
# Reflections on the Green's challenge to the fiscal straightjacket

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PIE is pleased to republish Susan St John's reflections derived from her substack, on issues raised by the launch of Green's Fiscal Strategy document on the 16th June in Wellington. The panel chaired by Rob Campbell, comprised former Productivity Commissioner Ganesh Nana and Susan St John as politically independent economists, with Green Party co-leader Chloe Swarbrick.

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## The fiscal straightjacket

Lying behind the Green Party's Fiscal Strategy document, launched in Wellington on 16th June, is a well-researched academic critique of the narrow fiscal accounting framework that locks us into a poor use of our scarce economic resources, ever-growing poverty and an unsustainable and increasing wealth divide.

> *In New Zealand, the need for fiscal restraint has become an article of faith across successive governments. Despite consistently low debt levels by international standards, recent decades have been characterised by systematic underinvestment in infrastructure, climate adaptation, and public goods and services - leading to deteriorations in real economic capacity and productivity that threaten long-term prosperity more than any "deterioration" in fiscal indicators is ever likely to. Today's coalition government has pushed fiscal conservatism even further, adopting debt and spending targets more restrictive than Treasury's recommendations.* [1]

This research critiques the excessively conservative assumptions behind the conventional fiscal rules and cannot be easily dismissed as ravings from the 'looney left'. Max

Rashbrooke (Spinoff) offers an accessible and succinct summary of the main themes that Greens co leader Chloe Swarbrick outlined at the launch: The Greens have broken dramatically with the James Shaw era. Simon Wilson (NZ Herald), Chlöe Swarbrick and

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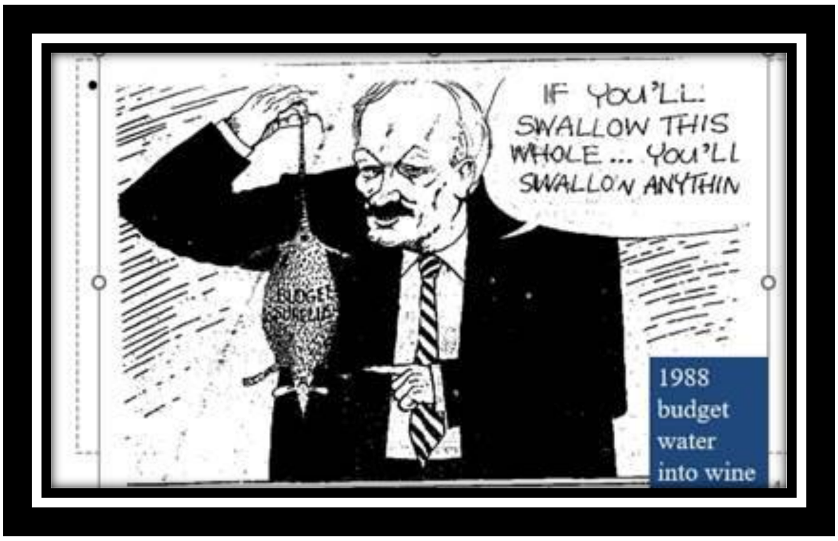
Green economics - the lost Monopoly lessons likewise offers a balanced and fair summation.

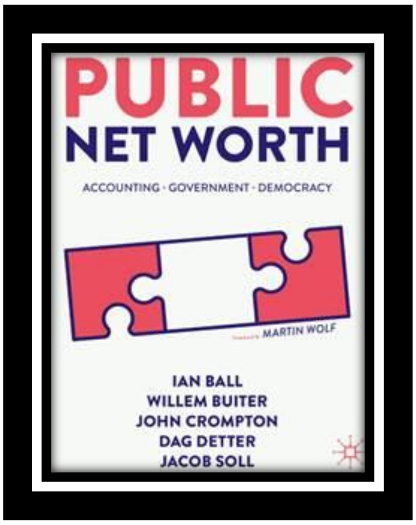
The Greens are suggesting we must start to solve our real resource problems as opposed to the narrowly conceived financial approach that is taking us further away from a well-functioning society. As was stressed at the launch, the Greens are not saying they have the full answers, rather they wanting to initiate a wide discussion. I sense a paradigm shift will be required in the way we think about the role of government. That will be painful, as new thinking and new narrative often is.




Here I reflect on some of the issues that have bothered me about the public sector accounting framework over many years teaching public economics and policy courses.

I remember the bad old days of the cash in cash out approach to the budget. I can still see Roger Douglas depicted by the cartoonist as holding a dead rat tattooed "Budget Surplus", while the 1988 headline screamed 'water into wine'. Roger Douglas had claimed to deliver a budget surplus, but he did so by selling assets and then treating the proceeds as current revenue.

Ian Ball, architect of New Zealand's fiscally responsible approach, in a very comprehensive, recently co-authored book on Public Net Worth explains how New Zealand is a world leader, adopting the accountant's world view earlier and more aggressively than any other country. He argues New Zealand should recognise the strength of government's balance sheet and focus on Net Worth rather than debt measures. Certainly, that would be a welcome improvement.




While we have gone further than other countries, have we been captured by our own cleverness and become prisoners of a fiscal straightjacket from which it is now hard to escape?

For example, a strong balance sheet must be a 'good thing', right? An insight I appreciated from the Greens' background technical paper suggests increasing Crown net worth by pursuit of ever-lower debt could represent lost opportunities, more private debt, a poorer country, and lower private net worth.

The state has been created in the image of the private sector company, but the state is very different to a profit-seeking private company. Its assets are not all well-defined, it has the power to tax and create money, and it doesn't have to make a profit. It has fundamentally different roles to play, such as redistribution to provide social equity, and provision of public or common goods to correct for 'market failure'.

An example of how New Zealand has adopted private sector accounting for the state with more rigour that other countries is 'line by line consolidation' under accrual accounting. Introduced in the early 2000s, this made the budget interpretation so much harder to follow (and teach) by conflating purely commercial activities with core spending and revenue activities. I have never seen an explanation of why this was a good idea, but it has successfully reinforced the concept that government is 'just a large company'.

The language of fiscal responsibility: balanced budgets, low net debt, debt ceilings, small government, low taxes are goals, prioritised over taking meaningful action on the critically important things we need government to do and that the private sector will **never** provide. As we teach less and less practical public economics in the universities, there is less understanding of the notion of public goods, externalities and market failure, consequently government's unique role is not well understood.

For example, Nicholas Barr, UK economist, author of 'The Economics of the Welfare State', argues that a primary purpose of the welfare state is to correct for market failure in insurance. Left to the free market, private insurance cannot cover or can only partially cover many risks we face. For example, even those that are relatively well-off can't buy proper unemployment insurance, catastrophic accident cover, climate change protection, full health insurance, or basic inflation/wage proofing of benefits. State involvement can correct for these 'missing markets' thus making the economy more ***efficient,*** as well as more equitable.

At its heart, economics is about ensuring the best use of scarce resources: finance should be the lubricant not the constraint. By giving accounting primacy, fiscal targets of government spending, tax, net debt (all as percentage of GDP), and a structural budget balance of zero or surplus, have become ends in themselves regardless of the state of the economy or real resources considerations or distributional consequences.

Worse still, these fiscal targets and measures are not black and white, and their measurement assumptions reflect bias. For example, net debt depends critically on what is netted off-- that can be politically determined as we have seen in recent years. For example, in Budget 2023, net debt under Labour was 20% of GDP, but in 2024 under National who chose to ignore the assets of the NZ Super fund (NZSF). It suddenly became a much more scary figure of 43% of GDP.

Another example of mismeasurement is the goal of lowering Government spending (to 30%) as percentage of GDP to reduce the size of the state when this target is NOT a measure of government size in the economy. Transfers are not payments for goods and services. They are included in the numerator, not the denominator. It's like adding apples and oranges and finding that as a percentage of total apples.

Macro models use net taxes (T) as equal to taxes minus transfers to make it clear that transfers are not part of GDP. In macro models, government consumption excludes transfers as it should. When government current and capital expenditure is expressed as a share of GDP, it is only around only 20%; a much clearer indicator of government's actual claim on real resources.

As well, government expenditure as a percentage of GDP can be readily manipulated. For example, Since the early 1990s, students have been forced to pay more of their own tertiary costs by borrowing under the Student Loans scheme.

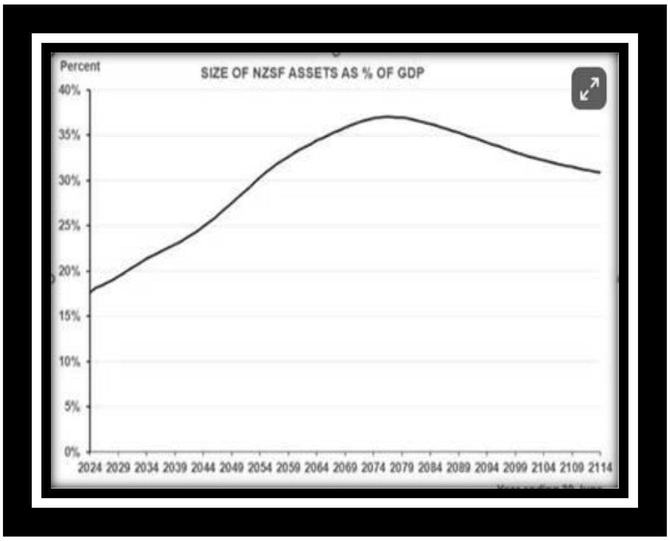

Outstanding Student Loans after annual write-downs become a dodgy asset on Crown balance sheet; but they are not an asset overall for New Zealand.  While it has allowed government spending to look smaller and made the budget easier to balance by treating loans to students as capital expenditures, students are forced to be fiscally irresponsible by borrowing to pay their fees with no business plan or job security, and in addition many are also forced to borrow for their living costs.

The massive student debt has a crippling effect on many students, especially women who face an additional 12% tax on every dollar above a very low annual income threshold of $24,100. To save a small amount to help meet unrealistic fiscal targets, this threshold was fixed in this year's budget for 4 years. Instead, the government's ***strong*** balance sheet should be seen alongside low income students' ***weak*** balance sheets and used to write off existing loans, say for example for students who stay and work here.

The current narrative implies private contributions to GDP are always better than public sector ones and must be prioritised. But Economics 101 tells us that reducing state spending in a recession on things that ordinary people need, and cutting jobs, just forces more contraction. The private sector is wary and uncertain and unlikely to take up the slack and is especially unlikely to provide 'the missing markets' for things we actually need. If middle income people face uncertainty and attempt to save more, that too can make things worse.

It seems to me we should have more faith in Economics 101 and reestablish the concepts of the production possibility curve, opportunity costs, the paradox of thrift, and countercyclical fiscal policy.

Finally, as one who works in retirement policy, I want to return to the myth of prefunding our pensions. The NZSF is set to reach 35% of GDP mid-century and contributes significantly to the strength of the Crown balance sheet.




The projections show the ageing population and the next decades of increased demands for pensions and healthcare. There will be a **real resource** shortage made worse by the current loss of skilled and young to Australia and to chronic underemployment.

We have been seduced into thinking the NZSF assets will help but refuse to take credit for these assets in the net debt figure.

NZSF is portrayed as a free lunch but has meant real sacrifice by working-age people as contributions to it have precluded other capital expenditure. The opportunity cost is the other foregone investments that might have provided real capacity to meet the needs of an ageing population.

NZSF does not guarantee any aspect of NZ Super. Not the entitlement age, nor the rate of super, nor the link to a wage floor, nor the universality. The money that trickles out mid-century does not change the cost of NZ Super just which pot of money it is funded from. The withdrawals from the fund also have an opportunity cost because they could be spent on other pressing needs.

At the same time as there a protective ring around the NZSF assets, we suffer social distress on a massive scale. A treasure chest of paper assets at the end of the century won't help the ageing population if the planet is burning and our skilled young have all left New Zealand.

Thirty-five years ago, we were world leaders in public sector accounting. Let's have more debate about how to unshackle ourselves from fiscal targets that don't work for us anymore.

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[1] See forthcoming November 2025 Policy Quarterly, article by Tayla Forward and Madeleine Ford.

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