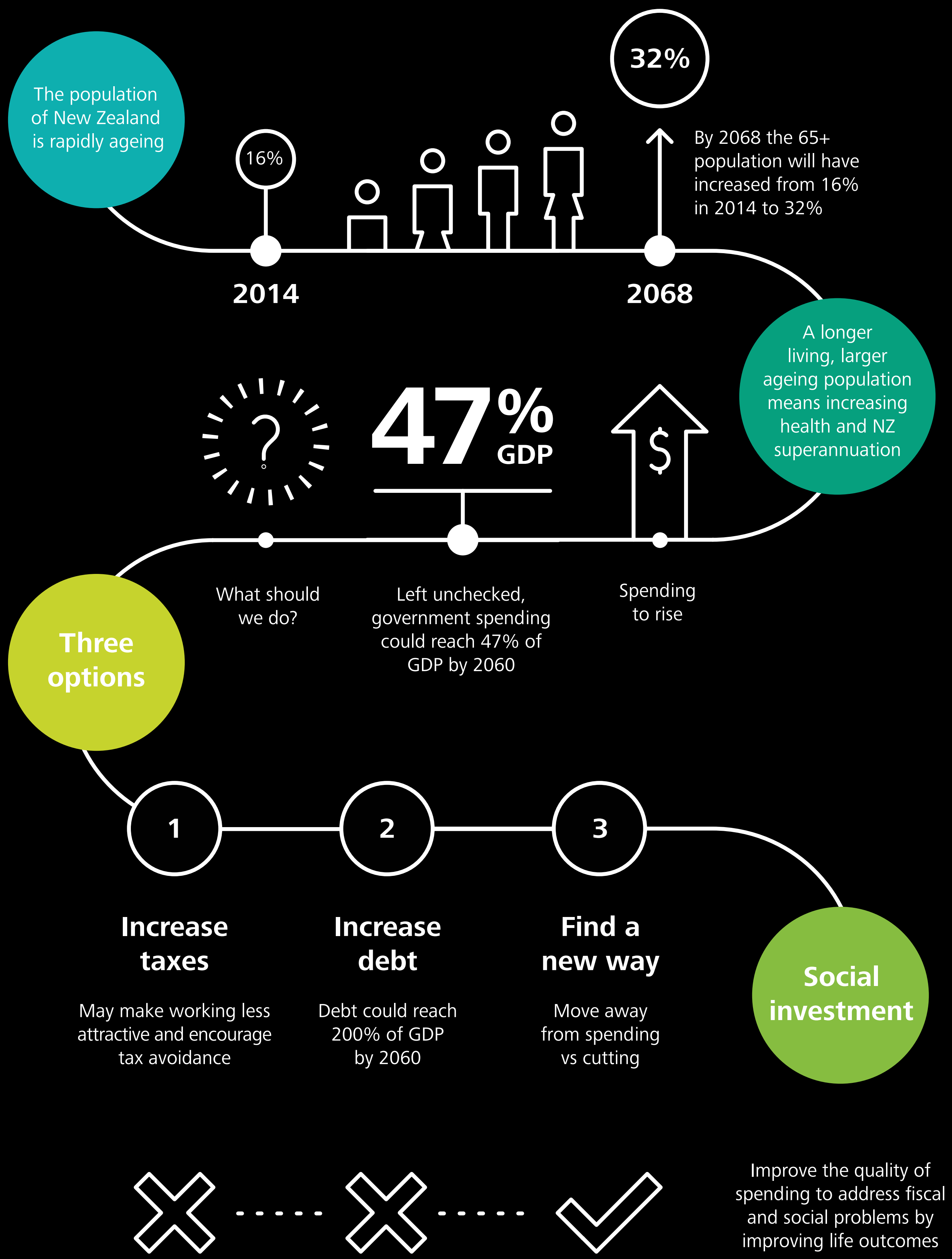
Why social investment?



Crown finances

The government's books are in relatively good shape. But our ageing population will put Crown finances under significant pressure. Social investment may prove valuable in managing this pressure while supporting better outcomes for Kiwis.

Setting the scene for social investment

The New Zealand government's books are in relatively good shape – at least for now. The governments target of returning to operating surplus was achieved in June 2015, the first surplus in seven years. This is an admirable outcome given recent events including the global financial crisis (GFC), the Canterbury earthquakes and the severe drought of 2012-13.

Underpinned by increasing tax revenue from rising employment, wages, labour force participation and net positive migration, government revenue has grown at a compound annual growth rate (CAGR) of 4.0% over the last five years. During this same period, a focus on fiscal restraint has seen overall government spending increase by a CAGR of 0.6%. This relatively modest increase in government spending has mainly been driven by increases in social expenditure such as social welfare, education and health.

Since 2008, New Zealand's net core Crown debt has risen rapidly to around $61 billion or 25% of GDP. In response, government has made reducing debt a priority with a target of bringing it down to 20% of GDP by 2020.

Compared to many other OECD countries post-GFC, the current picture of our Crown finances is a positive one. Other countries still have sizable fiscal deficits while the UK, France, Canada and the US have gross debt ratios in the range of 80-120% of GDP.

But long-term projections of our Crown finances aren't so rosy. Similar to other OECD countries, this is driven largely by our ageing population. By 2038, the number of Kiwis aged 65 and older is projected to nearly double to 1.3 million people and will account for over a quarter of the total population. This trend will continue with those 65 and over reaching 32% of the population by 2068. What's more, the number of people aged 65 and older per every 100 working aged person (aged 15-64) is currently around 22. This dependency ratio is set to rise to 48 by 2068. With relatively fewer people in the working population the income tax base will shrink, meaning there will be less government revenue to support increasing government expenditure on the non-working population.

If current spending and taxation patterns were to be maintained, costs associated with the ageing population would push net debt up to as high as 200% over the next 50 years.

It is simply not feasible to let debt as a percentage of GDP rise this high. Doing so would place an intolerable burden on future generations to repay the debt, and the risk associated with the New Zealand economy would depress the currency and push up borrowing costs.

Over the coming decades, this pressure on government resources will require a change in the approach to public spending. In particular, improving the quality of social expenditure will need to be a priority.

Social investment may prove valuable in managing this pressure while supporting better outcomes for Kiwis.