



2017 Budget Policy Statement Finance and Expenditure Committee

The Salvation Army New Zealand Fiji and Tonga Territory Submission

BACKGROUND

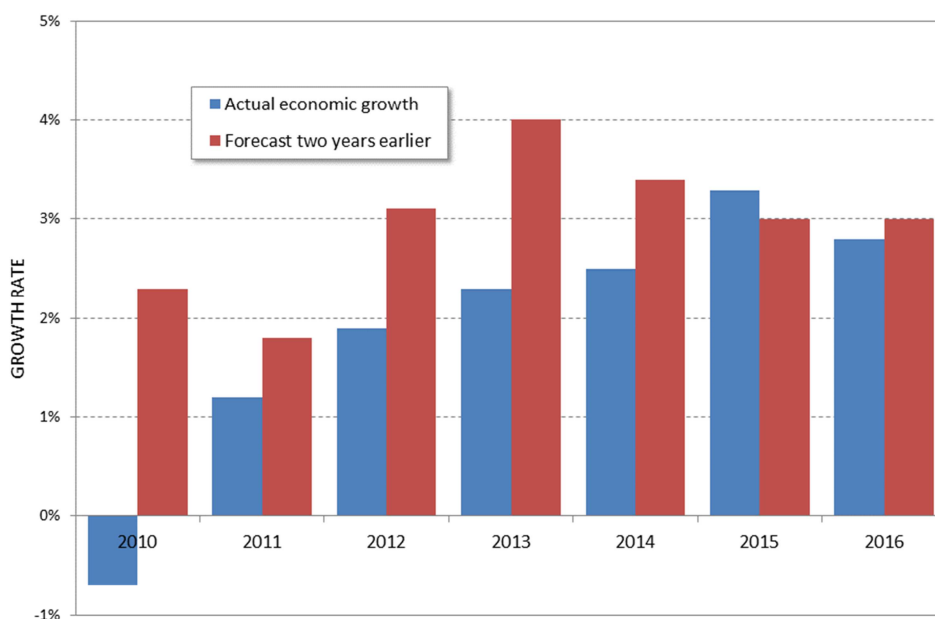
1. The Salvation Army is an international Christian and social services organisation that has worked in New Zealand for over one hundred and thirty years. The Army provides a wide-range of practical social, community and faith-based services, particularly for those who are suffering, facing injustice or those who have been forgotten and marginalised by mainstream society.
2. For much of its history in New Zealand the Army has, as a civil society organisation, taken an active interest in the affairs of Government. This interest has been and is still is driven by a desire to see the State play an active role in building a New Zealand which is prosperous, fair and peaceful. Our interest in making a submission to the 2017 Budget Policy Statement is driven by this desire.
3. This submission has been prepared by the Social Policy and Parliamentary Unit of The Salvation Army. This Unit works towards the eradication of poverty by encouraging policies and practices that strengthen the social framework of New Zealand.
4. This submission has been approved by Colonel Willis Howe Chief Secretary of The Salvation Army's New Zealand, Fiji and Tonga Territory.

THE SALVATION ARMY'S PERSPECTIVE ON THE STATEMENT

5. The Salvation Army generally supports the strategy outlined in the 2017 Budget Policy Statement. As we understand this strategy it is based on the Government's finances being managed responsibly and perhaps even moderately conservatively to ensure that public debt remains within prudent limits and that Government's share of the economy remains within boundaries which have been broadly accepted by New Zealanders. The 2017 Budget Policy Statement appears to do this and for this reason we support it in general.
6. Our concerns with the Statement relate in part with the reliability of the underlying assumptions and in part on the expectations which are being set as a result of these assumptions. In line with this concern around expectations, the Army is interested in how this Statement and the forthcoming 2017 Budget address the challenges raised in the recently released Statement of the Long-Term Fiscal Position – *He Tirohanga Mokopuna*.

THE ASSUMPTION OF STRONG ECONOMIC GROWTH

7. The 2017 Budget Policy Statement presents quite a rosy picture of our fiscal future. After six years of sometimes quite daunting operating deficits, the Government's accounts have returned to a relatively moderate surplus during the current financial year and from here on these surpluses are forecast to grow handsomely to \$8.5 billion by 2020/21. Some of these surpluses will be used pay down debt, some will be used for capital investment and around \$1 billion will be used to assist with the rebuilds associated with the Kaikōura earthquake. The Salvation Army accepts these proposals as being reasonable and responsible.
8. The revised budget estimates offered in the 2017 Budget Policy Statement are predicated on stronger economic growth than was anticipated by Treasury at the time of the 2016 Budget. For example Table 1 of the Statement reports that cumulative GDP growth from 2016 to 2020 was forecast at 11.6% in the 2016 Budget. The revised forecasts offered in the 2017 Statement suggest cumulative growth of 12.4% over this period. These differences are not material when we consider the accuracy of forecasts although they do, in our opinion, create a sense that things are going well and that the challenges we face around public debt and the cost and quality of public services are not that serious.
9. However Treasury has generally tended to be over-optimistic in its past growth forecasts. This is illustrated in the following graph which compares for the past seven years, Treasury's GDP growth forecasts two years out with the actual growth figure achieved. For example in the 2009 Budget, Treasury forecast economic growth in 2011 to be 1.8% yet the actual growth achieved in that year was 1.2%. It is of course always fine to be wise in hindsight but there is a consistently optimistic bias apparent in these comparisons. In all but one year Treasury's forecast has been higher than the actual growth rate achieved. In addition, and once again with the wisdom of hindsight, Treasury completely missed forecasting the GFC which accounts for the wide discrepancy in the 2010 figures.



10. The Budget and Fiscal Updates which are provided at the time of the Budget contain different economic and fiscal scenarios and these are useful in both testing the sensitivity of the assumptions behind the Budget's settings and in informing the public of the possible impacts of a reversal of fortunes such as occurred in the GFC. In addition, by their nature shocks such as those which brought about the GFC are unpredictable so it is not really reasonable to expect future sudden events, such as a trade war between China and United States, to be built into budget forecasts.
11. While The Salvation Army does not have a crystal ball or any expertise in economic modeling, it seems to us that the assumptions behind the 2017 Budget Policy Statement are a little too optimistic. This view is not a reason to change these assumptions but we believe that the Committee and the general public should be aware of this possible optimistic bias and form expectations around future fiscal settings in light of this.

REVENUE SETTINGS

12. The 2017 Budget Policy Statement says nothing about tax and other revenue forecasts but instead forecasts the OBEGAL as well as providing some indication of fiscal policy settings. A greater disclosure of the underlying tax assumptions would have been useful. However given the only small changes expected in the OBEGAL as signaled in Table 3, it seems likely that the tax and revenue assumptions offered in the 2016 Budget still largely hold here.
13. Since the 2016 Budget the then Prime Minister and Minister of Finance have however hinted at tax cuts. It is The Salvation Army's view that the presentation of growing surpluses in the 2017 Budget Policy Statement further creates the scope in the public's mind for tax cuts in the near future. We believe that if tax cuts are still being contemplated by Government for the 2017 Budget then these should have been discussed as part of the Budget Policy Statement.
14. The Salvation Army does not at this stage support tax cuts given the longer term fiscal challenges we as country face. We prefer that continued efforts are instead made to retire public debt and to consolidate the funding and provision of public services.

PROVISIONS FOR ADDITIONAL GOVERNMENT SPENDING

15. In setting any budget there is a need to balance competing needs and ambitions and the exercise of Budget Policy Statements is the discussion and deciding of these balances. In doing this the 2017 Statement makes provision for new operating allowances of \$1.5 billion each year for the forecast period being considered. This provision in The Salvation Army's opinion is unrealistic. This view is based on three reasons.
16. Firstly, this provision of \$1.5 billion in extra spending each year through to 2020/21 needs in part to fund additional spending on New Zealand Superannuation. This additional cost is around \$600 million each year and is never talked about in Budget speeches or Budget Policy

Statements. In effect 40% of this provision for new spending is already earmarked for one purpose and that purpose to date is non-negotiable and is rarely even mentioned.

17. Secondly, this \$1.5 billion provision needs to cover cost pressures in Government spending so in some respects is not new spending at all. Such cost pressures should not be underestimated given the relatively buoyant economic conditions which underpin the Budget assumptions including annual wage growth of around 3%. This wage growth will feed into the public sector and so will put cost pressures on the labour intensive public services of health, education and law and order. While higher health costs associated with an aging population will not be a massive challenge over the short forecast period being considered here, this cost pressure is nevertheless within the health system and should in the interests of fairness and prudence be planned for. In addition expenditure areas such as new health technologies and some capital investments may become relatively more expensive and these will be a source of additional cost pressure for the public sector.
18. Finally, recent budget settings and the road back to surplus have in part been based on other deficits – social ones. These social deficits include persistent levels of child poverty as \$600 million per year has been stripped out of Working for Families budget, static education budgets as the long tail of student under-achievement remains and a growing shortage of affordable housing as the Accommodation Supplement budget remains unchanged and based on rents ten year ago. It is The Salvation Army’s opinion that these social deficits should be recognised and addressed as part of this budget setting process.

OUR LONG-TERM FISCAL POSITION

19. The recently released Statement of the Long-Term Fiscal Position – *He Tirohanga Mokopuna* makes for sober reading. We expect that Committee members are already familiar with this document and with the challenges it raises. The Salvation Army believes that these longer term challenges should begin to be addressed in the 2017 Budget Policy Statement. We acknowledge that to some extent this is the case with some of the settings – such as debt to GDP and tax to GDP ratios, being incorporated in the Statement’s forecasts.
20. However, in our opinion there is a degree of naivety expressed in *He Tirohanga Mokopuna* that ‘*improved effectiveness of social spending has potential to be substantial enough to support sustainable long-term public finances*’ (p.67). The longer-term challenges of the business as usual approach is made quite plain in Table 6.1 of *He Tirohanga Mokopuna*. Historic spending patterns alongside current expectations around tax to GDP ratios promise us that public debt will reach Greek proportions by 2060 and will have become unmanageable by 2030. The main reasons for this are the growing cost of health expenditures with an aging population and the current policy settings for New Zealand Superannuation.
21. In the same way there is a certain naivety underlying the 2017 Budget Policy Statement’s reference to the Better Public Services targets as being one source of our fiscal salvation. The

underlying idea here is that if we can make the delivery of our public services more efficient we can then afford to save money on them without any impact on service levels or service integrity.

22. The Salvation Army fully supports the idea of public service targets and of driving to improve the efficiency and effectiveness of public services. We have however previously criticised the way in which the current Better Public Services targets are being measured and manipulated. For example the recent apparently remarkable decline in child abuse/neglect rates is entirely due to Child Youth and Family changing the way it manages child abuse/neglect cases. In addition some targets have not been met – such as those around released prisoner re-offending and in response Government has proposed to spend a further \$1 billion to expand our prisons by a further 1800 beds.

23. The 2017 Budget Policy Statement does not address or even raise the big challenges around the long-term sustainability of Government’s finances and it is the view of The Salvation Army that it should

CONCLUSION

The Salvation Army supports the overall strategy behind the 2017 Budget Policy Statement. This appears to be one of a continuation of current tax and revenue policies, a focus on retiring debt and provision for capital spending and additional spending on public services. We do however believe that the provisions being made for this new spending are inadequate given current commitments to New Zealand Superannuation and likely cost pressures in the public sector. We ask that Committee members pay some attention to this question in their deliberations.

The Salvation Army would like an opportunity to present a verbal submission in support of this written submission if the Committee has time for this within its deliberations. To arrange such an opportunity or for further information on this submission please contact:

Lieutenant-Colonel Ian Hutson-Director

Social Policy & Parliamentary Unit
The Salvation Army New Zealand, Fiji and Tonga

+64 274 713 645 | + 64 9 261 0885 (DDI) | ian_hutson@nzf.salvationarmy.org