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Trend to Bigger Government Must Be Reversed

President Bill Clinton once famously remarked that “the era of big government is over”.

He could not have been more wrong.

Recently the Organisation for Economic Cooperation and Development (OECD) released its bi-annual *Economic Outlook*. It makes for grim reading.

For OECD countries as a whole, government expenditure (‘general government total outlays’) is forecast to jump from 40.2% of GDP in 2007 to 45.7% in 2010: over 5 percentage points.

The reason for the increase, of course, is the global financial crisis. This led many governments to implement large ‘fiscal stimulus’ packages while economies shrank and welfare spending and interest payments on public debt grew.

The New Zealand pattern is similar, with total government spending (which includes local government) set to rise from 40.3% of GDP in 2007 to 46.4% in 2010 – an increase of 6 percentage points, which puts us above the OECD average.

Moreover, almost all OECD countries are now running budget deficits. On the OECD’s measure of general government financial balances, the United States is facing a 2010 deficit of 11.2% of GDP and the United Kingdom a 14% deficit. The figure for New Zealand is 5.0%.

The stage is therefore set for steep increases in public debt, particularly as interest rates rise, as they inevitably will.

Rahm Emanuel, President Barack Obama’s chief of staff, observed that a crisis is too important to be wasted. Crises have always been seized upon

by politicians to ratchet up the size of government. We are seeing history repeat itself.

The Obama administration has implemented a massive fiscal stimulus package (without, as yet, much effect on the economy), nationalised banks and car manufacturers, and proposed greatly increased public spending on health care.

The political challenges posed by these trends are formidable. Governments will face increasing pressure to cut spending or raise taxes. Tax hikes would further stifle economic growth.

In Australia the Rudd government's strategy, outlined in its May budget, is to allow tax revenue to "recover naturally" as economic activity picks up while simultaneously limiting real growth in public spending to 2% a year.

The director of the respected consultancy firm Access Economics, Chris Richardson, has commented, "The 2% real rule doesn't sound scary, yet it implies a tight straitjacket on federal spending ...

"After 4½ years the cumulative impact will be devastating. It would be the equivalent cost savings from abolishing the Defence Department or from lifting the pension age, not just to 67 years but to 107."

In New Zealand, the government sensibly refrained from adding to fiscal stimulus in the 2009 budget. It avoided a credit rating downgrade, mainly by cutting provisions for future new spending, although Fitch Ratings has subsequently put us on negative creditwatch.

Even so, core Crown expenses are forecast to grow at a faster rate than in Australia, averaging 2.75% per annum in 2011 and 2012.

This growth is driven particularly by welfare spending and higher debt servicing costs. Spending on health and education is actually projected to fall in real terms.

Given the public outcry over modest cuts to community education in this year's budget, the government's dilemma is apparent.

It is little wonder that Treasury Secretary John Whitehead recently went public to spell out the need for expenditure savings and productivity increases in the public sector.

Clearly the government will have to look at shrinking or eliminating programmes and agencies if it is to keep to its spending provisions.

And even if they are adhered to, the share of government in the economy may continue to grow if recovery from the recession is weak. Reserve Bank governor Alan Bollard has recently stated that the trend rate of economic growth over the next few years may be just 2%.

Governments and voters in New Zealand and the OECD face tough choices. If the growth of government spending and the increase in regulatory burdens in recent years are not reversed, the so-called West may be in for a long period of economic malaise.

Big government is bad for economic growth because it crowds out the private sector, implies high deadweight costs of taxation and has other harmful effects. New Zealand does not have the proverbial snowball's chance of catching up to Australian living standards by 2025 with the government spending well over 40% of GDP.

We must focus far more on the policies and achievements of the small-government, dynamic economies of Asia if we are serious about such a goal.

Public expenditure for 2009-10 in the Hong Kong budget is well under half New Zealand's level at 19.4% of GDP. It is forecast to fall to 18.9% by 2013-14 and the budget is projected to be in surplus.

By law, public spending in Hong Kong may not exceed 20% of GDP. Although now a high-income country, Hong Kong is maintaining its economic dynamism with its trend annual growth rate projected to be 3.5% in real terms.

Anyone who thinks that a small country at the end of the earth with a huge tax burden, an aging population and facing growing international

competition will become a dynamic success story without major change to its institutions and policies is away with the fairies.

It is almost axiomatic that the first recommendation of the 2025 Brash Taskforce should be a legislated limit on government spending in New Zealand.

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