RESEARCH NOTE

A HISTORICAL PERSPECTIVE ON THE 2017-2023 GOVERNMENT'S SPENDING SPREE

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BRYCE WILKINSON

FOREWORD BY MATTHEW BIRCHALL

THE NEW ZEALAND INITIATIVE

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About the New Zealand Initiative

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. We believe in evidence-based policy and are committed to developing policies that work for all New Zealanders.

Our mission is to help build a better, stronger New Zealand. We are taking the initiative to promote a prosperous, free and fair society with a competitive, open and dynamic economy. We develop and contribute bold ideas that will have a profound, positive, long-term impact.

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Foreword

How big is too big? This question has puzzled economists since the birth of the discipline in the eighteenth century – and it continues to perplex us today.

There is never going to be a consensus on the appropriate size of government. Indeed, few topics arouse such passionate debate and diverse viewpoints. Arch-libertarians dream of limited government; avowed socialists conjure up ways to expand the welfare state; and anarchists would rather dispense of Leviathan altogether.

To put it simply, the size of the state is contested terrain.

For that reason, it is important to turn to economic history. The growth of government may be politically contentious, but empirical study and analysis can provide insights into the consequences and trade-offs associated with various levels of government intervention in the economy.

In 1870, governments in the Western world accounted for just over 10 percent of the economy. That figure surged to around 20 percent of GDP by 1920, before rising again during World War II. Since then, it has steadily expanded, driven by ever increasing demands for welfare.

Today, in advanced economies like New Zealand, government expenditure amounts to over 40% of GDP on average. In countries like Belgium and Denmark, more than half of all economic activity has the state involved. And there are few signs that these ratios will shrink substantially anytime soon.

The American economist Robert Higgs once suggested we can understand the growth of government through the concept of the Ratchet Effect. According to Higgs, government tends to expand during times of crisis, such as war, pandemic, or depression, but it rarely reverts entirely to its previous size once the crisis has passed.

Where does New Zealand fit into this global story? And what are the implications for public policy in the wake of Covid-19?

In this research note, Bryce Wilkinson, one of New Zealand's most respected economists, documents the Sixth Labour Government's spending spree between 2017 and 2023 and puts it into historical context.

Bryce's findings should give us pause for thought. Elected on the back of an ambitious policy agenda, the Ardern government quickly found itself struggling to balance the books. Their Fiscal Plan prior to the 2017 general election forecast an $11.7 billion increase in government spending in the five years to June 2022.

That was wildly optimistic. Especially with the additional spending triggered by the pandemic, government spending had blown out by $77 billion.

Yet that is only half the story. Few would begrudge the emergency spending in the face of the Covid pandemic and the associated lockdowns. Lives and livelihoods were at stake and the global outlook was awash in uncertainty.

However, as Bryce's research shows, government spending had begun to spiral out of control well before the onset of Covid. The $11.7 billion projection had already increased to $29.7 billion by the time we were acquainting ourselves with a strange new virus from Wuhan. And it continued to increase thereafter in a textbook case of Higgs's Ratchet Effect.

Bryce does an exemplary job of putting these facts and figures on the record. But it is what he does next that significantly enhances our understanding of public finance in New Zealand.

Drawing on tax receipt data that goes back to the 1910s, Bryce situates the Sixth Labour Government in historical context. The parallels he draws between the First Labour Government (1935-49) are especially illuminating. Like Labour today, Michael Joseph Savage's administration spent liberally. Tax receipts increased from 13.4% of GDP in 1935-36 to around 24% by the time it left office. The increased tax burden would endure, but with mixed results. Although still venerated in some quarters, the First Labour Government's big spending policies helped trigger a serious foreign exchange crisis.

What can we learn from Bryce's history lesson?

Perhaps the first thing to realise is the enormous changes in the size of government New Zealand has experienced over the past century. There is no 'natural' size of government. The size of government is always a political choice.

Secondly, we have seen periods of increased government spending followed by periods of (at least relative) moderation. Historically, we could interpret them as times when governments were forced to clean up the worst spending excesses of their predecessors.

But thirdly, and most importantly, we can infer from Bryce's historical overview that more government spending does not equal better government services. Governments can spend little money wisely and a lot of money foolishly.

Especially when funds are tight, as they will likely be over the coming years, government will need to be better with money and demand higher efficiency from the public service.

Future historians will judge the next government on the way it will deal with this challenge.

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A historian by training, Matthew's writing on the British Empire has been published in the *Journal of Global History and Global Intellectual History*. He was awarded the Royal Historical Society's prestigious Alexander Prize in 2021 for the best scholarly article based upon original historical research.

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Setting the scene – quantifying this government's spending splurge

The Sixth Labour Government has been a big-spending government. Its spending has vastly exceeded even its expectations.

Its Pre-election Fiscal Plan in 2017 assured the public it would increase government spending by a modest $11.7 billion. This increase was to be spread over the five years, ending in June 2022. This is an increase of $2.3 billion a year on average. It lifted projected spending in those five years by 2.7%.

Labour's planned $11.7 billion increase had blown out to $29.7 billion before Covid-19 reached New Zealand. The arrival of Covid-19 in early 2020 justified the assumption of emergency powers and increased spending during the lockdown.

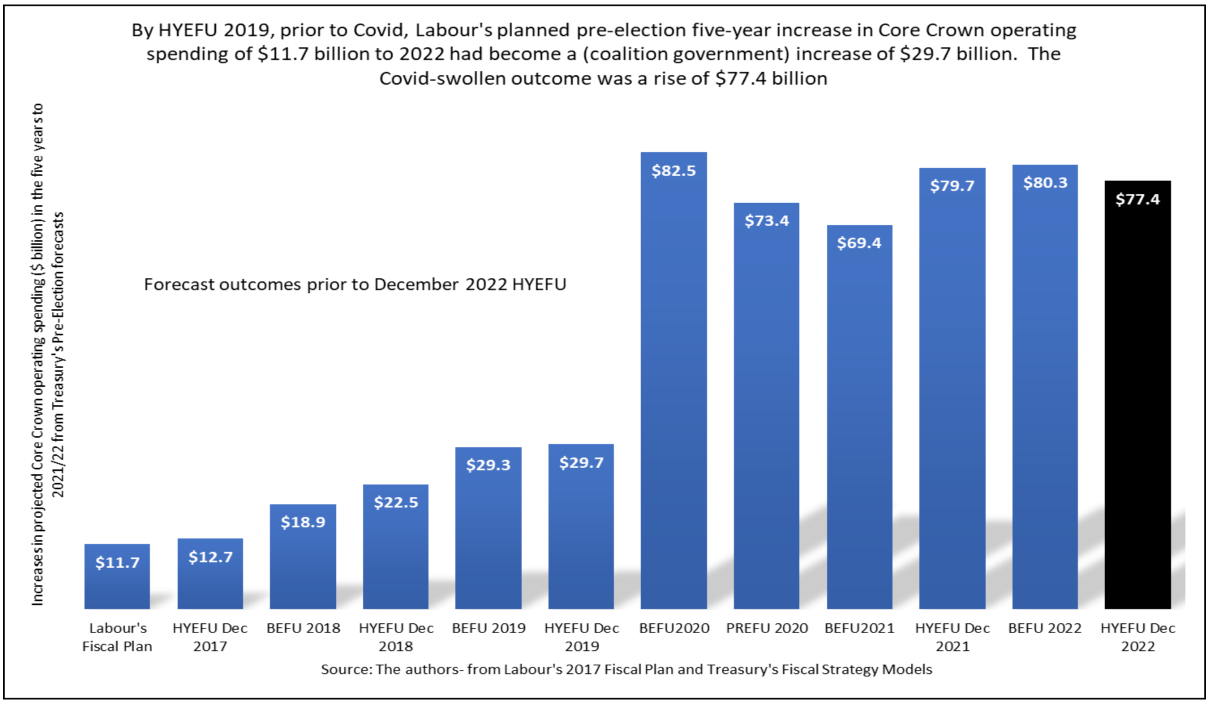
By the end of its five-year plan, cumulative spending had increased by $77.4 billion, or 17.9%. Justifiable or not, the cost in terms of future indebtedness was very significant. That $65 billion overshoot is an average overshoot of $13 billion a year. That is over $6,500 per household per year.

A big increase in spending as part of emergency powers in response to an epidemic does not justify a major permanent increase in spending. But this is not how the government saw it.

The Government saw the epidemic as a chance to "hit the reset button" for spending and much else.[1]

The following chart summarises the path to that outcome. (EFU = Treasury's Economic and Fiscal Update, B = budget (usually in May or June), H = Half-year (i.e., December), P = pre-election.)

Figure 1: Labour's track to massive over-spending 2017-2022



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[1] See chapter 1 in Bryce Wilkinson," *Illusions of History: How misunderstanding the past jeopardises the future*", New Zealand Initiative, 2021, and Bryce Wilkinson, "Past illusions and future follies mar Grant Robertson's economic strategy", September 2021, https://www.nzinitiative.org.nz/reports-and-media/opinion/new-opinion-95/

Adjusted for inflation and population growth, forecast core Crown operating spending in 2023-24 will be 22% higher than in 2018-19 and only 2% lower than in the peak spending year of 2019-20.[2]

Core Crown operating spending in the 2017-18 fiscal year was 27.8% of GDP. Before the 2017 general election, the Treasury expected spending would be 27.4% of GDP in 2023-24. Its projections assumed unchanged (National-led) government policies. Treasury now projects it will be 33.5% of GDP (Table 1).

Table 1: Treasury's spending projections for 2023-24 as a % of GDP

Treasury's evolving model forecasts for core Crown operating spending in 2023-24 as a % of forecast Gross Domestic Product:	
2017 Pre-Election Update	27.4%
2020 Pre-Election Update	31.9%
2023 Pre-Election Update	33.5%

This is a massive 6.1% of GDP increase from Treasury's 27.4% of GDP forecast for the 2017 general election.

It raises the question of how it compares with earlier big-spending governments and what followed when they departed. That is the focus of this research note.[3]

Setting the scene – a broad historical sweep in two charts

It is difficult to get a consistent time series for government operating spending figures before the 1950s. However, the Official Yearbooks covering those years do a fine job of reporting total tax receipts on a time-comparable basis.

This is why the following two charts focus on time series for taxation rather than spending.

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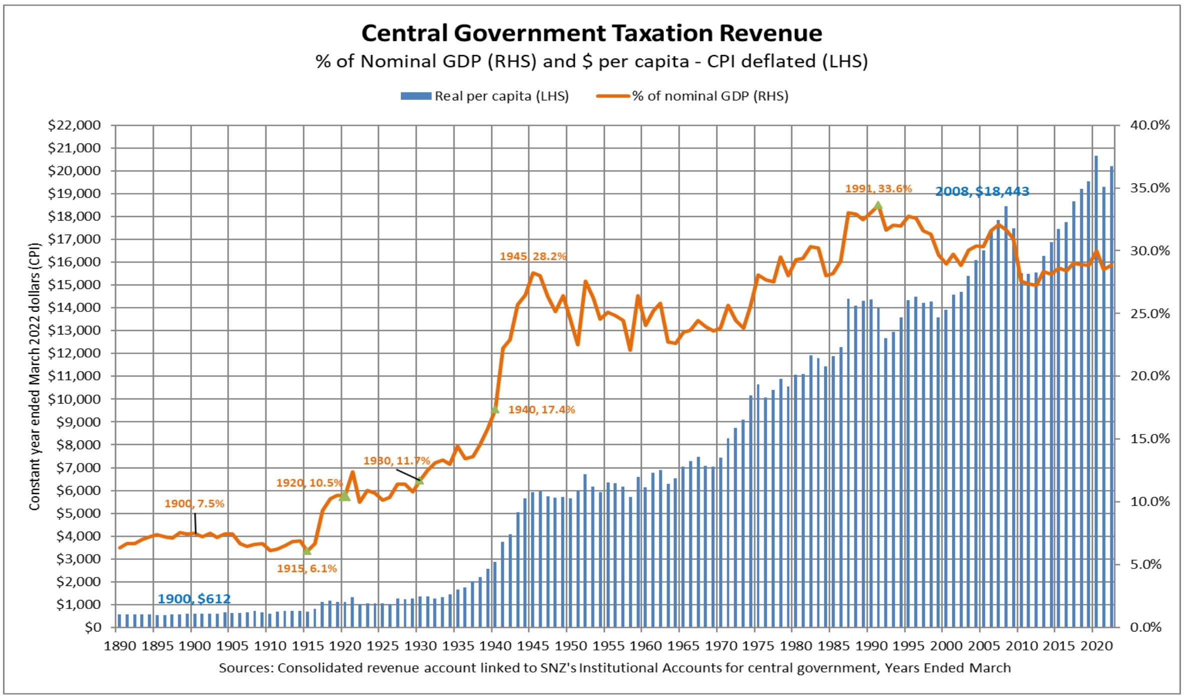
2 Increased finance costs from bigger debt and higher interest rates have contributed to this increase, but only to a small degree.

3 See Oliver Hartwich and Bryce Wilkinson, *The Deficit Diaries: Six Years of Red*, The New Zealand Initiative, 2023 for a forward-looking view of the deficit and debt situation.

Figure 2: Central Government tax revenue 1890-2021



War always justifies additional taxation, as can national disasters and epidemics. While in principle, such increases should be temporary, this is not what seems to happen in practice. US economist Robert Higgs has examined the reasons for this in depth.[4]

As shown in Figure 2, World War I saw tax revenues rise by about 3% of GDP to 10% of GDP in 1919-20.[5] Tax revenue exceeded 10% of GDP for the first time in 1917-18.

By the year ended March 1936, extra spending, including Great Depression relief spending, had lifted the ratio to 13.4% of GDP.

By the year ended March 1939, under the First Labour Government (1935-1949), tax revenues had risen to 15.8% of GDP.[6] This government was fortunate to take office when the economy was growing rapidly after the Great Depression. That recovery increased tax revenues. (See Appendix 1 for more details.)

That 2.4 percentage point rise was merely a trickle from its spending tap. World War II provided an opportunity to achieve a permanent quantum leap in spending and tax burdens.[7] It was taken.

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4 Robert Higgs, *Crisis and Leviathan: Critical Episodes in the Growth of American Government*, (1987).

5 Specifically, tax revenues increased from $11.8 million to $32.5 million between the years ended March 1914 and 1920. Inflation was an important factor. The rise in taxation per capita, exceeded the contemporaneous increase in the consumers price index by 56% (taking it from $723 to $1,128 in the year ended March 2022 dollars). Nominal GDP was $172 million and $310 million in those years respectively, based on historic figures from Treasury's Debt Management Office. So, the increase was from 6.9% of GDP to 10.5% of GDP.

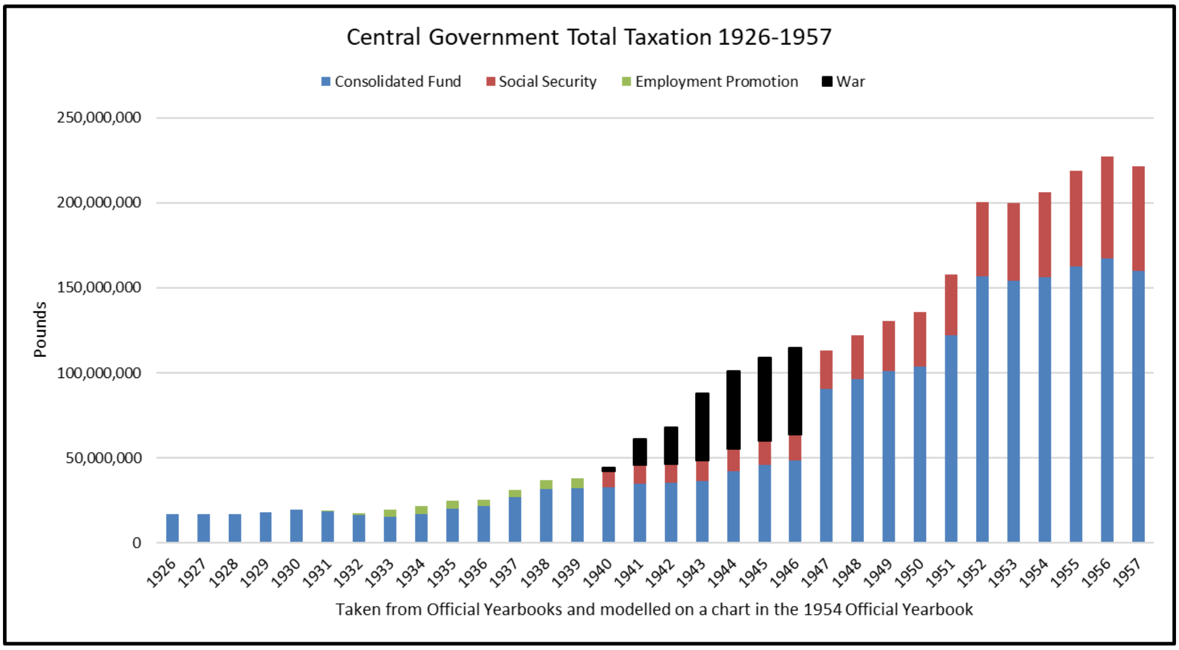
6 Per capita, they rose 48% relative to the Consumer Price Index in these three years to reach $2,556 per capita in the year ended March 2022 dollars.

7 Along with many restrictive regulations, import licensing, foreign exchange controls, and retention of ready access by a future Minister of Finance to extraordinary war-time powers in peace time. (See the Economic Stabilization Act 1948 http://www.nzlii.org/nz/legis/hist_act/esa19481948n38261/)

Figure 3 shows how quickly the war-time taxes became permanent tax increases.

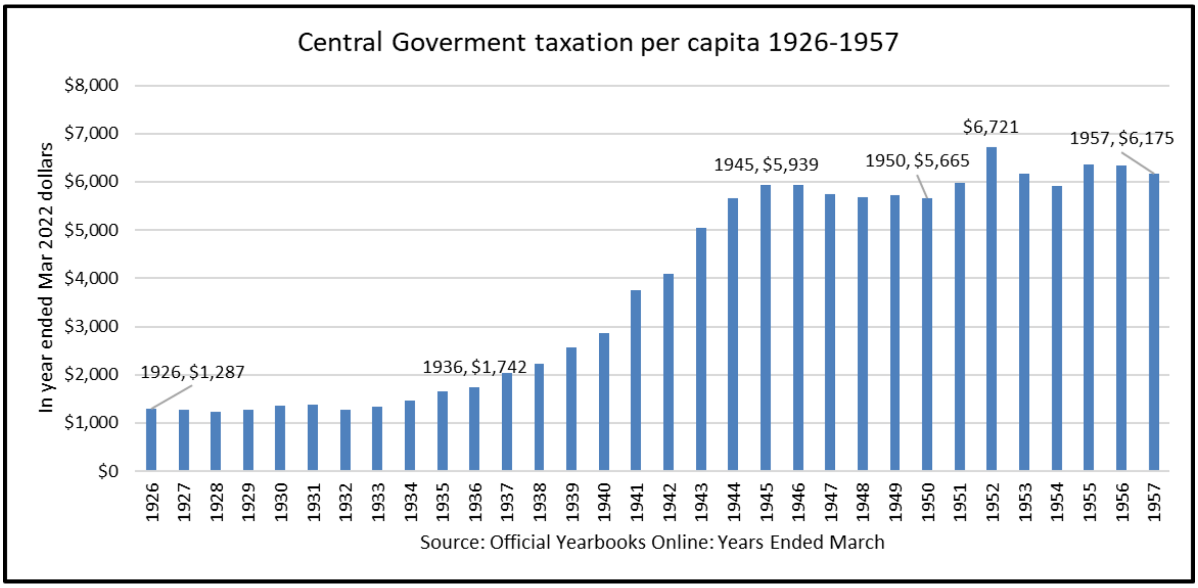
By the year ended March 1950, tax revenues were 24.6% of GDP, 8.8% of GDP higher than in 1938-39.[8]

Figure 3: War-time-justified increase in taxation became permanent increases



The increases in Figure 3 does not adjust for inflation and population growth. Various Official Yearbooks do report total taxation per capita in those years. The following chart shows the result of using the Consumers Price Index to adjust those per capita figures for inflation.

Figure 4: Real per capita taxation 1926-1957



[8] Per capita, this rose to $5,665 in the year ended March 2022 dollars. This was 3.3 times larger than the level in the fiscal year in which the 1935 Labour government was elected.

In a nutshell, inflation-adjusted total taxation per capita in the year ended March 1957 was 4.7 times higher than in the year to March 1926. Over two-thirds of the $5,182 increase (in the year ended March 2023 dollars) occurred during the term of the First Labour Government.

Tax revenues averaged 24.8% of GDP for the decade to 1960. (In comparison, core Crown tax revenues averaged 28.1% of GDP during the decade ending in 2023-24.)

In short, the First Labour Government increased government spending (and taxation) by an extraordinary amount. It increased central government tax receipts from 13.4% of GDP in 1935-36 by around 11 percentage points of GDP, with permanent effect.[9]

What was the extra tax revenue spent on? The greater proportion was spent on additional social security benefits and pensions. The Government's 1938 Social Security Act was a major development in this respect. Spending on social security benefits and pensions rose from 3.1% of GDP in 1938-9 to 7.2% in 1948-50. It averaged 6.8% of GDP during the next decade.[10]

A significant proportion went into funding government capital spending. In the decade to 1960, current revenue outstripped current expenditure by 4.2% of GDP on average.

Spending on goods and services (including education and health) was 9.6% of GDP in 1938-39 and 10.1% in 1949-50. It averaged 10.0% of GDP for the next decade.

Most spending on education and health benefits the individual recipient, as does a monetary benefit. Government statisticians call the former social assistance in kind and the latter social welfare benefits and pensions. In 1950-51, early national income account estimates indicate that central government spending on goods and services, excluding education and health, was only 4.9% of GDP. (It was 6.3% of GDP if transfers to local authorities are included.)

Spending on social assistance in cash and in-kind, including pensions, was 10.3% of GDP in 1950-51. That was half of central government spending of 20.0% of GDP. Per capita tax revenues were sustained at the higher level, inflation-adjusted, until the mid-1960s. That meant that they were falling relative to an increasing GDP.

That revenue restraint did not last. New Zealand, and many other countries, increased social services spending from the mid-1960s, both absolutely and relative to GDP.[11]

Tax revenues increased again, as did deficit spending after 1974. The heavy borrowing precipitated a foreign exchange crisis in 1984. Even so, tax revenue today, at 29% of GDP, is marginally higher relative to GDP than at the end of World War II.

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[9] A different government could well have done much the same. A comparison with spending growth during the same period in other warring countries could throw light on this.

[10] This paragraph and the following paragraphs use the Government Statistician's earliest national income account estimates of government spending and of GDP. Methodologies for estimating GDP have since changed, and backdating for those changes would alter the orders of magnitude of the quoted ratios, but not necessarily the changes in the ratios from one year to the next.

[11] See, for example, António Afonso & Ludger Schuknecht & Vito Tanzi, 2020. "**The Size of Government**," Working Papers REM 2020/0129, ISEG - Lisbon School of Economics and Management, REM, Universidade de Lisboa. In New Zealand, the major lift occurred in the early 1970s.

Periods of strong growth in taxes and spending tend to be followed by periods of fiscal restraint. Figure 5 illustrates this. It shows 9-year increases in real taxation per capita at yearly intervals.

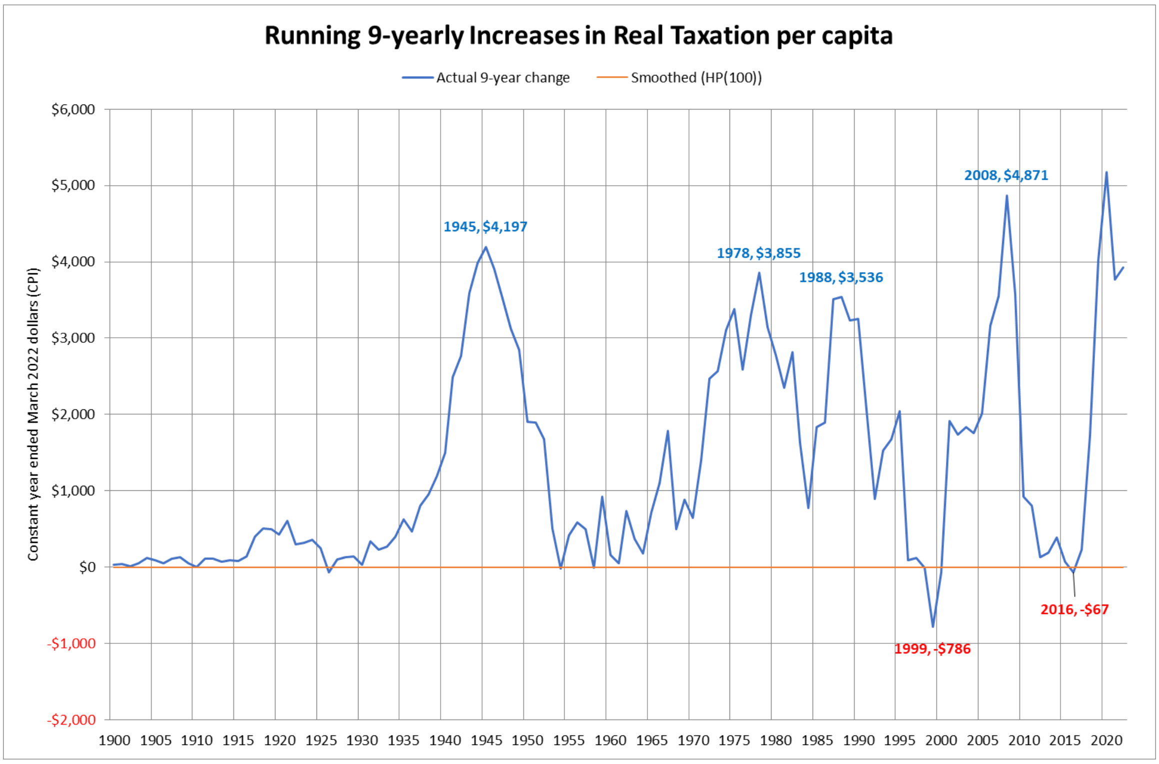
For example, taxation in the World War II year of 1944-45 represented an inflation-adjusted increase of $4,197 per capita, on taxation 1935-36. (These amounts are expressed in the year ended March 2022 dollars, based on movements in the Consumer Price Index.)

Overall, tax revenues on this measure barely rose in the next fifteen years to 1960. However, in the nine years to 1978, they rose by $3,855 (Figure 5).

The tendency for per capita tax burdens to rise inexorably is shown by the outlier result in 1998-99 – a rare fall in real tax revenues per capita in 9 years.

It is striking that in 1900, the government needed $612 of tax revenues per person to fund itself, whereas today it needs $20,000 (both in the year ended March 2022 dollars).

Figure 5: Ebbs and flows in tax revenues 1900-2021



From the late 1980s, tax revenues per capita increased markedly in constant prices. This was to reduce the chronic fiscal deficits. Tax revenues were held around this higher level for the rest of the 1990s. They increased sharply again during the term of the Fifth Labour Government (1999-2008). The subsequent global financial crisis knocked the stuffing out of such revenue growth for the next nine years.

The Sixth Labour Government initially experienced strong growth in tax receipts, but the onset of COVID-19 lockdowns ended that temporarily in 2020. However, by 2022 fiscal drag (i.e. inflation leading to income taxed at a higher rate) increased tax revenue to 29.9% of GDP by 2022, where it had only been 27.9% of GDP three years earlier, in 2019.

Spending increases of New Zealand Governments since 1911

New Zealand's political history is littered with big-spending governments as summarised in Table 1. It quantifies the average annual rate of increase per capita in government spending during each period in office.[12] The figures are adjusted for inflation using the Consumer Price Index.

Since only annual spending figures are published, the calculations behind the table take the level of spending in the fiscal year in which a government first gets elected as the starting year. The spending in the fiscal year in which that government loses a general election is the end year for calculating the annual average rate of increase or decrease in its real spending per capita.

To explain the results, the Reform Government (1911-1928) was in power for 17 years (straddling World War I). For data limitation reasons, the statistics for spending growth during this period measure spending growth for the 13 years between the years ended March 1912 and 1925.

The spending growth in these wartime-inclusive 13 years averaged 1.4% pa. The total increase was 19.8%, and government current spending in 1925-26 was 16.0% of GDP. The spending measure was Consolidated Fund Payments taken from Official Year Books. (This is largely a measure of current spending, but it is not comprehensive and can also include transfers to capital-spending funds. It just happens to be the best of the measures available for this period.)

The table shows some significant differences in spending growth across administrations.

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[12] A serious discontinuity in the spending statistics occurred between 1924-5 and 1925-26. To avoid this problem, the spending growth figures in Table 1 show the growth between the fiscal years ended March 1912 and 1925. However, the Reform Party continued until the 1928 general election after which it and the United Party governed.

Table 2: A timeline of spending growth across government administrations 1911-2023

Lead Political Party in Power	Years in Office	Increase in real spending per capita during term in office		Spending in last year in office as a % of nominal GDP	Spending Measure
		Annual average compounded rate	Total change while in office		
Reform 1911-1928	8*	1.4%	19.8%	16.0%	Consolidated Fund Payments
United & Reform 1928-1935	7	2.8%	21.7%	15.4%	Consolidated Fund Payments
Labour 1935-1949	14	6.5%	141.1%	20.4%	Consolidated Fund Payments
National 1949-1957	8	0.0%	0.4%	20.6%	SNZ: Total Govt spending
Labour 1957-1960	3	3.6%	11.1%	21.9%	SNZ: Total Govt spending
National 1960-1972	12	3.0%	42.3%	23.6%	SNZ: Total Govt spending
Labour 1972-1975	3	5.9%	18.7%	31.0%	Treasury long-term series
National 1975-1984	9	2.9%	29.0%	34.4%	Treasury long-term series
Labour 1984-1990	6	2.0%	12.6%	39.9%	Treasury long-term series
National 1990-1999	9	-0.9%	-7.9%	30.4%	Treasury long-term series
Labour 1999-2008	9	2.8%	28.5%	33.6%	Treasury long-term series
National 2008-2017	9	-0.3%	-3.1%	27.3%	Treasury long-term series
Labour 2017-2023	6	3.8%	24.9%	32.9%	Treasury long-term series
* Actually 17 years in office, but used growth rates to 1924 to avoid a data discontinuity difficulty. So the 16.0% of GDP figure is for 1923-24.					
Caution to readers: These comparisons are problematic. The earlier the period, the more incomplete the spending measures. Different measures for the same period could give somewhat different figures for the increases.					

Readers should treat these statistics as indicative rather than definitive. The earlier the period, the more partial and problematic the measure. There are discontinuities in most of the time series. Furthermore, different measures for the same period may give different rankings. Changes in the scope and accounting basis for the measures (e.g., from cash to accrual accounting) are another reason for caution.

It would be good if other researchers improved on these comparisons. Table 3 in Appendix 1 makes the sources of the statistics in Table 1 easier to identify,

Accepting those qualifications, the First Labour Government (1935-1949) stands out as the biggest spending government of the last hundred years and more. Its average annualised growth in real per capita spending of 6.5 % per annum, sustained for 14 years increased the tax burden on New Zealanders permanently and to a major degree.

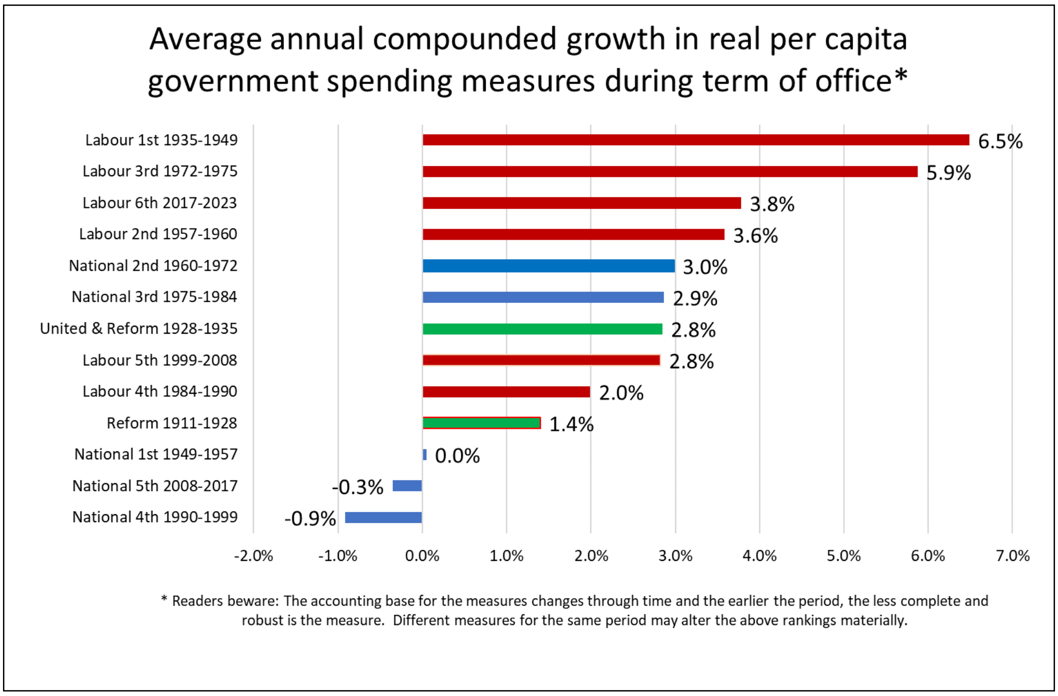
The timeline in this table shows that periods of significant increases in spending have been followed by periods of relative fiscal constraint.

This is particularly evident from 1972 onwards. Since 1972, a National-led government's spending growth rate on this measure has always been lower than its predecessor Labour-led administration.

Which governments have increased spending fastest?

Labour-led governments have form as the biggest spenders. Figure 1 ranks the average annual spending estimates in Table 1. The only times a National-led government has managed to outspend the lowest spending Labour-led governments was when Sir Robert Muldoon was Minister of Finance for National.

Figure 6: Spending growth by government from 1911



Further details on the swings in government spending growth since 1957

The Second Labour Government (1957-1960) brought down a tough budget in 1958 in the face of a weakening export outlook. Demonised for this "Black Budget", it lost the 1960 general election to a formidable political opponent in Keith Holyoake.

In the lead-up to the 1972 general election, the National Government (1960-1972) spent so freely that its then Minister of Finance, Robert Muldoon, infamously declared that the Labour opposition would not be able to promise more spending because he, Muldoon, had already "spent it all".

Norm Kirk, Prime Minister in 1972, was no wimp regarding big spending. Undeterred by Muldoon's challenge, his Third Labour Government (1972-1975) spent up large. It assured voters that strong economic growth under its inspirational leadership would produce the needed tax revenue. Spend first, and the money to fund it would follow. It was the heyday of Keynesianism, after all, when Richard Nixon declared "We are all Keynesians now". New Zealand certainly was not the only country with policies like these at the time.

All was good until the quadrupling of world oil prices in 1973-74 ended rosy scenarios. Export prices were almost as low relative to import prices as in the Great Depression of the 1930s. And they stayed low for many years.

Big deficits and heavy overseas borrowing in foreign currencies followed.[13]

Somewhat hoist with his own petard, Robert Muldoon, then Prime Minister and Minister of Finance, brought in a tough budget in 1976. He blamed the need on his (undeniably) "borrow and hope" predecessor.

However, before long, fearing recession, he quickly reversed fiscal tack. He restored large fiscal deficits in time for the 1978 general election. After winning that one, his hopes were dashed by a second global oil shock. Ongoing fiscal and balance of payments deficits, inflation and rising unemployment became entrenched.

He eschewed the tight disinflationary monetary policies of the Thatcher government in the UK and the Reagan administration in the US. Instead, Muldoon reluctantly imposed a comprehensive wage, price and rent freeze.[14] This suppressed measured inflation but built inflationary pressures. Treasury and the Reserve Bank advised against this unsustainable measure.

The result was that the Fourth Labour Government (1984-1990) received the biggest political, fiscal and economic hospital pass of all. It was confronted with a major foreign exchange crisis the day after the 1984 general election. It also had to deal with credit rating downgrades, suppressed inflation, chronic fiscal deficits, a serious public debt problem, major losses from the previous government's ambitious energy projects, a blanket wage, price, rental and exchange rate freeze, and rising unemployment.

Astonishingly, its tough and wide-ranging measures saw it handsomely re-elected in 1987. Shortly after it fell apart through internal division and was in disarray by the 1990 general election.

The Fourth National Government (1990-1999) still had work to do. It inherited a serious recession, inflation and yet another nasty and undisclosed fiscal surprise.[15] Monetary and fiscal policy settings had to continue to be restrictive.

The Fifth Labour Government (2000-2008) got the fiscal dividend from a decade and a half of corrective action from 1984. Labour could enjoy strong revenue growth from strong inherited

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13 For the legacy of that borrowing for New Zealand's International Investment Position, see Bryce Wilkinson, *New Zealand's Global Links:* Foreign Ownership and the Status of New Zealand's Net International Investment Position, 2013. https://www.nzinitiative.org.nz/reports-and-media/reports/new-zealands-global-links/document/43

14 He had hoped instead to come to a voluntary understanding with the Federation of Labour for wage restraint, perhaps with tax cuts to preserve take-home pay.

15 The new National Government passed a Fiscal Responsibility Act to make it harder for a future government to hide fiscal problems from the public and opposition parties in the lead-up to a general election.

economic growth.[16] It lifted spending sharply and used some surpluses to build a superannuation fund. It was initially known as the Cullen Fund.

The Fifth National Government (2008-2017) was elected in time to reap the whirlwind of the global financial crash and projected fiscal deficits for the foreseeable future. The costs of the Christchurch earthquakes soon followed.

It took nine years of largely holding spending at heightened levels to restore projected fiscal surpluses. Waiting for economic growth, inflation and fiscal drag to grow tax revenues and eliminate fiscal deficits takes many years of hard slog resisting spending pressures.

The latest move to fiscal excess was triggered by Winston Peters' decision to anoint Labour to form the government in 2017.

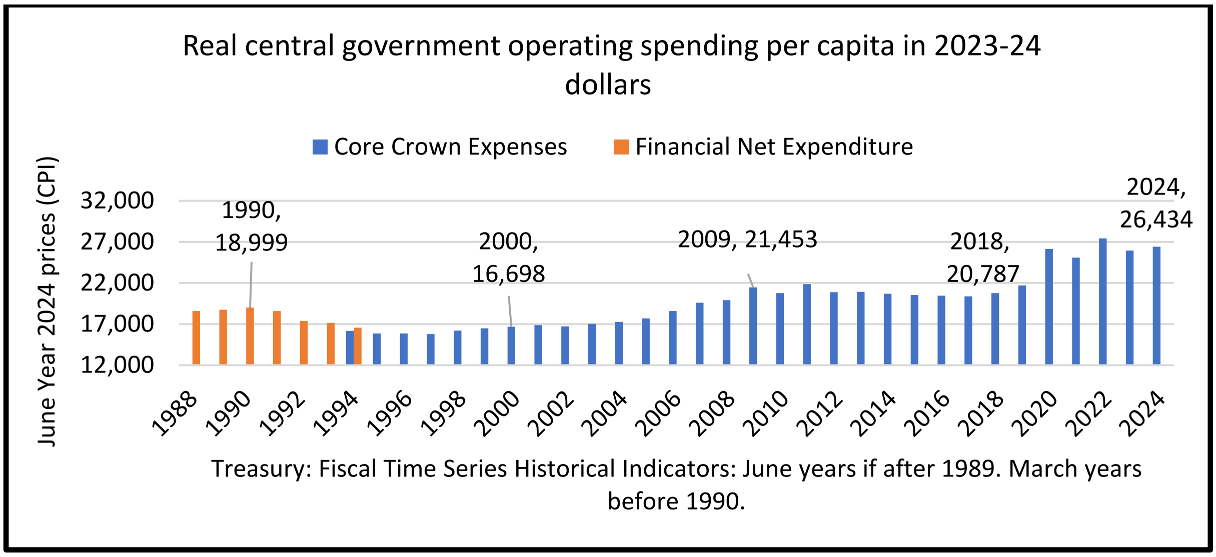
Politics is what it is. The new Sixth Labour Government blamed the previous government for imposing unnecessary "fiscal austerity". As shown above, it cranked up spending per capita even before Covid-19.

Its inherited fiscal surpluses allowed it to present itself to superficial assessors that it was still being prudent. By the same argument, tax cuts would have been prudent. The real issue is the quality of the spending relative to tax cuts.

The time path for core Crown operating spending per capita, adjusted for inflation, is shown in Figure 6. It is in year ended June 2024 prices, using Treasury's CPI inflation forecasts in its PREFU 2023.

Some see the 30-year time path to 2019 as evidence of prolonged fiscal austerity.[17]

Figure 7: Core Crown spending per capita 1988-2024



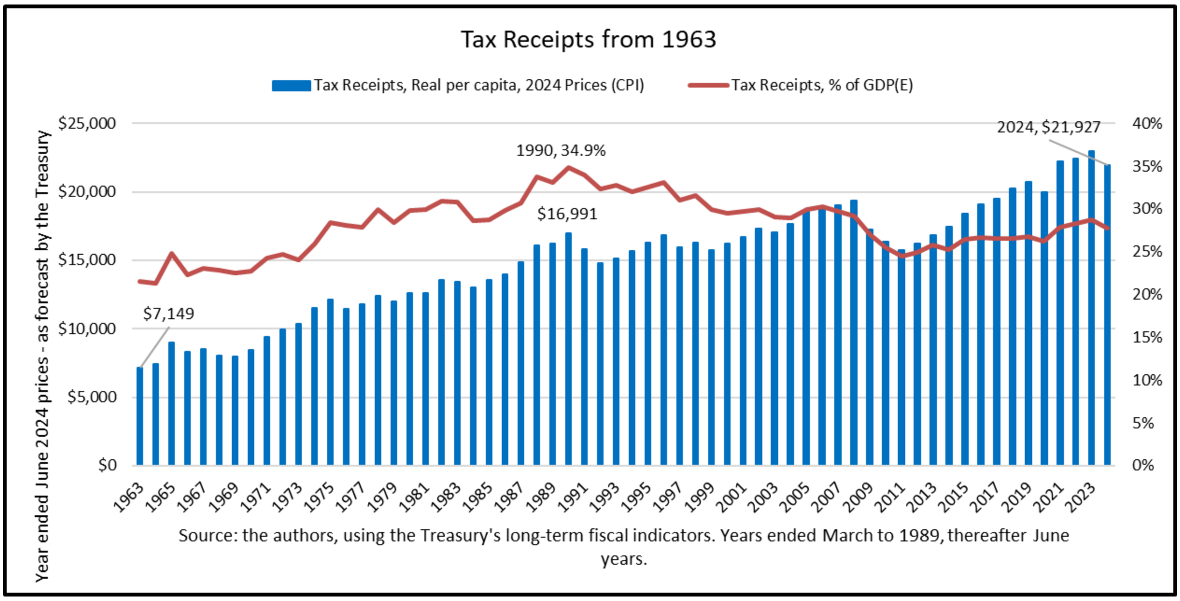
16 Initially, the Asian economic crises adversely affected its revenue, but this soon passed.

17 Bernard Hickey, "The building case for big and long fiscal stimulus everywhere" Newsroom, 13 August 2019, https://www.newsroom.co.nz/the-building-case-for-big-and-long-fiscal-stimulus-everywhere

By the year ending June 2022, current spending per capita was undoubtedly the highest in New Zealand's history, at $24,560. The Fifth Labour Government achieved the previous peak in the year ended June 2009.

Of course, the burden of taxes to fund spending increases can also be assessed against income increases.

The following chart uses the Treasury's long-term time series to track central government cash tax receipts relative to gross domestic product and real per capita dollars. Taxes on this measure have ranged between 21% of GDP (in 1963) and 35% of GDP (in 1990).



What might be said about the optimal size of government?

Perhaps the most striking fact in the above historical review is that the proportion of national income needed to fund genuine collective consumption has been under 10% during peacetime for the last hundred years.

Far more important for the level of government current spending and taxation since 1950 is spending that benefits the individual recipient. Spending on education, health care (other than public health measures, such as vaccinations) and social welfare dominate this category. (Corporate welfare benefits the individual recipient also. It is curious that Labour governments tend to promote corporate welfare – from the First Labour Government that created a licence to print money when handing out import licences to the Provincial Growth Fund of the Sixth Labour Government.)

In essence, the dominant focus of fiscal government activity since 1950 has been and still is on redistribution – taking from citizens' pockets in tax to give it back to them in cash or goods and services in kind.

Hardly any attention is given to the costs of this. People alter their affairs to avoid taxes and to make themselves eligible for the handouts. People can put serious effort into these activities, as Inland Revenue and social welfare officers likely witness daily. People want benefits.

Moreover, what is said to be free, such as free public transport, is not free. The costs of its provision must be paid for by the community by more indirect means. When something is free at the point of use, the value of the extra use may be very low. Wasteful use is likely.

Nor does this register in public debate. When one political party promises to make something else free, the media typically accost other party leaders to see what they will promise to match it.

In addition, the question of who benefits from the redistribution does not attract enough interest and concern. Concerns about the plight of the poor are easy to express, but policies that are more likely to benefit the relatively well-off also seem acceptable. Interest-free loans for first-year university students fit this category. (An argument the author has encountered is that it is acceptable for handouts to benefit the relatively well-off because they pay most of the taxes.)

An important aspect is the absence of any principled criterion for determining the optimal degree of redistribution. The demand for larger tax revenues is as bottomless as the demand for more handouts. (Outcomes are determined by the evolving political balance of forces, rather than by any principle.)

It does not matter how heavy the tax burden is; making it heavier would benefit some recipients of the largesse. As the saying goes, if the government is robbing Peter to pay Paul, it can be sure of Paul's support.

Nor would taxation at 100% of national income satisfy redistributionists. Those at the top would direct resources to areas likely to keep them at the top while looking after their own material interests very well indeed. Most people would be very poor, à la Russia.

None of this is to deny the need for charitable provision through some combination of private and collective means.

Yet the question of at what point such redistribution makes a community worse off does not disappear. What determines the optimal degree of government redistribution, messy political swings in government aside?

The answer is not straightforward. Families, friends, workmates, religious groups, clubs, friendly societies and charities can and should all play an important role in helping those who need help. What the government must do depends on the capacity of these other parts of civil society.

But civil society's own capacity can depend on the depth and breadth of state services. Friendly societies traditionally placed reciprocal obligations on the recipients of aid. State provision which comes with fewer obligations may be preferred by the recipient, eroding civil society capacity. If state capacity and competence itself erodes in time, the worst of both worlds can result. Resources that could have been used to greater long-term benefit by civil society are instead consumed by the state.

One thoughtful perspective is that, on the evidence, countries with higher levels of economic freedom tend to become more prosperous. Getting this right does not mean a nightwatchman government.[18] But there is a great deal that governments have been and are doing poorly in New Zealand currently. Housing, education, infrastructure and environmental legislation all spring immediately to mind.

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[18] For a review of the complexities involved in assessing where government might be able to do more good than harm, see Richard Epstein, *How Big Should Government Be?* New Zealand Business Roundtable, 2005. https://www.nzinitiative.org.nz/reports-and-media/reports/how-big-should-government-be/. Epstein shows why a simple answer to this question is likely to be wrong.

Size is one thing, competence is another. Tax burdens may be the same in two countries. Still, the one likely to be more prosperous in time is the one with the more competent government with an eye on economic freedom rather than authoritarian dictates.

There is a great deal in New Zealand that more competence in government could improve.

Concluding comment

The current big-spending government has historical precedents.

It is reasonable to anticipate that the government that eventually succeeds it will have to raise tax revenues and keep a tight rein on spending for many years – unless it acts more decisively.

Either way, it has happened before.

Appendix 1: More details on the First Labour Government

The historical perspective of this research note is partly motivated by the appeal of the current Minister of Finance to the First Labour Government as a model.

In his Budget 2020 speech, he took inspiration from the First Labour Government (1935-1949), and strongly disparaged the reforming Fourth Labour Government (1984-1990). He saw the onset of the Covid-2019 epidemic as a chance to "hit the reset button."[19]

The first myth about the First Labour Government is that its spending extricated New Zealand from the Great Depression. In fact, its timing was fortuitous; economic activity bottomed in 1932-33.

The following table replicates a table in the 1938 Official Yearbook. By June 1936, the volume of goods available from imports and domestic production was already 32% higher than in June 1933.

Table 3: Volume of production 1927-1936

INDEX NUMBERS OF VOLUME OF GOODS AVAILABLE FOR USE				
Year ended 30th June	Produced in New Zealand	Imported	Total	Average Volume per Head
1927	100	100	100	100
1928	100	97	98	97
1929	108	108	108	105
1930	118	118	118	114
1931	100	88	99	94
1932	90	67	80	75
1933	85	68	78	73
1934	95	71	85	79
1935	97	93	95	87
1936	105	108	100	96
Source: 1938 Official Yearbook, Chapter 44, Section XLXIII				

That recovery helped give it strong revenue growth.

A related myth is that it was a competent economic manager. On the contrary, it spent its way into a serious foreign exchange problem in 1938. This was despite strong revenue growth from the economic recovery (Figures 7 and 8). It ran into difficulties borrowing heavily in the London market when it was tight as military capital funding needs rose. [20]

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[19] See chapter 1 in Bryce Wilkinson," *Illusions of History: How misunderstanding the past jeopardises the future*", New Zealand Initiative, 2021, and Bryce Wilkinson, "Past illusions and future follies mar Grant Robertson's economic strategy", September 2021, https://www.nzinitiative.org.nz/reports-and-media/opinion/new-opinion-95/

[20] Ibid.

In the event, the approaching war with Germany meant the UK Government needed the support of British Commonwealth members. As a result, the UK authorities ensured New Zealand did not default on debt that needed to be rolled over.

War-time arrangements with the UK and heavy war-time taxation dominated the news and hid the borrowing debacle from the general public.

Appendix 2: Background information for Table 1

Table 4: Background information for Table 1

	Spending in fiscal year government was elected	Spending in fiscal year government was voted out	Increase in nominal spending during period in government	CPI Increase in same period (final year average/ elected year average)	Population increase (final year average/ elected year average)	Change in per capita spending relative to the CPI during period in government
	$m	$m	%	%	%	%
Reform 1911-1924*	20.680	54.798	165.0%	73.5%	27.5%	19.8%
United & Reform 1928-1935	48.354	51.782	7.1%	-17.9%	7.1%	21.7%
Labour 1st 1935-1949	51.782	241.378	366.1%	60.9%	20.2%	141.1%
National 1st 1949-1957	272	490	80.1%	50.5%	19.3%	0.4%
Labour 2nd 1957-1960	490	631	28.8%	9.0%	6.3%	11.1%
National 2nd 1960-1972	631	1,908	202.4%	73.1%	22.8%	42.3%
Labour 3rd 1972-1975	2,006	3,562	77.5%	41.0%	6.1%	18.7%
National 3rd 1975-1984	3,562	14,534	308.0%	202.0%	4.8%	29.0%
Labour 4th 1984-1990	14,534	30,298	108.5%	78.0%	4.1%	12.6%
National 4th 1990-1999	29,573	34,829	17.8%	14.9%	11.3%	-7.9%
Labour 5th 1999-2008	34,829	63,711	82.9%	28.0%	11.2%	28.5%
National 5th 2008-2017	63,711	80,576	26.5%	15.0%	13.5%	-3.1%
Labour 6th 2017-2023*	80,576	136,991	70.0%	25.4%	8.5%	24.9%
Note: Years ended March to 1989, Years ended June thereafter. Labour could be re-elected in 2023.						

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