capita basis. This is below the values that we would expect if spending were to increase with the historical trend. Across the four-year forecast period, this represents a cumulative fall in investment of \$18 billion.

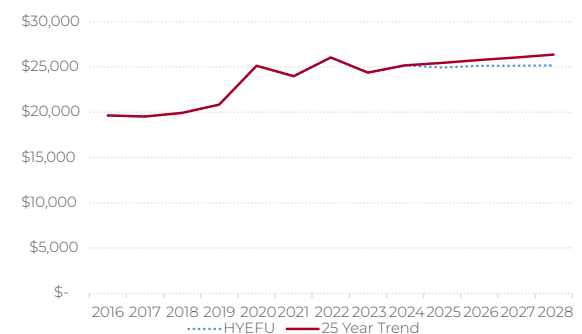
The HYEFU was written before the new Government’s cuts programme was announced. If these cuts are made, government investment will be consistently lower than the HYEFU projections, by a further \$2.4 billion (or \$2.2 billion in 2023 dollars).

If the population grows at the same rate that it did in the pre-COVID years (alternative

scenario 1), then real per capita investment will fall an additional \$7.95 billion dollars over the forecast period. If the population grows at the current rate of 2.8% per annum (alternative scenario 2), then real per capita investment will fall an additional \$19.9 billion over the forecast period – which is more than the total programmed investment in primary education over the forecast period. These are the “hidden cuts” that will occur if the population grows faster than forecast.

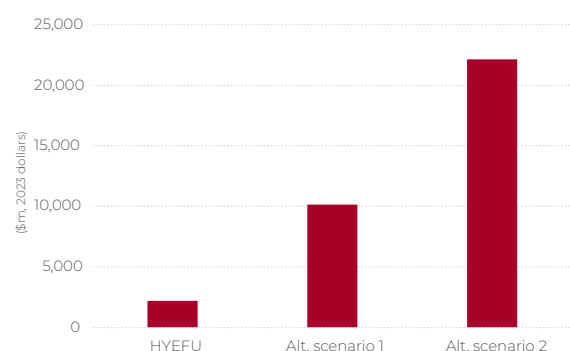
Figure 6 shows the total reduction in real per capita investment under the three different population growth scenarios, incorporating the Government’s planned \$2.2 billion in cuts over the next four years.

Figure 5: Real investment per capita – 25-year trend and HYEFU 2023 forecast.



Source: Stats NZ; Treasury.

Figure 6: Total shortfall in public investment by June 2028 (\$m).



Source: Stats NZ; Treasury. Note: 2023 dollars, HYEFU 2023 inflation forecast.

A new approach is needed



Our public services are already under pressure, and this pressure will intensify if funding fails to keep up with population growth over the coming years.

Indeed, increased demand will come not just from population growth, but also from increased intensity of need in some areas. For example, even if New Zealand's population remains stable in the future, our ageing population will increase the demand for health services and care facilities. According to the Ministry of Health, people aged over 65 currently use over 42% of health services even though they make up just 16% of the population.²

A fiscally responsible government would not only seek to manage its expenditures to deliver strong accounts. It would also ensure that public investment is sufficient to maintain our vital infrastructure and public services as our population grows. Yet the coalition Government has embarked on exactly the opposite, a programme of tax cuts funded by slashing public investment.

Let's be clear: New Zealand's growing population is a good thing. A growing

population can support economic development, and migrants help to fill essential skills gaps and make New Zealand a more prosperous and culturally rich country.

But a growing population also requires higher levels of investment in the things we all use and rely upon: our hospitals, our schools, our water infrastructure, our roads, and our public transport – the very fabric of the country.

We can't continue to simply accept the benefits of population growth without paying for it. It is time that we reconsidered the true meaning of "fiscal responsibility". We must recognise that we are taking the value of the work produced by this increased population. We must therefore provide them with the assets they need to thrive.

This evidence suggests that the Government should rethink its policy of cuts to public investment. A growing population, together with growing needs should mean more investment not less. The alternative is to stop migration occurring at current levels, with the impact that this would have on the wider economy and the loss of access to the skills and capital migrants bring.

² *Ministry of Health*, "DHB spending on services for older people".

Appendix



Table 1: Population growth scenarios.

June years	HYEFU 2023 per capita expenditure	HYEFU 2023			Alternative scenario 1				Alternative scenario 2			
		Population growth rate	Population	Core Crown expenditure (\$m)	Population growth rate	Population	Modelled Core Crown expenditure (\$m)	Difference to HYEFU (\$m)	Population growth rate	Population	Modelled Core Crown expenditure (\$m)	Difference to HYEFU (\$m)
2023	\$24,363	2.3%	5,236,300	127,574	2.3%	5,236,300	127,574		2.3%	5,236,300	127,574	
2024	\$25,182	2.2%	5,351,499	134,761	2.2%	5,351,499	134,761		2.2%	5,351,499	134,761	
2025	\$24,949	1.6%	5,437,123	135,649	1.96%	5,456,388	136,130	481	2.81%	5,501,876	137,265	1,616
2026	\$25,151	1.3%	5,507,805	138,525	1.96%	5,563,333	139,921	1,397	2.81%	5,656,478	142,264	3,739
2027	\$25,153	1.2%	5,573,899	140,202	1.96%	5,672,375	142,679	2,477	2.81%	5,815,425	146,277	6,075
2028	\$25,192	1.2%	5,640,786	142,101	1.96%	5,783,553	145,697	3,597	2.81%	5,978,839	150,617	8,516
2025–2028 Total				556,476			564,427	7,951			576,422	19,946

Source: Stats NZ; Treasury, NZCTU analysis.

Note: Alternative scenario 1 uses the average annual population growth rate from 2013–20 (June years); alternative scenario 2 uses the current annual population growth rate from December 2022 to December 2023. 2023 dollars, using the CPI forecast in HYEFU 2023.

nZCTU

Te Kauae Kaimahi

