

PUBLIC SPENDING AND HOME HEALTH SERVICES

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I have been asked to present an account of the economic context in which the home health services industry will function. I am not going to talk about the rising demand for its services because of population shifts taking that as a given. Another source of the rising demand may be as we keep more elderly and disabled at home – again I take that as given. And I am not going to say that you must improve the productivity and effectiveness of your service delivery. I would say that to any sector, whatever the economic context.

Rather, in the short time at my disposal I am going to explain how the Global Financial Crisis has added a further dimension to the future pressures on home health services. In particular there is going to be less public and private expenditure than one might have thought a couple of years ago, there will be severe competition for that spending, and your service – like every public service delivery sector – is likely to experience squeezed resources, despite the rising demand that I have just mentioned. So I shall conclude with some suggestions about how your might respond.

There is a general misunderstanding about the Global Financial Crisis. When the public became aware of it in late 2008, many thought that the Great Depression of the 1930s was repeating itself. The Great Depression was a very unusual event in the history of the world economy, its severity being a consequence of monetary mismanagement. The central bankers of the world have avoided repeating those mistakes, and the prospect of a deep drop in output, a major rise in unemployment and a five year slump now seems unlikely.

The relief that a second Great Depression had been avoided swung opinion to the other extreme, so many thought there would be only a short cyclical downturn like – say – the Asian crisis of the late 1990s. There would be some loss of production and some rise in unemployment, but any hardship these events generated would be temporary. It was thought that within a couple of years there would be a strong economic recovery and the economy would be soon on its pre-crisis track.

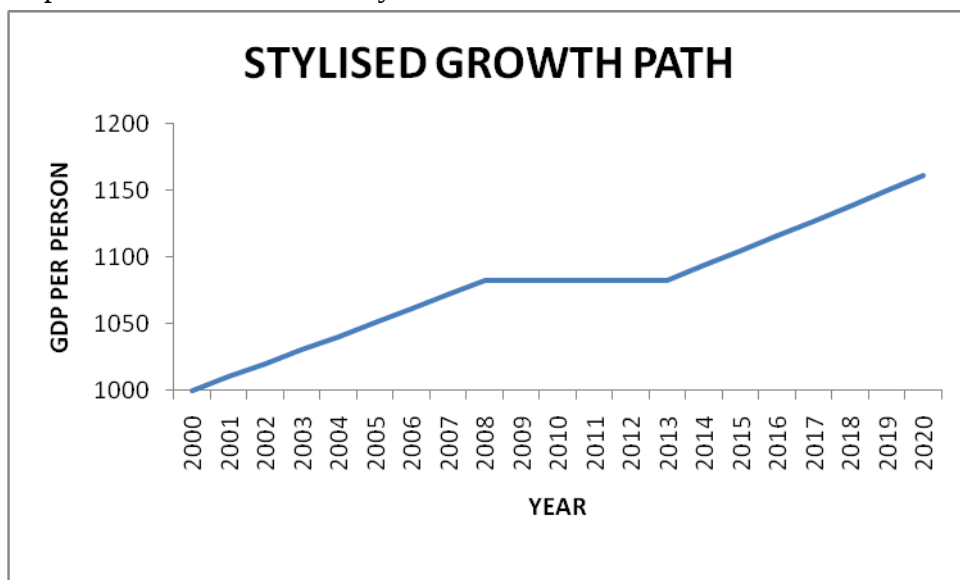
That recovery was expected to be happening about now. But if there is one, it is certainly not strong. Indeed there is an increasing view that the track may be a ‘double-dipper’, that is, a contraction of output, followed by a short weak recovery, followed by a second contraction. That is consistent with the gloomy prospect that we are going to have a long recession, a period of some years when the economy will broadly stagnate.

⁰1. Economic and Social Trust On New Zealand; www.eastonbh.ac.nz

We have had them before. There was the Rogernomics Recession from 1986 to 1993 – some seven years. There was the wool price crash of late 1966 followed by a recession of twelve years; there was the recession of the 1920s which started after the First World War and lasted around ten years, until the collapse into the Great Depression. And there was the Long Depression of the 1880s.

When in 2008 I reviewed the state of the New Zealand economy from an historical perspective, the best parallel was the Long Depression of the nineteenth century. It was precipitated by a banking crisis in the financial capital of the world – it was then London – and most of the world economy was sluggish as a result for a long period. Significantly, New Zealand's Long Depression was preceded by the Vogel inspired borrowing boom which resulted in a lot of overvalued assets which resulted in financial, farm and business collapses. One of the roles of long recessions and depressions is to squeeze out those over-valuations.

This means that the overvaluations in 2008 – in the balance sheets of finance companies and others, and in property prices has to be down-valued to be better aligned with reality. This may be by bankruptcy and writing off the value of investments, or by prices falling or stagnating (perhaps during an inflation). If the assets remain overvalued then the risk of another crisis remains. Re-aligning over-valuations takes time, which is why the Long Depression lasted around 17 years.

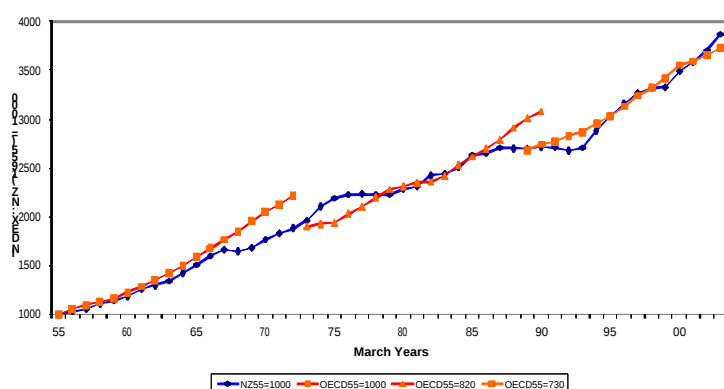


This is not to say the recession which follows the Global Financial Crisis will also last 17 years. Quite frankly I don't know how long it will last; anybody who tells you they do know, hasn't been following what is going on. But from the beginning I was reasonably sure it will last longer than the 18 or so months some predicted. There were ups and downs in all our long recessions, and there will be in this one. During the ups the optimists will declare it over, during the downs they will be devastated. That is what is happening at the moment.

We can use the histories of New Zealand and other countries to get a better feel about the course of a long recession. One clear result is that we can expect the track of economy to take a step down after a financial crisis. As the diagram schematically shows the growth rate remains broadly the same, but the growth track is lower after the crisis than before. One way of thinking about the long recession is that as the economy transfers from a higher growth path to a lower one it appears to stagnate.

Chart 7: GDP (1955-2003):

Based on Official Data



How big is the step down? The short answer is that we cannot be sure although it may be large. Here is a graph which shows what happened between 1955 and 2000. The growth path of production after the wool price collapse in 1966 tracked about 20 percent below the path up to 1966; the growth track of the Rogernomics Recession was another 15 percent lower than the one before those policies were applied. Notice that the short business cycles which happened

every three or so years are hardly visible, although when they occurred everyone was very aware of them; that is what I meant by the ups and downs which occur during a long depression.

While it is very difficult to predict, currently the common estimates of how much lower the recovery track are in the 3 to 9 percent range; let us assume 6 percent. But we also need to look at the expenditure track as well as the track of production. In the last few years there has been heavy borrowing for financial speculation including on housing and consumption. In recent years that excess borrowing – aggregate expenditure including investment exceeding production – has amounted to around 7 percent of GDP so. A prudential rate of national borrowing might have been 3 percent of GDP. That means we have to cut another 4 percent of expenditure relative to production. That suggests a total reduction in public and private expenditure of about 10 percent.

This is not an absolute cut in expenditure. Rather, over a period we are going to have to restrain the expenditure path below what we thought it would be tracking in 2008. That is my message today. Under current economic expectations we are going to have to spend less than

we thought – almost everyone including, I regret, the home help services industry is going to have to spend less than they hoped in 2008.

At this point I can branch out in a number of directions including what it means for industry, what it means for growth policy, what it means for macroeconomic policy. But today I am going to focus on what it means for you, and the people you serve.

Responding to the expenditure cuts is rather like ‘pass the parcel in a Belfast pub’, as everyone tries to pass their share of the expenditure reductions onto someone else. Thus the rich demand tax cuts to maintain the growth of their incomes – as occurred during the Rogernomics Recession – so those further down the distribution have to take a bigger hit – as happened in the Rogernomics Recession too. That is the point of the benefit cuts and the higher rate of GST.

Should the public sector should be cut harder than the private sector? It is perfectly true that public consumption grew faster than production in the last decade. But so did private consumption. The balance between them did not change a lot at all. Of course one might argue, as this government does, that there should be more private consumption relative to public consumption. That is a political judgement which economists don't have any particular competence in making – although there are those who don the mask of economists to disguise their ideology.

All I shall say about this issue is that in 2008 the electorate voted for a government that favours tipping the balance towards private sector consumption. In so far as the government is successful, we can expect public sector spending to grow even more slowly than private sector spending. The effect is not great in aggregate; if you cut public spending by an additional 1 percent you get an increase in private spending of less than a third of a percent. That does not include cutting transfers such as social security benefits and New Zealand Superannuation, which are really about reducing some people's private spending and increasing others. But while these changes are small in total, they impact heavily on particular spending areas.

Note that even were there a government at the other side of the ideological spectrum, it too would have to severely restrain public spending. Of course it is in the interests of all political advocates to fudge the need for cutting public and private spending, but unless we do that we don't get back on a growth track and prolong the recession.

(I promised not to talk about productivity improvements because we should do them anyway. But beware the fudge that says it is a productivity improvement when it is really an expenditure cut, and the public gets less or poorer quality service.)

While a 10 percent cut in total spending may be necessary is relative to the past spending track, it is a cut over the period of the long recession. Were it to last ten years then the cut would be only be 1 percent a year. (Do we really want a 10 year recession?) But to understand the implications, imagine what would happen if there were a 10 percent cut of public expenditure overnight.

A 10 percent overall cut – even one phased over a five to ten year period – is tough on those providing and using public services. It wont be across the board: some activities will have to be cut harder than others. Some public spending can expect some growth during the recession if only for population change, some will face a number of years of stagnation, and some must expect a reduction in aggregate spending relative to the earlier track even if demand for it increases. Sometimes the effect of the cuts will be wage restraint among public employees.

Which group you or any other public funded sector belongs to is a political decision. In our democratic system you can have an effect, although that is true for every sector. What will determine the outcome will not only be how just your cause is but how well you are organised. Your Home Health Association should be at the forefront of that organisation.

The decisions to fund you may be directly made by the government – the minister or the cabinet – or it may be indirectly made by them giving a lump sum to each district health board, and the board allocating amounts to various services. That means you need to operate, at both political levels. That does not mean you need to operate party politically, although you may well decide to press your cause at this year's local body and next year's general election.

Moreover, it is not just a matter of your doing that. You need to recruit the general public. Now the health sector involves a bit of interesting economics which goes like this. An individual may support the public health system while hoping never having to use it. When somebody you dont know goes to hospital you may yet be delighted that they have because one day you or your family or friends may have to use the service.

That means the public expenditure on health gets two bangs for the spending buck, the value of the treatment to the individual, plus the satisfaction by everyone else that the service is there if they, or someone that is important to them, needs it.

But to have that satisfaction, people need to know about the service. Do they know enough about yours? If they dont they will not defend it from expenditure reductions as fiercely as other spending. Lobbying against decided cuts is too late, and in any case it sounds like self interest. What you need before the decision is a groundswell of opinion that the public knows what you do, they like what you do, and they want what you do. Additionally it may contribute to their vision of society – what a prime minister once called 'applied Christianity'.

There is another important channel through which you can pressure the political process. General practitioners are prominent gatekeepers for your services. As such they, and their colleagues in hospitals, have an interest in the effectiveness of your industry, not only because they don't want your clients stuffing up their clinics and beds, which will happen if your services get reduced, but because being at home with good external support is often the best thing for their patients – and resource saving too.

In summary then, while the Global Financial Crisis will reduce the resources available to the public sector, it will not reduce the need – indeed it may increase it given that the loss of savings mean some potential public sector clients have less resources of their own. The challenge you face is not only to continue to do your job efficiently and effectively, but to ensure there are sufficient resources to do the job. Since most of them will come from the public, you need to make a clear case to the public of your sector's importance and needs.

Best wishes with both those tasks, from somebody who does not need your services but is glad you are there.