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Castalia's review of the National Party's fiscal plan

28 September 2023

The New Zealand National Party (National) has prepared a fiscal plan for the period to FY2028. The announced policies will have implications for government forecast expenditure and the national debt. The fiscal plan estimates the costs and savings of National's policies and their fiscal implications.

Castalia was asked by National to review the underlying assumptions and the calculations of elements of the fiscal plan, as well as its overall consistency. We have not been asked to comment on the merits of the proposed policies or to cost all of them. This report sets out the results of our review and explains our approach.

We reviewed National's Excel spreadsheet models, the Government's budget publications, and various Departmental publications in our assessment. We built our own Excel-based model to test some of National's analyses and forecasts.

Castalia has reviewed National's fiscal plan and can confirm that the policies contained within their fiscal plan can be met from the proposed allowances. Castalia has also calculated net and OBEGAL forecasts based on the proposed spending allowances. Our findings were consistent with those of the National Party.

In addition, National asked Castalia to assess specific policy costings for three announced policies:

- Changes to indexation of benefits
- Changes to transport policies
- Increase in correctional occupancy.

Castalia's estimates were generally consistent with National's cost estimates – although we judged National's estimate of the cost of growth in correctional occupancy was conservative.

The following tables present Castalia and National's results and provide an explanation of Castalia's approach to calculating our results.

Table 1: Budgeted spending items

Item	National's estimate over four years	Castalia's estimate over four years	Castalia's approach to analysis
Operating savings from benefit indexation changes	\$2,042m	\$2,042m	Castalia undertook an independent costing of National's policy to change inflation indexation on some benefits.

			National's policy is to apply CPI indexation rather than net wage indexation to the following benefits: ▪ Jobseeker ▪ Emergency support ▪ Supported living payment ▪ Sole parent support ▪ Youth payment ▪ Young parent We calculated the proposed savings by reversing increases linked to wage growth and instead applied calculating increases linked to CPI. Because the Government's forecast only goes to FY2027, we estimated what the budgeted value would be in FY2028 by applying a historical average growth rate in each benefit's cost. Overall, we replicated the process of calculating the Annual General Adjustment. This includes following the timing and specific indexation measures used in the current adjustment calculations. The difference between the cost under the National's plan and the cost in the Government's budget projection is our estimate of the value of the savings. We understand that National used a different calculation methodology focusing on building the costs from the ground-up and have arrived at a very similar result.
Changes in costs from National's Transport policies	Net cost of stated policies: $140m	Net cost of stated policies: $140m	Castalia was asked to check that the sum of National's policy costings in the transport sectors was correctly calculated and that the allocation between operating and capital allowances made sense. We were not asked to verify the accuracy or reasonableness of the individual policy estimates. The net effect of the stated policies means that the National Land Transport Fund (NLTF) will have a $140 million reduction in total net income over the four-year period from FY2025 to FY2028 after the capital contribution is taken into account. We understand that National intends to address this gap by reducing the NLTF's operating costs in the following activity classes: ▪ Walking and Cycling ▪ Coastal Shipping ▪ Inter-regional Public Transport For reference, the average of the range of estimates provided in the FY2024 GPS for the above three activity classes is about $300m per year.
Review of the cost of increased corrections	$718m	$508m	Castalia was asked to check the reasonableness of National's approach to calculating the cost of a higher prison population. Castalia did not assess and makes no judgement regarding the effects of the proposed policies on the number of additional prisoners. National provided us with an indicative number (350 additional prisoners per year) to use in our calculations. We understand this would broadly reverse the current annual trend in the reduction of prison numbers.

Our assessment of the costs of the expected increase in prisoner numbers depends on whether the increase in prisoner numbers will require expansion in prison capacity over the forecast period. We assume that the proposed increases can be accommodated within the current officially stated capacity of New Zealand's prison system.[1] If no additional capacity needs to be constructed, the cost of the increase in prison population can be derived as the marginal cost of each additional prisoner multiplied by the number of the additional prisoners.

We first assessed the average cost per prisoner for both rehabilitation and incarceration services using budget figures. International literature[2] on prison costing suggested that as long as prisons were under capacity, the long-term marginal cost of additional prisoners is approximately 70% of the average cost.

We understand that National has opted to take a more conservative approach and assume that the additional cost per prisoner is equal to the average cost per prisoner.

The projection suggests that prisons will start reaching full capacity in some areas in either FY2029 or FY2030. We understand that National has noted that there is sufficient uncommitted budget allowance to fund additional capital spending during the calculation period to prepare for the additional capacity requirements. We were informed that National will re-assess to what extent additional capacity will be required in successive budgets once the effects of the announced policies become clear.

Table 2: Overall metrics

Item	FY2024/25	FY2025/26	FY2026/27	FY2027/28
		National calculations		
OBEGAL	-6,129	-1,030	2,909	1,786
OBEGAL as a % of GDP	-1.4%	-0.2%	0.6%	0.3%
Net debt	99,754	102,824	100,584	97,628
Net debt as a % of GDP	22.8%	22.2%	20.6%	19.1%

[1] The total official prison capacity as at June 2022 was 10,683. See: *Ara Poutama Aotearoa – Department of Corrections,* "Annual Report: 1 July 2019 – 30 June 2020."

[2] We reviewed several international academic sources tracking the prices per prisoner, including: Stuart John Wilson, Jocelyne Lemoine, "Methods of Calculating the Marginal Cost of Incarceration: A Scoping Review," *Criminal Justice Policy Review*, vol. 33(6), 2022. pp. 639-663. *Allegheny County Department of Human Services,* "Calculating Unit Costs in Allegheny County: A Resource for Justice System Decision-Making and Policy Analysis," September 2021. M. Block; T. Ulen, "Cost functions for correctional institutions (Technical Report CERDCR-2-79)," *Centre for Econometric Studies of the Justice System,* May 1979. Etc

Castalia calculations				
OBEGAL	-6,123	-1,017	2,930	1,815
OBEGAL as a % of GDP	-1.4%	-0.2%	0.6%	0.4%
Net debt	99,748	102,805	100,544	97,559
Net debt as a % of GDP	22.8%	22.2%	20.6%	19.1%

Castalia approach to calculation

Castalia calculated net government debt and OBEGAL once all National's proposals are summed up.

In addition to reviewing National's tax plan, we also assessed the specific policy costings for changes to benefit indexation, changes to transport policies, and an increase in correctional occupancy. Castalia has not modelled the costings of some other policies in National's fiscal plan.

Overall, we confirm that National's calculations are consistent and that their policies can be met from the proposed spending allowances. Their proposed allowances are fully reflected in the projected net debt and OBEGAL. Given the estimated reduction in the net debt, we calculated the additional avoided cost of debt service that would be achieved. These savings are added to the total savings.

The total change from the sum of National's policies was netted from the PREFU net debt and OBEGAL forecasts to forecast net debt and OBEGAL under National policies.

As mentioned above, the calculation of savings includes interest avoided as a result of those savings. National assumes that the savings made in the previous year avoid interest from the start of the following year. Castalia also applies interest reduction to the savings made during year. We assume that savings are available for half of the year in which they are made. National's approach is the more conservative of the two.