AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY

COMMONWEALTH SPENDING (AND TAXES) CAN BE CUT - AND SHOULD BE

A Discussion Paper
by
Des Moore

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FOREWORD

On behalf of the Australian Chamber of Commerce and Industry (ACCI) I am very pleased to release the discussion paper *Commonwealth Spending (And Taxes) Can be Cut - And Should Be* by the eminent Australian economist and former Deputy Secretary of the Commonwealth Treasury, Mr Des Moore. The detailed examination of proposed spending cuts is the most comprehensive document of its type in the past decade and it aims to inform the public debate that significant tax cuts are possible provided they are accompanied by a sensible program of spending restraint.

Over the past year many individuals and groups have advocated the need for tax reductions. However, they have not faced up the discipline of outlining how they can be sustainably delivered.

ACCI commissioned Mr Moore to consider a range of realistic measures the Commonwealth Government could implement, over time, to reduce spending and thereby offer the opportunity for a responsible program of income tax reductions.

The scope of possible taxation reductions is outlined in the ACCI *Taxation Reform Blueprint* released in November 2004. The *Blueprint* advances an argument for taxation reform over the next decade. We believe that a second wave of tax reform that builds on the Government's 2000 reforms is a pressing priority for business. Tax reform is needed to increase Australia's economic growth rate and our international competitiveness by encouraging workforce participation, skills development and entrepreneurship. Implementing these changes will ensure Australia can meet long-term challenges of an ageing of the population; increasing skills shortages and the need for increased private sector expenditure on research and development.

All the taxation matters raised in that *Blueprint* are of importance. Nevertheless, ACCI's membership has identified the following areas as needing priority reform: tax compliance; personal income tax; state taxation; capital gains tax; and retirement incomes tax. The cost of ACCI's proposed taxation policies, excluding personal taxation, would be less than $4 billion per annum. The cost of personal tax changes could rise to as high as an additional $10 billion. The effect of a tax cut of $14 billion to the budget would be to reduce total taxation revenues from approximately 32 per cent of Gross Domestic Product (GDP) to 30 per cent of GDP. Further, if in the longer run the abolition of payroll tax (costing some $10 billion) were added to the list and it was also funded by expenditure restraint, that would see revenues as a share of GDP fall to around 29 per cent. This would place Australia closer to the US in terms of total taxation as a percentage of GDP.

The views expressed in this document and the nomination of specific areas of spending restraint are those of Mr Moore and are not necessarily those of ACCI and its members. However, ACCI fully endorses a program of expenditure cuts and believes that the Government and the Opposition party should look at Mr Moore's paper with a view to achieving what is possible.

Finally I would like to thank Burchell Wilson, Greg Evans, Michael Potter and Jennifer Jay of the ACCI national office who assisted Mr Moore in the overall preparation of the publication.

Peter Hendy
Chief Executive

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ABOUT THE AUTHOR

Mr Des Moore is a graduate in law from Melbourne University and in economics from the London School of Economics. During his 28 years in the Commonwealth Treasury, he was, at one time or another, head of most of the main policy areas, including the division responsible for producing the Commonwealth budget. His last five years in the Treasury were as one of three Deputy Secretaries.

In February 1987, Mr Moore resigned from Treasury at age 55 to join the Melbourne-based think-tank, the Institute of Public Affairs, as the Senior Fellow of the Economic Policy unit. One of his many publications at the IPA was "Commonwealth Budget: Cut Spending by $15-16 Billion", February 1995.

In February 1996 Mr Moore decided to establish his own think-tank, the Institute for Private Enterprise, to promote the role of genuine private enterprise in Australia. As director he has published on a wide range of issues regarding the respective roles of government and the private sector in Australia.

In 2001 he was appointed to the board of the Australian Strategic Policy Institute (ASPI) that was established by the Government as an independent think-tank on defence and strategic issues. That appointed was renewed in 2005. In 2003 he was appointed to the Board of the Public Sector and Commonwealth Superannuation Schemes.

SUMMARY

"It is the highest impertinence and presumption in kings and ministers to pretend to watch over the economy of private people, and to restrain their expense … They are themselves always and without exception, the greatest spendthrifts in the society"
Adam Smith, Wealth of Nations

A strong case exists, on both economic and social grounds, for Australia to have a "small government" society. Avowedly, the Coalition supports that approach.

To reduce the burden of taxation requires a reduction in spending.

However, the Howard Government has made no progress in that direction, either in practice or philosophically. Indeed it has gone backwards. ABS national accounts data on Commonwealth spending show that, excluding interest, it has increased as a per cent of GDP. Extensive "tax expenditures" – substitutes for direct expenditures delivered through the tax system – add another 17 per cent to Commonwealth spending levels.

Analysis of Commonwealth spending/revenue concessions indicates immediate potential for saving $19.5 bn pa or over 2 per cent of GDP. That would allow income tax to be reduced to a top rate of 30 per cent – and additional tax changes.

Savings can mainly be achieved by reducing benefits to higher income groups but by "compensating" most of them through tax cuts. This is possible because those groups receive 30 per cent of social security (including selected education and health) benefits and thus receive back nearly half the taxes they pay. Most of such "churning" is a useless product of a society that has become bureaucratised by political parties buying votes.

Internationally, Australia has a larger sized government than commonly supposed: allowing for compulsory superannuation contributions, our government size is close to the OECD average. The downward trend in Europe has missed the Commonwealth Government.

A smaller Government here would likely enhance economic activity and employment, increase the role and responsibilities of individuals and improve the functioning of society. It would also avoid or greatly diminish the need for future increases in taxation to fund the needs of an ageing population.

The cuts of $19.5 bn would represent a total percentage reduction of 8.2 per cent. The main potential for savings in expenditure comes from social security and welfare ($7,278 mn), health ($2,844 mn), education ($1,689 mn), housing ($1,038 mn) and industry assistance ($457 mn). This would be a percentage cut in expenditure of 8.1 per cent (including a 20 per cent cut in industry assistance). In addition it is proposed that total tax expenditures will be cut by $2,993 mn or 8.7 per cent.

With the much higher than expected States' revenue from the GST, a major reduction would be justified in specific purpose payments to the States ie a greater responsibility would be passed back to the States.

INTRODUCTION

In recent months there has been some debate about whether the burden of Commonwealth taxation (ie tax as a percentage of gross domestic product) has increased under the Coalition. Whatever the resolution of that debate, the emergence of strong pressure from many quarters (not least from the Australian Chamber of Commerce and Industry) to implement early tax cuts confirms that both the overall burden and the progressiveness of rates are widely judged as excessive. And, when they claim the burden has risen, even Labor spokesmen have at least implied opposition to any increase. But, while the Government has rejected claims that the burden has risen, its broader reaction seems disappointingly confined to highlighting specifics such as reductions in the company tax rate and increases in the top income tax threshold.

Indeed, despite the Coalition's avowed "small government" philosophy, the large spending "initiatives" in the election campaign and the absence of overt support for a major reduction in the tax burden raise a question as to whether that philosophy remains extant.

Recently, while not ruling out tax cuts, Prime Minister Howard has focussed mostly on an objective of budgeting for a "strong surplus" and his claim that "our goal is to expand individual choice, freedom and opportunity, not to expand the reach of central government" does not seem consistent with his record.[1] And, although Treasurer Costello has publicly supported more tax reform, he was scarcely reassuring when he commented that "we have got to have a tax system which is capable of delivering …expenditure requirements in relation to health, education, aid to tsunami victims, protecting against terrorism, building air-warfare destroyers and balancing the budget" (*The Age, 4 February*).

What is sometimes overlooked is that no significant lessening can occur in the tax burden unless the Government is prepared to implement a major reduction in Commonwealth spending. Tax "cuts" financed from revenue generated by inflation, such as the return of bracket creep, do not reduce the tax burden or signal a move towards smaller government. Assuming that a budget balance is broadly sustained over time, the test is whether spending is being reduced on a sustainable basis as a proportion of GDP.

The present report points out that, although since the last year of the Labor government in 1995-96 there has been a reduction in total outlays as a proportion of GDP, that is (more than) entirely due to a reduction in interest costs and the relative size of discretionary spending has actually increased. It argues that a strong case exists on both economic and social grounds for reducing the size of government and identifies savings that would reduce Commonwealth expenditure/revenue concessions by over $19 billion or more than 2 per cent of GDP in 2005-06. Of course, it is not practical at this stage in the formation of the Budget to expect proposals of this magnitude to all be implemented in 2005-06. But they provide an illustrative basis which the Coalition could use to implement savings of, say, around $16 bn or 2 per cent of GDP in the very near future. The following table summarises by function some possible savings to existing estimates of Commonwealth spending and (where appropriate) revenue for 2005-06.

Although some will doubtless assert that this proposal would involve too large a reduction in the role of government, such an objection could hardly be sustained given that, as the report explains, the major effect of the changes would be on middle and higher income groups. Moreover, while there could be negative effects on the incomes of some in those groups, the majority would be "compensated" if a commensurate flattening in tax rates accompanied the proposed changes. Estimates by private sector economists, for example, suggest that the cost of reducing income tax rates to a maximum of 30 per cent would be in the $13-15 billion range in 2005-06.

It goes almost without saying that, with an imminent majority in the Senate, the Coalition has an almost unique opportunity to give practical effect to its avowed philosophy by initiating a major shift in the respective roles of government and the individual. This could be portrayed as a new phase for government, a definitive turning of the tide in what has generally been an expansive post World War II era. That would throw out a major challenge to an Opposition that displays increasing uncertainty of where it

Table 1
Reductions in Commonwealth Spending by Function

	2005-06 Projected Outlays $m	Proposed Saving $m	Proposed Saving %
Social Security and Welfare (a)			
Assistance to the Aged	30,170	1,302	4.3
Assistance to Families with Children	25,493	3,888	15.3
Assistance to People with Disabilities	11,810	1,354	11.5
Assistance to Veterans and Dependents	6,086	128	2.1
Assistance to the Unemployed	5,733	606	10.6
Other Welfare Expenses	7,704	-	-
Total Social Security and Welfare	86,592	7,278	8.4
Health (a) (b)			
Medical Services and Benefits	15,383	1,664	10.8
Hospital Services	1,837	-	-
Health Care Agreements	8,336	829	9.9
Pharmaceutical Services and Benefits	7,844	350	4.5
Other Health Expenses	4,120	-	-
Total Health	37,520	2,844	7.6
Education (a) (b)			
Higher Education	4,984	1,242	25.0
Vocational and Other Education	1,764	112	6.4
Schools	8,103	335	4.1
Student Assistance	586	-	-
Other Education Expenses	71	-	-
Total Education	15,508	1,689	10.9
Defence	14,518	170	1.2
General Public Services	12,066	135	1.1
Fuel and Energy	4,069	265	6.5
Public Order and Safety	2,788	-	-
Recreation and Culture (incl. ABC/SBS)	2,535	864	34.1
Transport and Communication	2,637	358	13.6
Agriculture, Forestry and Fishing	1,963	-	-
Mining, Manufacturing and Construction	1,823	-	-
Housing and Community Amenities	1,717	1,038	60.4
Other Economic Affairs	5,064	1,010	19.9
Other Purposes (a) (c)			
Nominal Superannuation Interest	5,322	-	-
Assistance to States and Territories	1,153	-	-
Assistance to Local Government	1,613	322	20.0
Miscellaneous Other Purpose	3,348	-	-
Total Other Purposes	11,199	322	2.9
Industry Assistance (d)	2287.2	457	20.0
Total Above	**200,000**	**16,430**	**8.2**
Public Debt Interest	3,585	63	1.8
Total Outlays (Excl. Asset Sales)	**203,585**	**16,493**	**8.1**
Tax Expenditures			
Family Tax Benefit A & B		1,510	
Private Health Insurance Rebate		790	
Other		693	
Total Tax Expenditures	34,516	2,993	8.7
Total Spending and Tax Concessions	**238,101**	**19,486**	**8.2**
Privatisation Proceeds			
Telstra	32,200	-	
ABC/SBS (net)	702	39	
Medibank Private	437	24	
Total Privatisation Proceeds	**33,340**	**63**	

(a) Expenditures by sub-function are as in Budget Paper No. 1 2005-05.
(b) Approximate updates have been made to sub-function expenditures to reflect expense measures after the 2004-05 Budget.
(c) Excluding public debt interest.
(d) Industry assistance is provided through a range of expenditure functions and this projected outlay is not part of 'Total Above'.

Source: Mid-Year Economic and Fiscal Outlook 2004-05, Tax Expenditures Statement 2004.

stands on the role of government. Such a reversal would be based on the notion that, particularly in today's more educated society, a higher proportion of individuals could safely be given an increased capacity to make their own decisions on health, education and retirement and would, in turn, readily accept a greater responsibility for doing so.

WHAT HAS BEEN HAPPENING TO SPENDING UNDER THE COALITION

The move from cash to accrual accounting in 1999-00 has led to a situation in which there exists no published series that provides Commonwealth expenditure on an historically consistent basis. The published official data in both the budget papers and the Australian Bureau of Statistics (ABS) publication on government finance statistics show a break in the series in that year and an examination of the data suggests that aggregate and most functional data are not usable in terms of comparability before and after 1999-00.[2] Requests to the Treasury and the Department of Finance for more historically consistent data produced helpful responses but revealed that, while internal work has been undertaken, their results have only limited practical use. It is surprising that relevant Government Ministers do not appear to have commissioned the production of data that is more historically consistent. They should do so.

My research has revealed, however, that historically consistent figures on Commonwealth expenditure can be derived from national accounts data available from the ABS.[3] The (limited) functional breakdown for 2003-04 (the latest available) is set out in Table 2 (page 14) attached and Tables 3 (page 15) and 4 (page 16) are also compiled on an historical basis from this source. They provide the following perspective:

- Total outlays were reduced by 1.1 percentage points of GDP in the first year for which the Howard Government can be held responsible for outlay levels (1996-97). They then moved still lower until the election year in 2000-01, when they reverted to 1996-97 levels and stayed around there through to 2003-04. However, while they were then lower than in the last year of Labor, that reduction did not reflect a diminution of spending in discretionary areas.

- Thus, if interest and defence are excluded on the ground that they are not part of discretionary spending, total outlays were nearly a percentage point of GDP higher in 2003-04 than in the last year of Labor. Indeed, the reduction of 1.8 percentage point of GDP in interest costs more than accounted for the 1.1 percentage point fall in total outlays since that year.

- If grants to the States ("S and L" or State & Local) are also excluded to remove the effect of the ABS' inclusion in Commonwealth expenditure of the payments of GST revenue to the States, 2003-04 outlays by the Howard Government were about the same as in the last year of Labor. Note that, for these outlays excluding interest, defence and States grants, the Howard Government's "low" point in 1998-99 was 1.4 percentage points lower than in 2003-04 but in 2003-04 they were 2.5 percentage points higher than in the last year for which the Whitlam government can be held responsible (1975-76) and 3.1 percentage points higher than the low point reached in the 1980s.

- As Table 4 shows, a major contributor to the continued high rates of more discretionary spending has been the upward trend in payments of Social Security benefits. Since 1995-96 these benefits have added 0.4 percentage points of GDP to total outlays and in 2003-04 were at an all time high and 3.3 percentage points higher than in the last year of the Whitlam government. Reflecting much "churning" of taxes, these benefits are also now contributing an all time high 14.3 per cent to household disposable incomes.[4] This is despite the much stronger growth in recent years in average real per capita incomes – in the eight years from 1995-96 about 2.5 per cent pa compared with about 1.5 per cent pa in the previous eight.

Any assessment of the extent of the Commonwealth Government's influence on individual and corporate decision-making also needs to take account of the provision of large "tax expenditures", estimated for 2005-06 at $34,516 mn or 3.8 per cent of GDP, slightly higher than in 1995-96 (3.7 per cent of GDP). These "expenditures" comprise the net cost of concessions, benefits or incentives provided through the tax system by comparison with the revenue that would be collected if the standard tax treatment were applied to the general activities or classes of taxpayers subject to tax ie the general level of revenues/rates of taxation is higher than would otherwise be the case.

The Tax Expenditures Statement (TES) for 2004 (*The Treasury, January 2005*), which takes over 100 pages to list the very large number of concessions, points out that "tax expenditures are substitutes for direct expenditures, delivered through the taxation system and accordingly affect the budget position". It could have said (less diplomatically) that Commonwealth outlays for 2005-06 are, in effect, about 17 per cent higher than the estimate of $203,585 mn in the *Mid-Year Economic and Fiscal Outlook 2004-05* (MYEFO).

But, even though the provision of these "tax expenditures" has obvious economic/social policy implications, the TES acknowledges that they "do not receive regular scrutiny through the budget process." This seems wrong: each item of "expenditure" should surely be subject to review in the annual budget process. As TES notes, several OECD countries "explicitly link tax expenditure reporting to the budget process."

There are large costs to annual revenue from "expenditures" such as the concessional taxation of funded superannuation ($12.8 bn in 2004-05), the exemption of family tax benefits ($2.7 bn), the discount of capital gains tax for individuals and trusts ($2.6 bn), the tax offsets/exemptions of various income support benefits, pensions or allowances ($2.2bn), the tax offset for senior Australians ($1.7 bn), and the application of a statutory formula to value car benefits ($1.1bn). It is proposed below that some of the foregoing be eliminated or reduced.

In summary, despite the continued strong growth in the economy (and absent a recession year) and the drop in unemployment from 8 to 5 per cent, the small reduction in aggregate outlays during the period of the Howard Government has to date entirely reflected falls in non-discretionary spending, with lower interest costs being the main contributor (but even defence has fallen slightly too). Historical analysis suggests that, if Commonwealth government outlays excluding interest and defence were reduced by about 2 percentage points of GDP, they would then still be above the "low" point reached during the period of the Howard Government in 1998-99 and the "low" point of the Hawke-Keating Government - and about the same level as in the final year of the Whitlam Government. With a commitment to smaller government, that should be both sustainable and capable of being lowered even further.

Table 2
Commonwealth Government Taxation - $m and % GDP

	1995-96	1996-97	1997-98	1998-9	1999-00	2000-01	2001-02	2002-03	2003-0
Consumption/Capital Expenditure									
General Public Services	5,736	5,527	4,799	5,542	6,064	5,818	6,318	5,503	7,380
Defence	10,258	10,497	10,788	11,529	12,677	12,984	13,727	15,547	15,606
Public Order and Safety	731	701	741	734	856	931	1,080	1,004	1,076
Education	4,885	5,160	5,614	5,842	5,868	5,986	6,081	6,168	6,876
Health	12,374	12,892	14,080	13,798	14,247	14,343	15,331	15,820	17,034
Social Security and Welfare	2,684	2,855	2,817	3,121	3,895	4,389	4,626	6,167	6,081
Housing and Community Amenities	30	-212	-181	-138	11	-14	-90	2	85
Transport and Communication	36	31	24	28	144	108	97	65	48
Other Economic Services	3,247	2,670	3,093	3,198	3,226	3,269	3,314	3,419	3,416
All Other	1,611	1,418	1,322	689	1,607	2,352	2,725	4,398	4,378
Total Transfer Payments									
Interest	15,128	13,561	11,014	10,252	10,506	10,711	10,030	9,868	9,815
Subsidies	2,965	3,135	2,957	2,481	2,156	3,929	4,955	5,257	5,383
Social Assistance Benefits in Cash to Residents	43,437	45,743	46,126	48,972	52,249	59,827	62,785	65,220	74,081
Current Transfers to State and Local General Government	27,827	28,745	29,446	31,643	33,255	44,415	49,773	51,445	52,707
Other Current Transfers	4,343	4,093	3,703	3,440	4,774	5,390	5,766	5,171	6,363
Total Outlays (a)	135,276	136,372	136,036	141,092	149,717	173,205	186,743	194,594	210,148
Per cent of GDP	27.0	25.8	24.3	23.9	24.0	25.9	26.2	25.7	25.8
Gross Domestic Product	501,257	527,994	559,139	589,597	623,461	668,426	713,229	758,147	813,225

(a) Includes change in inventories and acquisitions less disposals of non-produced non-financial assets.

OVERSEAS EXPERIENCE AND COMPARISONS

Opponents of reducing government expenditure sometimes ask why even contemplate such action when, among OECD countries, Australia already has one of the smallest government sectors when measured by taking the published proportion of GDP allocated to government spending. True, OECD figures for 2004 put total general government outlays (including for state and local governments) for Australia at 35.7 per cent of GDP, about 5 percentage points below the OECD average. And, of the 28 OECD countries surveyed, only Korea (27.9 per cent) and (heavily European-Community-subsidized) Ireland (33.9 per cent) have lower proportions, with the USA and Switzerland around the same proportion as Australia. The OECD data shows that since 1996 Australia has decreased outlays by 2.2 percentage points of GDP compared with the OECD average reduction of 1.3 percentage points.

Critics of our "small" government sector fail to take account of the fact that in Australia a higher proportion of services is provided through the private sector. Total Australian spending (that is, both government and private) on services such as education and health is broadly in line with total spending in other countries with comparable income levels. Our larger private sector is an advantage in that it reduces the adverse effects of taxation on productive effort and, importantly, also means that a more efficient and higher quality service tends to be provided. Far from 'worrying' about the small size of our government sector, we should be flaunting its benefits and looking for ways to reduce it further.

The statistical treatment of our superannuation arrangements is also relevant. Under this treatment, even though the Commonwealth Government makes employers legally liable to pay a superannuation guarantee charge equivalent to a payroll tax if they do not make a superannuation contribution for their employees, the contribution is not treated as a tax because it is not paid into government accounts but straight to superannuation funds. The resultant payout from our super funds to contributors is thus not included in our government expenditure. By contrast, in European and North American countries a higher proportion of pensions are financed by payroll taxes[5] paid to governments by employers and employees and the government payouts to contributors are counted as public sector expenditure.

Table 3
Commonwealth General Government Outlays

		Total		Total Excluding Interest		Total Excluding Interest & Defence		Total Excluding Interest & Defence Payments to S&L (a)	
Financial Year	**GDP $m**	**$m**	**% of GDP**	**$m**	**% of GDP**	**$m**	**% of GDP**	**$m**	**% of GDP**
1973/74	57,680	11,127	19.3	9,914	17.2	8,458	14.7	5,964	10.3
1975/76	79,597	19,860	25.0	18,148	22.8	16,411	20.6	10,928	13.7
1986/87	272,264	79,083	29.0	67,541	24.8	60,289	22.1	40,863	15.0
1989/90	384,884	93,803	24.4	82,016	21.3	73,407	19.1	50,521	13.1
1995/96	501,257	135,277	27.0	120,149	24.0	109,891	21.9	82,064	16.4
1996/97	527,994	136,372	25.8	122,811	23.3	112,314	21.3	83,569	15.8
1997/98	559,139	136,036	24.3	125,022	22.4	114,234	20.4	84,788	15.2
1998/99	589,597	141,091	23.9	130,839	22.2	119,310	20.2	87,667	14.9
1999/00	623,461	149,719	24.0	139,213	22.3	126,536	20.3	93,281	15.0
2000/01	668,426	173,203	25.9	162,492	24.3	149,508	22.4	105,093	15.7
2001/02	713,229	186,744	26.2	176,714	24.8	162,987	22.9	113,214	15.9
2002/03	758,147	194,595	25.7	184,727	24.4	169,180	22.3	117,735	15.5
2003/04	813,225	210,147	25.8	200,332	24.6	184,726	22.7	132,019	16.2

(a) Payments to State and Local government.

Source: Australian System of National Accounts (ABS Cat. No. 5204.0), 2003-04, Special Data Request. Total outlays have been derived as the sum of final consumption expenditure, gross fixed capital formation and total income payable. "S&L" comprise all payments to the states, including transfers of GST revenue.

Australia's Superannuation Guarantee Contribution started at 3 per cent in 1992 and had reached 6 per cent in 1995-96, the last year of the Labor Government. Although the scheme (which does not appear to have succeeded in increasing net private saving) was opposed by the Coalition, it decided to retain the arrangements put in place by Labor and the contribution is now equal to 9 per cent of wages and salaries, which is equivalent to about 3.5 per cent of GDP. In consequence, this different statistical treatment understates the effective relative size of our government expenditures – in reality, they are significantly higher than in the US, not as low as they appear to be relative to European countries, and are close to the OECD average. (As only about half of OECD countries currently report tax expenditures, it is not possible to say definitively what effect the inclusion of such expenditures would have on comparisons between Australia and OECD countries).

The downward trend is also worth noting, particularly in Europe itself where between 1996 and 2004 the relative size of general government outlays fell by almost 6 per cent to 48.6 per cent of GDP – and is projected to fall further. Although the weighted average reduction in outlays of all OECD countries since 1996 is only 1.3 per cent of GDP (mainly because outlays in the bigger countries such as the US, France and the UK have been relatively stable), 20 of the 28 countries surveyed have reduced their outlays, including some (such as Sweden and Finland) by more than 7 percentage points of GDP. From being only one of two countries in 1996 with outlays above 60 per cent of GDP, the new Slovak Republic has cut them to 39 per cent of GDP. While the downward trend in Europe starts from a higher level than in Australia, it is a sign that those countries that started with more socialist structures have begun to recognize that smaller sized governments may have some merit. And, although Korea on the other hand has effected a large increase in outlays (6.1 percentage points) since 1996, like other countries in Asia, it still has a considerably smaller government sector than Australia.

Some economic analysts[6], including even sympathizers with private enterprise economies, point out that international comparisons do not necessarily reveal a direct correlation between the size of government and the rate of economic growth. They note the experience of countries like Japan and Switzerland with small government sectors and relatively low growth and compare them with the experience of countries such as Sweden and Finland where large government sectors have not prevented relatively strong growth rates. And they rightly say that many factors determine growth and that a country with quality institutional structures and sound underlying social and political values may be able successfully to combine big government and growth. In short, they argue that, if societal structures and attitudes allow citizens to live happily with a large government sector, this may not be detrimental to growth.

THE GENERAL CASE FOR SMALLER GOVERNMENT

Such theses are, like a good deal of economic analysis, concerned (rightly) with pointing out exceptions to general rules and with avoiding unjustifiable generalisations. But they overlook the important point that, while some countries with big government sectors have experienced "respectable" rates of economic growth, smaller government sectors may well have allowed them to perform better from both economic and social perspectives. Indeed, the downward trend in government outlays in many European countries, including the two quoted as having "respectable" growth rates (Sweden and Finland), implies that their societies have become more sympathetic to that view and, perhaps, to the view that societal aspects would be improved too. Note

Table 4
Social Security Benefits

Financial Year	$m	% of GDP	% of HDI
1973/74	2,389	4.1	5.7
1975/76	4,642	5.8	8.0
1984/85	16,967	7.5	10.7
1989/90	24,656	6.4	9.3
1995/96	43,437	8.7	12.7
1996/97	45,743	8.7	12.7
1997/98	46,126	8.2	12.4
1998/99	48,972	8.3	12.5
1999/00	52,249	8.4	12.6
2000/01	59,827	9.0	13.2
2001/02	62,785	8.8	13.3
2002/03	65,220	8.6	13.4
2003/04	74,081	9.1	14.3

Source: Australian System of National Accounts (ABS Cat. No. 5204.0), 2003-04. Social security benefits do not include health benefits paid under Medicare.

also that the country which has maintained one of the smallest government sectors since its inception – the USA – has real per capita income levels that are about 25 per cent above the next highest in the OECD and is a society in which individual freedom is at a high level.

For Australia, a not dissimilar argument is also applicable, viz our strong economic growth in circumstances where we have the maintained a relatively small government sector does not mean that we would not have done better with a smaller government. The question that now needs to be addressed is whether a reduction in the extent of government intervention in individual and corporate decision-making would be likely to improve economic growth and social satisfaction. In short, is the Commonwealth Government spending taxpayer's money at the margin (which is potentially a wide one) more productively from both an economic and social perspective than if taxpayers spent it themselves?

The following outlines the main arguments for an early major reduction in Commonwealth spending.

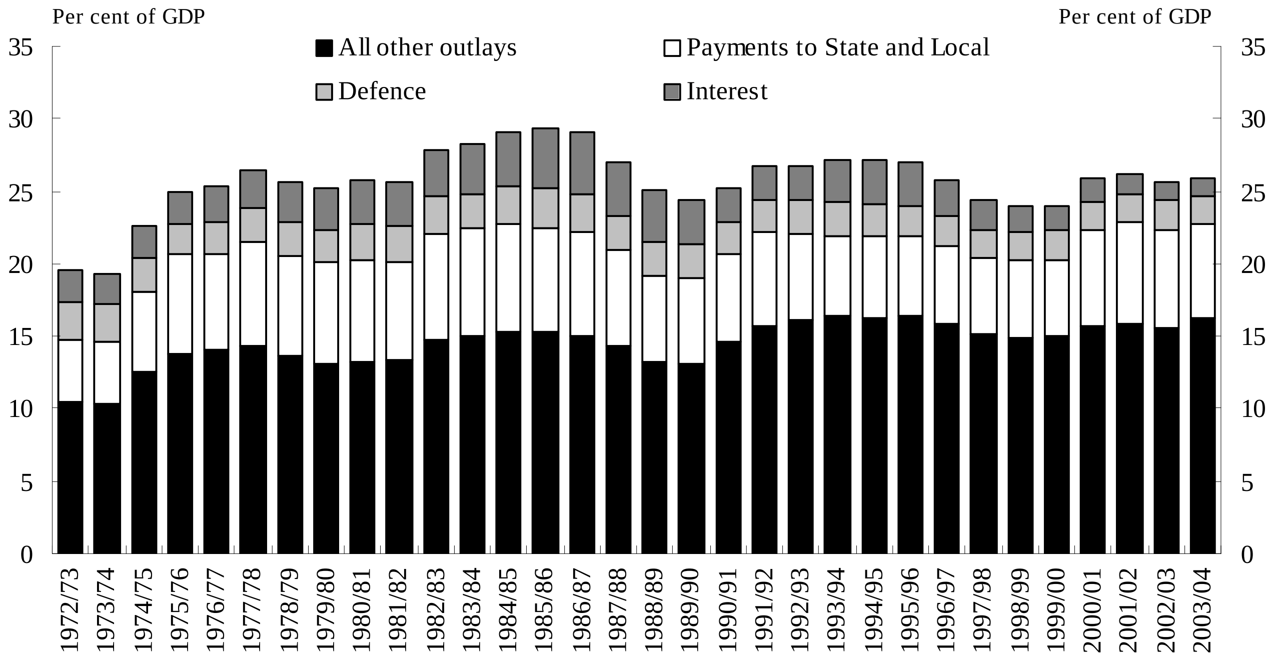
Increased Productivity and Employment Needed Now

As pointed out in the *Intergenerational Report 2002-03* circulated by Treasurer Costello as Budget Paper No. 5 for that year, if action is not taken to increase productivity and employment Australia faces the longer term prospect of a large increase in taxation in circumstances where economic growth is likely to be slower. But the issues it raises are ones that are relevant to today. The *2004 Economic Survey of Australia* by the OECD quietly brought that home when it said

> "Challenges lie ahead, but policy actions are required now. The main challenges lie in the medium and longer term, but to address them, further policy actions should not be delayed. Ageing will exacerbate the underlying rise in public health costs and to a lesser extent in public pensions, putting pressure on public finances. More fundamentally, although Australia has moved up the 'league table' in terms of per capita incomes during the past decade, it has returned only to the relative position

Chart 1

Commonwealth General Government Outlays 1972-73 to 2003-04



Source: Australian System of National Accounts (ABS Cat. No. 5204.0), 2003-04, Special Data Request. Total outlays have been derived as the sum of final consumption expenditure, gross fixed capital formation and total income payable. "S&L" comprise all payments to the states, including transfers of GST revenue.

Table 5
Average Benefit Payments

	1995/96		2003/04		Change	
	No. (000)s	$ per head	No. (000)s	$ per head	No. (000)s	% (a)
Age Pension	1,602.8	$7,726	1,876.3	$10,415	273.4	11.6
Disability Support Pension	499.2	$8,231	696.7	$10,754	197.5	8.1
Family Tax Benefit A & B	n.a.	n.a.	3,090.9	$4,164	108.6 (b)	13.6
Newstart Allowance (c)	n.a.	n.a.	483.1	$9,842	-145.8(e)	-2.1
Parenting Payment (d)	n.a.	n.a.	626.5	$9,570	5.2 (b)	2.9
Youth Allowance	n.a.	n.a.	381.8	$5,913	-10.1 (e)	6.8

n.a. - benefit was either not paid in 1995-96 or is not comparable.
(a) Real percentage increase.
(b) Change in recipients and real benefits per head relative to 2000-01.
(c) Youth Allowance replaced payments made to certain recipients of Newstart Allowance from 1 July 1998.
(d) Both single and partnered.
(e) Change in recipients and real benefits per head relative to 1998-99.

Note that all data on recipients prior to 1999-00 is for June of those financial years.

Overtime average benefits may be influenced by the changing proportion of recipients receiving part-payments.

Source: ABS Year Book, various (Cat. No. 1301.0).

it already held in the early 1970s and remains well below the leading countries in terms of labour participation and labour productivity".

A reduction in spending of the magnitude proposed in this report would in fact allow a major lowering of the overall level of taxation and, as part of that, of existing high marginal rates. This could, in turn, be expected to increase economic activity and employment at an early date. Note that such an increase in activity would itself produce an increase in taxation revenue ie fiscally responsible tax reductions would be partly self-financing.

Smaller Government & Lower Taxes = Good Economics & Politics

A program of reduced spending that was accompanied by a commensurate reduction in taxation would not only be

Table 6
Commonwealth Government Taxation - $m and % GDP

	1995-96	1996-97	1997-98	1998-99 (a)	1999-00	2000-01	2001-02	2002-03	2003-04
Income Tax on Individuals	60,604 12.1%	66,281 12.6%	70,786 12.7%	75,518 13.1%	83,788 13.4%	77,425 11.6%	86,112 12.1%	91,484 12.1%	98,979 12.2%
Income Tax on Enterprises	20,819 4.2%	23,222 4.4%	23,571 4.2%	25,472 4.3%	29,516 4.7%	42,221 6.3%	31,782 4.5%	38,696 5.1%	41,990 5.2%
Income Tax on Non-Residents	1,194 0.2%	936 0.2%	1,010 0.2%	1,070 0.2%	1,215 0.2%	1,215 0.2%	1,138 0.2%	1,098 0.1%	1,097 0.1%
Employers Payroll Taxes	3,065 0.6%	3,201 0.6%	3,215 0.6%	3,376 0.6%	3,521 0.6%	3,577 0.5%	3,831 0.5%	3,085 0.4%	3,658 0.4%
Taxes on Goods and Services	29,613 5.9%	30,486 5.8%	31,909 5.7%	33,246 5.6%	34,365 5.5%	50,186* 7.5%	53,883 7.6%	59,371 7.8%	62,646 7.7%
Other (incl Tax on Property)	397 0.1%	424 0.1%	486 0.1%	412 0.1%	453 0.1%	670 0.1%	722 0.1%	757 0.1%	811 0.1%
TOTAL	115,700 23.1%	124,559 23.6%	130,984 23.4%	141,100 23.9%	152,869 24.5%	175,306* 26.2%	177,481 24.9%	194,504 25.7%	209,195 25.7%
Total excl General Sales Tax/GST	102,730 20.5%	111,266 21.1%	116,899 20.9%	126,017 21.4%	137,225 22.0%	149,476* 22.3%	149,301 20.9%	162,351 21.4%	174,072 21.4%

(a) Note data prior to 1999-00 is presented on a cash accounts basis.
* First year of GST.

on the right economic track: it should also be politically acceptable, particularly if the spending reductions are focussed on middle and higher income groups and those groups are themselves "compensated" through a flattening of tax rates. Moreover, the political case for lowering the tax burden is strengthened given that, between 1995-96 and 2003-04, there appears to have been an increase in the burden of Commonwealth taxation excluding either general sales taxes or (since its introduction in 2001) the Goods & Services Tax (see Table 6). As the Commonwealth levies 82 per cent of all taxes (69 p ercent if the GST is regarded as a State tax), any major lowering of taxation will have to be undertaken mainly by it and, hence, the chief driver in reducing expenditure has to be the Commonwealth too.

While the MYEFO estimates project cash surpluses equivalent to 0.5-0.7 per cent of GDP over the next three years, if substantial spending reductions are implemented with similar-sized tax cuts, this would in turn almost certainly increase the size of future surpluses. Accordingly, there may also be scope to cut taxation by a little more than any (commensurate) reduction in spending. However, care would need to be taken to avoid inflationary effects.

Big Government is Outdated

During a period when standards of living (including health) are increasing there should be a progressively reduced need for spending on items such as health and social security and welfare, which together constitute over 60 per cent of total Commonwealth spending (excluding GST payments to the States). The *2004 OECD Economic Survey* suggests that

> "Three mutually supportive policy responses can help mitigate the impact of rising health and other ageing related costs on budget balances and material living standards. First, policies need to raise productivity in the health sector itself and transfer more of the costs to users of services. Second, policies directed to increasing the growth of productivity throughout the economy would help offset the rising resource cost of delivering health services irrespective of who is paying for them. Third, welfare reforms should encourage higher participation rates so as to boost output, reduce social spending and increase tax receipts."

In short, the proportion of the population needing Commonwealth welfare and health assistance should have been falling – and should be continuing to do so. Clearly, a progressive reduction in the proportion receiving government assistance would make a major contribution to dealing with the longer term problem identified in the Intergenerational Report.

At present, however, about 2.7 million or around 20 per cent of the working age population receives income support compared with only 15 per cent at the end of the 1980s and 4 per cent in 1969. Looked at from another perspective, social assistance benefits (which exclude health benefits) now contribute 14.3 per cent of gross household disposable income, compared with j ust 8 per cent in the last year of the Whitlam government.

Table 7
Government Benefits – Estimated Distribution 1998-99

	Tax	Benefits (Direct & Indirect)		
	$m	$m	% of Total	% of Tax Returned
Bottom Quintile	2,922	20,874	19.3	714
Second Quintile	5,699	31,205	28.8	548
Third Quintile	13,279	21,718	20.1	164
Fourth Quintile	24,000	18,072	16.7	75
Fifth Quintile	48,975	16,410	15.2	34
Total	94,875	108,278	100.0	114

(a) Average annual per capita incomes for bottom, second, third, fourth and fifth income quintiles are $10,425; $14,065; $17,437; $21,861 and $34,271.

Note: Data source allocates 53 per cent of total government revenue and 50 per cent of total government expenditure. Average annual per capita incomes are therefore lower than actual levels.

Source: Government Benefits, Taxes and Household Income (ABS Cat. No. 6573.0), 1998-99.

Much of Existing Government Simply Churns Taxes Back to Those Who Pay Them

Moreover, while re-distributional objectives may be being achieved insofar as a large chunk of tax revenues is being channelled back to lower income groups, a significant part of the tax and social security system (sic) also consists simply of churning taxes back whence they came, that is, to higher income groups themselves. For example, while the latest official published analysis - *Government Benefits, Taxes and Household Income, 1998-99, ABS 6537.0* - provides an (acknowledged) incomplete coverage of the various benefits and taxes, it gives a broad indication of the extent of such churning by showing that households with incomes in the top two quintiles:

- received over 30 per cent or about $34 billion pa of all social security and "selected" education and health benefits covered; and
- those benefits were equivalent to 47 per cent of the taxes paid by them.

This indicates that much scope should exist for reducing both taxes and benefits of those households in the two quintiles, with obvious economic benefits.

Nowadays, Individuals Are Much More Able to Look After Themselves

As noted, the avowed policy of the present Government is to support small government and an increased role/ responsibility for the individual. With increased standards of health and education, individuals are more able to take care of themselves. The Government should give effect to this admirable philosophy and to what must surely be a desirable direction for society to move.

There is thus a strong economic and social case for reducing the availability of government benefits, not by reducing benefit rates but by tightening the eligibility for obtaining them so that a much higher proportion of recipients are in the lower income groups. From an economic perspective this would increase the availability of labour and, with reduced labour market regulation, employment. It would also help lift the rate of personal saving from the very low level to which it has fallen. From a social perspective, welfare dependency would be reduced as an increased proportion of individuals and families would assume more responsibility for their own welfare. There would be less of a "nanny" state.

WHERE EXPENDITURE SAVINGS COULD BE MADE

As indicated, the initial objective of achieving smaller government is to cut Commonwealth expenditure and/or add to revenue by about $16 billion in 2005-06 or the very near future, equivalent to 2 per cent of GDP. A major component is to reduce outlays on social security and welfare and health by tightening eligibility for benefit recipients, with a particular emphasis on middle and higher income groups.

In the case of health and education, which include considerable specific purpose payments (SPPs) to the States, account should be taken of the fact that those governments will be receiving considerably more from GST revenues than they would have done if general revenue grants had continued under pre-GST arrangements. For the three years to 2007-08 this "bonus" is estimated to amount to almost $7 bn, including $1.5 bn in 2005-06 alone. This provides a basis for putting special emphasis on reductions in SPPs to the States, which at an estimated $25.6 bn in 2005-06 would comprise 12.6 per cent of total Commonwealth outlays but 20 per cent of the States' general government revenues.

Indeed, the estimates for 2005-06 indicate that these SPPs will increase by no less than 7.4 per cent in real terms and are projected to continue to increase in real terms. A number of the payments are not even conditional on what the States spend in the areas concerned, which means that the Commonwealth is providing the States with "free" money in the sense that it is the States that decide how much in total will be spent in the area concerned from their own resources. For some SPPs it is difficult to avoid the conclusion that their main object is to allow the Commonwealth to make the political claim that it is "making a contribution" or "is involved" in this or that area.

There is a strong case for the Auditor-General to increase his reports on the performance of SPPs and to attempt to identify how the Commonwealth taxpayer is benefiting from them. His last report dealing with the overall situation (as distinct from particular SPPs) was in 1998-99.[7]

A more general question emerges here in regard to the respective roles of the Commonwealth and the States, viz to what extent should the Commonwealth be purporting to set standards in areas where States are probably best placed to be service providers? The States now have access, albeit indirect, to a "new" tax on consumption that should grow in line with the economy, if not faster.

Thus, while currently there are grounds for concern about the effectiveness of the States as service deliverers, the Commonwealth has little economic justification either for its intervention in areas where the States should be best placed to deliver services, such as hospitals and schools, or for making grants directly (and with questionable constitutionality) to local governments and individual bodies.

SPECIFIC PROPOSALS FOR REDUCING EXPENDITURE

The present report suggests that there is ample scope in the very near future to reduce outlays/revenue concessions by around 2 per cent of GDP. Using figures as shown in the MYEFO, a cut of about 8 per cent in the outlays estimate for 2005-06 would reduce them by about $16 bn from an estimated $203 bn to $187 bn. At that level they would be about 3 per cent below estimated outlays of $194 bn in 2004-05 and about 20.6 per cent of GDP (compared with 22.4 per cent now est). However, as noted, it is unlikely that such a program of reductions would be fully implementable in 2005-06: a more politically acceptable objective might be to aim to achieve an 8 per cent cut objective by 2006-07, which would imply expenditure in that year of about $195 bn or about 20.4 per cent of GDP.

The specific savings to 2005-06 estimates listed below should therefore be regarded more as illustrative of the potential savings for a full year, many of which would increase over time and hence increase the scope for tax reductions in future years. It will also be noted that, as the potential savings identified are significantly higher than $16 bn, there is scope to implement additional expenditure savings in future years too. As not all the data used for estimating savings for individual items is publicly available, the estimates should be regarded as having margins of error.

SOCIAL SECURITY AND WELFARE

Total expenditure on social security and welfare is estimated at $86.6 bn in 2005-06, an increase of 5.3 per cent on the current year or more than double the likely rate in inflation. Many beneficiaries are also eligible for a wide range of free or subsidised government services, covering medical, hospital, housing, pharmaceutical, transport services and the like. This provides an anti-savings and anti-employment bias because the incentives to save and work are eroded by the extension of government assistance to an increasing proportion of the population. It encourages the attitude - why save, and why try for a job, when the State will look after you if you don't? The fact that social welfare is now double the proportion of GDP it was in the early 1970s has almost certainly contributed to the decline in private sector saving rates and to higher unemployment rates – it is sometimes forgotten that unemployment was only 2.1 per cent in 1971-72.

Part of the problem has been that social security is susceptible to the politics of compassion and of interest groups, and to decision-making related to single issues rather than an examination of the whole picture. Once benefits are extended to a group, moreover, it has been difficult to withdraw them or scale them back. But today, with much higher real incomes and a greater preparedness and capacity to adopt a self-help attitude, it should not be too much to ask our politicians to address the problem.

While the Coalition is (for example) rightly concerned to promote the role of the family, this ought not to now require assistance to families with children totalling over $25 bn pa and extending to over 3 million people, including many in higher income households. Such treatment of the family (and of retirees) as political icons has surely been taken too far and has contributed to undermining the targeting of benefits. By contrast, the Hawke-Keating government succeeded in holding (actually reducing) the proportion of GDP going to social security. If spending on the latter were to return to the proportion of GDP in the last year of the Hawke Government (1990-91) that would mean a reduction of $16 bn in 2005-06. This report suggests a more modest cut of $8.8 bn.

Treasurer Costello got to the crux of the problem when he wrote on (*The Australian, 1 April, 2005*) that "more than one in five adults of working age are on income support. Of these, seven out of 10 do not have an ongoing obligation to seek work in return for receiving that income support. Most of these people are recipients of the disability support pension or single parenting payment previously known as the sole parent pension". He might also have tried to explain why this has been allowed to occur. Even Shadow Treasurer Swan is reported (*The Australian, 2 April*) to have opposed a further liberalisation of social welfare means tests.

Age Pension and Superannuation

At over $30 billion in 2005-06 the means and asset-tested age pensions constitute the largest single item of expenditure (over 10 per cent) in the Budget. If existing arrangements continue unchanged age pension expenditure is expected to increase from 3.3 per cent of GDP to 4.6 per cent by 2050. The aim should be to effect a reduction.

The number of age pensioners increased from 1,591,000 in 1995-96 to 1,876,250 in 2003-04, and over 70 per cent of those in the eligible age group now receive a pension. The average real level of the pension is about 12 per cent higher than in 1995-96 and 75-80 per cent of those aged 65 years and over own their own house without a mortgage. The Commonwealth also spends over $5bn pa on a residential aged care program (which subsidises the costs for each person in a residential care setting) and shares with the States the cost of home and community care programs (over $1 bn pa) to assist people being maintained in their own homes.

In addition, the Government provides assistance for retirement through generous tax concessions on superannuation as well as by requiring employers to fund contributions to superannuation funds for their employees. As superannuation accumulates from the compulsory levy, the Government should be able progressively to reduce its direct Budget contribution to retirement.

Indeed, with the rapid improvement in health over the past 10-15 years, and the accompanying increase in life expectancy, it is reasonable to expect that people should work for longer, should better be able to self-provide and that others should normally not have to provide retirement assistance until a later age. Australian rates of employment of persons aged 55 or over are only about 50 per cent and, although this is around the OECD average, there is considerable scope to increase it - in Sweden the rate is 70 per cent. But a pension age of over 12 years less than the average life expectancy for men, and (although being reduced) over 22 years less for women, provides undue encouragement to take ‘early retirement’.

Specific policies in place to encourage mature workers to continue work include a pension bonus scheme that provides a tax exempt “bonus” for those deferring the age pension, a tax offset costing over $300 m a year for those aged over 55 and earning up to $48,000 pa who stay in the workforce, and a concessionary tax schedule that includes a tax free threshold of $20,000. The increased subsidy to superannuation contributors ($1,500 for every $1,000 by a contributor with an income up to $28,000 pa, with a reducing co-contribution up to incomes of $58,000 pa) also benefits older people on lower incomes by (in effect) subsidising saving for retirement. The best “incentive”, however, is to reduce the availability of government assistance until a later age.

Measures to reduce progressively the cost of age pensions and encourage more self-help should include:

- Speeding up the move for women to be 65 years to be eligible for the pension – it now rises by six months only every two years – est saving $329 mn

- Start to move men towards 70 years eligibility by no later than 2009 – est saving $520 mn

- Changing the indexing of the pension to the Consumer Price Index (CPI) instead of the faster growing Male Total Average Weekly Earnings (AWE), until the pension is reduced to 20 per cent of AWE (now 25 per cent). This would increase the now much higher *real* pension in line with living costs and encourage increased workforce participation before taking the pension – est saving $453 mn

- Providing further assistance for savings for retirement by reducing the tax on superannuation in the accumulation phase and increasing the tax on benefits, with no net cost over the longer term. This would make super more attractive now and would defer net tax receipts to when, with an older population and lower tax receipts, higher tax receipts would be more needed and higher per head incomes would provide a greater capacity to pay – limit est initial net saving to *minus* $500mn pa.

- Reduce the income level at which a super co-contribution is payable – est saving $300 mn

Veterans’ Affairs

The Budget papers classify assistance to veterans and dependents (estimated at over $6 bn in 2005-06) as a component of social security and it would be consistent with indexing the age pension to the CPI to do the same with benefits for veterans. Most of such assistance continues to be provided through a separate department (Veterans Affairs) whose administrative costs run to about $80m pa. However, while veterans have specific needs, agencies used by the rest of the population could meet those needs –as some are doing already – and save administrative costs. It would be consistent with the 'mainstreaming' of Aboriginal health and income support to do this for veterans.

- Change to indexing with the CPI instead of the Male Total AWE – est saving $128 mn

- Without reducing benefits, reduce duplication by closing the Department of Veterans Affairs and transferring the administrative responsibilities for health and income assistance to other departments – est net saving $10 mn

Disability Support Pension (DSP)

Since 1995-96 the number on DSPs has increased from 499,000 to over 700,000 and, as Treasurer Costello wrote (*The Australian, 1 April,2005*), "forty years ago less than 1 per cent of the population was on an invalid pension. Last year we had about 3.5 per cent on DSP". Since 1995-96 the average *real* level of the DSP has increased by over 8 per cent, or about 1 per cent pa. With the DSP set at a much higher basic rate than the Newstart Allowance ($476 per fortnight compared with $399), coupled with the limited work requirement (eligible for DSP if unable to work 30 hours a week), this has encouraged people to move off the Newstart Allowance to the DSP (and thus disguised the real unemployment rate) and kept workforce participation rates lower than otherwise.

There are two approaches to improving this situation. First, require a stricter work test for DSP recipients with a capacity to work. A substantial proportion of DSPs have musco-skeletal complaints and, while reports of the outcome of pilot programs to test employability vary, there appears to be scope to increase workforce participation and reduce welfare dependency from this source. The movement of DSPs into the workforce would probably produce only a limited addition to aggregate (national) productivity and may require additional expenditure on training. But the net budgetary savings should be substantial. A combination of deregulatory workplace relations reform and the anti-discrimination legislation should also make it easier for the disabled to obtain work.

Second, with a DSP that is much higher than the NA, there is a strong case for indexing it to the CPI too (at present it is being indexed to AWE). That would be an additional incentive to seek work. In summary:

- Aim to reduce by at least 10 per cent the total number on DSPs by applying a much tighter work test – est gross saving $829 mn less additional training of, say, $250 mn = net saving of $579 mn

- Index the DSP to the CPI - est saving $179 mn

- As State Governments are best placed to operate sheltered workshops and attend to homeless people, end from 2007-08 the Commonwealth's involvement in the Disability Support program that is financed through SPPs – est saving 632m a year from 2007-08 (equivalent to a discounted saving of about $596 mn in 2005-06)

Parenting Payment (PP)

Treasurer Costello wrote (accurately) on 1 April, 2005 (*The Australian*) that "a system that has no work requirement – for a parent of school age children is … an inappropriate one in a country with possible labour shortages and the long term ageing of the population". He also pointed out (*The Australian 2 April,2005*) that "single and unmarried mothers are unequally treated because "single mothers get a benefit that married mothers don't". And Workplace Participation Minister Dutton was reported (*The Age 2 April*) as acknowledging that, of the 450,000 on PPs last June, 150,000 had their youngest child at school and were not working, while up to 100,000 had partners while receiving benefits. It is scarcely surprising, then, that the total number of PP recipients (single and partnered low-income parents) has been allowed to increase since 1995-96 at about 8 per cent pa (from 334,000 to over 630,000).

In fact, although many lone parents work, half rely on a PP for which there are only very limited mutual obligation requirements. At $471 a fortnight it is 18 per cent higher than the NA and has increased in real terms by about 3 per cent since 2000-01. Moreover, lower income level sole parents also have access to Family Tax Benefit B. As sole parents may continue on PPs until their youngest child reaches school *leaving* age (which means Australia has one of the most generous sole parent schemes), it is not surprising to find that the average time sole parents spend on PPs is 12 years. This naturally limits their employability.

Measures to reduce the cost of this scheme and to encourage greater work participation should include:

- Aim to cut the recipients of the PP by at least 10 per cent by a much stricter application of the work test (particularly for part-time work) once children are of school age – est saving $648 mn
- Index the single PP to the CPI (it is now indexed to AWE) – est saving $111 mn
- Restrict the access to those whose youngest child is 6 or less (the US provides pension support for only 12 months and Sweden for 3 years) – est saving $160 mn

Newstart Allowance –Time Limit

The Minister of Workplace Participation was reported (*The Age, 5 March,2005*) as indicating that up to 20 per cent of clients were "not genuine and might be in cash jobs … for those people …doing the wrong thing, we will come down hard". That may explain why he is also reported (*The Australian 1 April,2005*) to have instructed DEWR to issue new rules limiting the help available to job seekers. "I will not tolerate these funds being used for anything that would not be acceptable to Australian taxpayers", Mr Dutton said. According to *The Australian* report, those seeking a job have access to help with personal items such as "beautician visits, make-overs, pamper packs, weight reduction services or nicotine patches". Now they will be expected to furnish these items for themselves.

Despite these apparent "laxities", the application of mutual obligation requirements in addition to the job search stipulation appears to have been relatively successful in limiting access to the NA - and indicates the potential advantage of applying such requirements for some other benefits. In 1995-96, when 737,000 were statistically unemployed, over 782,000 were able to access the NA whereas in 2003-04 only 483,000 were on NA out of 586,000 statistically unemployed.

Note also that, although there were around 120,000 unemployed for more than a year in 2003-04, many of these so-called "long term" unemployed do eventually get jobs and are not necessarily "stuck" there. A change in workplace regulations could allow employers to treat such long-termers as a special category such as apprentices or youths rather than adopt a way subsidy as mooted. This would improve the employment prospects of these unemployed, as would the introduction of a time limit on the availability of NA. Although the basic (single) NA of $399 a fortnight is payable to those unable to find work after actively looking for it (and, in most cases, meeting the mutual obligation requirement), the absence of such a limit contrasts with the situation in the US and some other countries and reduces the incentive to obtain a job.

The standard NA is automatically increased in line with the CPI but in 2003-04 the average NA was slightly lower than in 1998-99 in real terms. With workplace relations reform presumably leaving employers facing fewer legally required conditions of employment, it should be possible to further reduce the cost of the NA and lift workforce participation by:

- Applying work activation and mutual obligation more firmly and restricting access to NA to those who are unemployed for less than a year. Those unable to find work after being unemployed for a year would have access to the Special Benefit (SB), which is payable at the same rate as NA but only "for those able to show they are experiencing financial hardship due to reasons beyond their control". Assuming that a time limit would result in 20 per cent of long term unemployed being ineligible for SB – est saving $606 mn

Australians "Working Together"

This package from the 2001-02 Budget (a response to *Participation Support for a More Equitable Society, Final Report of the Reference Group on Welfare Reform, July 2000* - known as the McClure Report) includes several measures designed to encourage greater participation in the workforce, including by helping people to find jobs, helping parents return to work, and assisting mature age workers and those with disabilities.

- With workplace relations reform and other measures that encourage workforce participation and help the disabled, these iniatives are largely offered under other programs and there is some duplication – est saving $620 mn

Child Care

Suggestions are currently being made that, despite the failure last year to take up the allocation of an additional 40,000 for "approved" child care places, a general "shortage" of such places has now emerged. However, large shortages are usually the product of regulatory arrangements that fail to adjust to changing circumstances. If existing regulatory arrangements were improved (including under workplace relations reforms and by changing approval criteria), the private child care industry should be able to provide additional places. Part of the problem here may be that the restrictions applying to "eligible" child care places inhibit private sector involvement. Note, however, that the private sector already provides quite extensive services on a competitive basis, including through several companies listed on the Stock Exchange, and pay rates for private sector care workers have increased. Thus governments themselves – and certainly not the Commonwealth – should not fund additional *public* child care institutions but focus on improving regulatory/assistance arrangements to ensure a more competitive market.

At present, the Commonwealth provides benefits of up to $4,000 per child to an extensive a range of families, including to those with incomes up to $115,000 a year. It also provides a tax rebate of 30 per cent for out of pocket expenses of those who receive child care benefits. Total benefits expenditure in 2003-04 was $1.6 bn, over a third higher than in 2000-01. Assistance for child care should be limited to those able to show that it is an expense necessarily incurred for the purpose of earning an income and, even then, there seems little justification for assisting higher income groups.

- Abolish existing benefit payment arrangements – est saving $1,619 mn (which will also remove revenue-reducing tax exemptions and save revenue of about $550 mn) but allow an increase to 50 per cent in the tax rebate for those families with joint incomes below a certain level that can show that child care expenses (including out-of-pockets) are justifiable as an earning expense claim - est net saving $1,656 mn

Family Tax Benefits (FTBs)

FTB A assistance is designed to provide income support to families to assist with the cost of raising children and is provided to families with dependent children up to 21 (and with full time students from 21 -24 years). Payments range from around $1,700 to over $5,000 pa per child and, although subject to an income test, these can extend to families with incomes of close to $100,000 pa. FTB B provides additional assistance for families with only one main income earner and payments range from around $2,000 pa to around $3,000 pa per child for dependent children under 16 (and students under 18) of sole parent families and two parent families where one parent stays at home. In the latter case no account is taken of the other partner's income and, according to FACS figures supplied to the Senate Estimates Committee, 30,000 families earning more than $100,000 pa received FTB B in 2002-03.

Both FTB A and B are tax exempt and total payments of $12.9 bn in 2003-04 were distributed between 1.8 million families in the case of FTB A and 1.2 million families in the case of FTB B.

While encouraging family formation is desirable, direct assistance should be concentrated on those with lower incomes who may otherwise be deterred from raising or bringing one up.

- Reduce by 10 per cent the number of families receiving Family Tax Benefit A by further limiting the income level at which families are entitled to receive it – est saving $1,017 mn

- Reduce by 10 per cent the number of two parent families receiving Family Tax Benefits B by taking account of the income of the other partner and limiting the joint income level at which the benefit can be received (and, to the extent necessary, also amend any taxation legislation that may still provide access to a dependent spouse rebate that would offset such limitations) – est saving $181 mn

- Remove tax exemption for higher income earners for FTB A & B – est saving $1,510 mn (on revenue) – but both should have tapered withdrawal rates

Maternity Payment

A lump sum maternity allowance (usually $3042) is paid for babies born after July 2004, is subject to no means or assets test, and is to increase to $4000 from 1 July 2006 and to $5,000 from 1 July 2008. In 2003-04 the estimated cost was $180 mn and was provided to 209,000 recipients. A maternity immunisation allowance costing $43 mn was also paid to similar number.

- Reduce the maternity allowance by 20 per cent by making eligibility subject to an income test – est saving $152 mn

HEALTH

In 2002-03 governments provided almost two-thirds of the total funding of health expenditure and, with Australia's ageing population, the Commonwealth faces a major policy challenge to reduce the extent to which its expenditure on health is funded by taxpayers. The projections in the Intergenerational Report circulated by Treasurer Costello indicate that, without a change in existing policies, Commonwealth health expenditure is likely to double from 4 per cent to 8 per cent of GDP by 2040-41, requiring a large increase in taxation.

In 2005-06 total health expenditure by the Commonwealth is estimated to increase by 5 per cent to $37.5 bn, or about 18 per cent of outlays. This funding is being provided in circumstances where Australia has a healthy life expectancy rate that is amongst the highest in the world (over 70 years), where the standardised death rate in 2001 was 20 per cent lower than ten years before, and where over 80 per cent of the population say their health status is good, very good or excellent.

The large existing burden on the taxpayer arises primarily from the introduction of Medicare in 1983-84 and the provision of free (to the patient) medical and hospital services, with the resultant higher utilisation of medical services and of pharmaceutical benefits reflecting the resort to more expensive medical services and drugs. Once a free service is established it also becomes politically difficult to restrict access to it. But with the government now apparently targeting welfare assistance more closely, it would be anomalous if similar (or even more restraining) action was not taken in the health area. It is sometimes overlooked that the much publicised public hospital waiting lists are the almost inevitable result of providing extensive services without charge.

Some may argue that the aged should not be expected to shoulder any additional responsibility for meeting their health expenses. However, just as access to the age pension is 'rationed' through means and assets tests, so there is good reason for a similar approach to be adopted for health services.

Given that the abandonment of Medicare would not be politically acceptable, what now needs to be done is to introduce or increase charges for the use of all three of the major services funded by the Commonwealth - medical, hospital and pharmaceutical. Such charges (or 'co-payments' to use a more politically-correct term) would be payable by all those who are not in either low-income or chronically-ill groups and would be subject to an annual maximum. If people wished to take out additional insurance against such potential co-payment liabilities, they should be permitted to do so.

Pharmaceutical Benefits

The Commonwealth subsidises over 80 per cent of the average cost of prescribed medicines, which amounted in 2005-06 to $7.8 bn and now accounts for over 3 per cent of total outlays. Under existing policies estimates are for a further rapid increase to $9 bn by 2007-08. Those eligible for concessional treatment (pensioners and health card holders) are entitled to free prescribed medicine after paying $239 pa (52 scripts times $4.60 per script co-payment) and those not classified as concessionals are entitled to free prescribed medicines after paying $875 pa. In 2003-04 a total of 165.4 mn benefit prescriptions were written, or 8.2 per capita compared with 6.9 per capita in 1995-96.

The Commonwealth negotiates wholesale prices with medicine suppliers and, after announcing a 12.5 per cent cut from 1 April to the reimbursement price of pharmaceuticals in a therapeutic drug class when the first generic drug of that type comes on the market, Minister

Abbott reportedly (*Australian Financial Review, 30 March,2005*) stated that "generics in the US and Britain are on average 50 per cent cheaper than brand name drugs compared with less than 5 per cent here." Chemists are permitted to add a10 per cent mark-up to what they pay suppliers of subsidised medicines, plus a dispensing fee, and are not constrained in mark-ups on other medicines.

The following policy changes should be implemented.

- Although co-payments are now indexed to the CPI, the amount paid by non-concessionals before receiving free medicines should be raised to $1,000 pa – est saving $100 mn

- Similarly, the total co-payment by concessionals before receiving free medicines should be raised to $333 pa (52 scripts @ $6.40) – est saving $150 mn

- Add another 5 per cent to the recent 12.5 per cent cut to the Commonwealth's reimbursement price of pharmaceuticals to wholesalers and announce a program of further cuts in the future – est saving $100 mn

Medical Services

These services include free GP services funded through Medicare, under which doctors receive a 100% rebate of scheduled fees (recently increased from 85% to encourage bulk billing) as well as grants under the Practice Incentive Program designed, inter alia, to encourage them to give greater attention to certain specific health problems. The Commonwealth also pays 80 per cent of out-of-hospital expenses for all amounts above $306.90 a year for most families, pensioners and health card holders and over $710.10 a year for others. Such assistance is provided to 1.9 million families and individuals. In addition, a tax offset is provided for 20 per cent of medical expenses (net of Medicare and insurance refunds) in excess of $1,500 in a year. Individuals with Private Health Insurance (which generally covers hospital costs, including medical treatment) are given a 30 per cent rebate without an income test. One survey estimates that 50 per cent of this rebate benefits families with incomes above $70,000 pa and it is now provided to around 40 per cent of the population at an estimated cost of $2.5bn in 2005-06.

- As the 100% scheduled fee rebate has increased doctors' incomes, remove grants under the Practice Incentive Program (including the Practice Nurses element) – est saving $350 mn

- To encourage limits to doctor visits, require all bulk billed patients to make a co-payment of $5 per visit to doctors and recover the payment by implementing a commensurate reduction in the bulk bill rebate – est saving $329 mn

- Reduce the medical expenses tax offset by 20 per cent by applying an income test – est *revenue* saving $56 mn

- Reduce by 20 per cent the cost of the 30 per cent Private Health Insurance Rebate by limiting its availability to those on lower incomes and removing the extra 5 per cent rebate for those above 65 as it does little to encourage extra coverage – est savings of $499 mn and $125 mn respectively

- Remove tax exemption of the 30 per cent of private health insurance refund – est saving $790 mn

- As recently announced by the Prime Minister, increase to $500 and $1000 respectively the thresholds on meeting 80 per cent of out-of-hospital expenses with the aim of reducing eligible families/individuals to 1.5 million, and indicate that a further reduction of eligible families will be introduced – est initial saving $130 mn

- Stop cash handouts to Commonwealth Health Card holders (introduced as part of the last election's programs when States refused to accept an SPP to finance extensions for concessionals for power, water, gas to such holders) – est saving $231 m pa

Hospital Grants to States

Under a Health Care Agreement concluded in 2003 and operating until 2007-08 the Commonwealth provides SPP grants to the States to help fund public hospital services. Under this arrangement the grants increase by 3 per cent pa in real terms and the States have agreed to increase their funding at a rate which at least "matches the estimated cumulative rate of growth of Commonwealth funding".

The access to free hospital services for all regardless of income increases waiting lists for treatment of those on lower incomes, particularly for elective surgery, and seems difficult to justify on equity grounds. The Commonwealth's regulation of the contracting arrangements between health insurance funds, private hospitals and medical device suppliers is estimated by one expert to add 6 per cent to insurance fund premiums (*The Australian, 18 February, 2005*). The Commonwealth also operates its own fund, Medibank Private, which pays no dividend but has recently intimated that it intends to convert from a mutual fund to a publicly listed company.

- Reduce the hospital grants to the States by 10 per cent and, to encourage a more limited usage of free public hospital services and increased usage of private hospitals, inform the States that a further reduction of SPPs will occur unless they introduce a co-payment by patients covering part or all of the first day's admission to a public hospital (as some private health insurers do now) except for pensioners and heath card holders – est saving $ 830 mn

- Announce a public review of access arrangements for free public hospitals – est saving *minus* $0.5 mn

- As the Commonwealth regulates the 40 plus health funds already in operation, there is no reason to continue a policy of having Medibank Private as a "check" on the performance of other funds – est interest saving from privatisation $24 mn pa

EDUCATION

While the increase in Commonwealth expenditure on education has not been as large as the increases in health and social security, the justification for reductions in spending may be just as great. This is not to deny the potential for significant returns from increased investment in human capital or that government may have some role to play in supplementing such investment by individuals. However, as real incomes increase, the capacity of individuals to fund their own investment in education also increases. Particularly as there is, moreover, ample evidence available to show the potential benefits in terms of higher incomes from such investment, there is a strong case on both economic and equity grounds for the Government to play a progressively smaller role in funding higher education and/or in providing assistance to people seeking more advanced forms of education but who are capable of making such investment decisions for themselves.

More generally, it seems difficult to justify the continued direct Commonwealth funding of higher education *institutions*, as opposed to providing assistance to those tertiary students who, though qualified, might otherwise (for financial reasons) be unable to avail themselves of higher education. The Government should thus move progressively towards direct student assistance and to limiting such assistance to financially disadvantaged groups.

Higher Education

Grants are made to higher education institutions, through the States as SPPs, to reduce the fees students would otherwise be charged and low cost loans are provided to help students finance fees actually payable to such institutions pending the acquisition by them of full earning powers. Although the maximum quota of *full* fee paying students has been increased to 35% of total enrolments in any course, only 2 % of domestic students pay the full fee. However, universities can set HECS competitively up to a limit of 25 per cent above the standard fee and most universities have now raised fees by this percentage. This suggests they judge the student "market" will bear the additional cost. Competition between universities would be increased if grants (in the form of vouchers) were paid to students and such grants were limited to students able to establish they have limited access to financial resources.

With reforms in workplace relations, the many students who are job seekers but unable to obtain employment under existing arrangements should be able to obtain more part-time jobs.

- Reduce Commonwealth funding to universities by 25 per cent but, to ensure universities can raise adequate revenue, increase the cap on university fees to 50 per cent above the standard – est saving $1,242 mn

- To further improve the financial viability of universities and increase competition, allow more full fee paying students, up to 50 per cent of the total enrolments in any course – est saving $ nil.

Vocational Education and Training

Considerable subsidies are payable by the Commonwealth to encourage the employment of apprentices by employers, whose expenditure on structured training totalled over $4 bn in 2001-02.

However, in addition following the decision to abolish the Australian National Training Authority, SPP grants of over $1bn pa are also being paid to the States through the Department of Education to "promote a nationally identifiable and consistent vocational education and training system". The present arrangements, which are not subject to any requirement as to spending by the States, are due to expire in June 2005 and are currently being discussed with the States. The recent offer from the Commonwealth does propose clearer outcomes which go some way to addressing this issue. However, the States still have primary responsibility for operating the system. For example, TAFE students pay State-determined fees up front.

- Reduce the SPP grants by 10 per cent and put the arrangements on a more efficient basis by, inter alia, making the SPP grants conditional on appropriate matching expenditures by the States and by having a HECS style loans system for TAFE students and trainees at private colleges – est initial saving $112 mn

SPP Grants to States for Schools

Although States have primary responsibility for schools education, the Commonwealth provides large SPPs for both government and non-government schools and for both current and capital spending. These grants absorb nearly 4 per cent of total outlays (est $7.9 bn in 2005-06) and, although subject to some conditions, do not require the States to spend from their own resources a certain amount or proportion of total governmental spending for such purposes. In effect, as States provide about 70 per cent of the funding of State schools, they are able at the margin to determine how much funding they provide from their own resources.

Under current arrangements, presently scheduled to apply from Jan 2005 to Dec 2009, the recurrent SPP grants increase in line with an Average Government School Recurrent Cost index. The effect of this indexation is to add $4.5 bn to total funding in this period compared with funding if indexed by reference to wage increases. The capital grants are indexed by the Building Price Index.

Shadow Treasurer Swan acknowledged on ABC Lateline (13 April) that, as in the UK, some school (and hospital) building projects financed by the private sector may provide "very good value" if the right balance is struck between public interest and private profitability.

- Index SPP grants for all schools to the CPI – est saving $335 mn pa

HOUSING AND COMMUNITY AMENITIES

SPP Grants to States for Public and Indigenous Housing

SPP grants to the States for public housing for low/moderate income households are estimated at $741 m in 2005-06. These grants, which are made on condition that the States contribute 48.95 per cent of base funding for each of the five years to June 2008, are indexed by reference to wages, with a 1 per cent efficiency "dividend". In general, Governments should leave the supply of all housing to the market: for governments to provide *public* housing is a hangover from the days of socialism.

Grants for indigenous housing are made in pre-determined amounts (estimated at $93.3 m in 2005-06) and are not subject to any conditions as to States' spending.

- Abolish public housing grants and instead provide rental assistance to all those on low incomes who are renting (existing rent assistance is mainly limited to families *not* renting public housing) – est net saving $806 mn

- Require States to contribute at least 50 per cent of the cost of Indigenous Housing – est saving $46 mn

SPP Grants to States for Supported Accommodation Assistance

These SSP grants to the States are stated to mainly be for helping homeless people "achieve self-reliance". They are provided on the basis that the Commonwealth pays "approximately" 60% of total funding but with the proviso that the States may add unmatched amounts to their respective bases.

- As the States have the main responsibility for this type of assistance, require them to contribute at least 50 per cent of total funding – est saving $30mn pa

First Home Owners Grant

The initial basis for SPP grants to the States under the First Home Owners' Scheme (FHOS) was to provide compensation for the effect of the GST on the cost of building houses. The need for such compensation has now passed and it is difficult to see any justification for continuing the scheme, particularly as it is not subject to any means test.

- Reduce the grants by 20 per cent by eliminating the availability of assistance to higher income groups – est saving $155 mn

- Remove the tax exemption for the grant – est saving $240 mn

AUSTRALIAN GREENHOUSE OFFICE (AGO) PROGRAMS

This office was established to encourage in various ways the reduction of greenhouse gas emissions in Australia. However, although the Kyoto Treaty has become operative and requires signatories to meet caps on emissions up to 2012, the 10th session of the UN Framework Convention on Climate Change in December 2004 failed to agree on reduction targets after 2012. Two major emitters (India and China) joined with the US in opposing such targets and even one European Union member (Italy) agreed that it was fruitless to attempt agreed reductions after 2012. Without greater international participation there is now little prospect of establishing an effective international system of trading in emission certificates.

- The AGO has now been "folded" into the department and some of its activities could be wound back although the Greenhouse Challenge Plus program (whose main aim is to encourage business and industry to manage and report on their greenhouse emissions) should be maintained. A proposed saving of approximately 20% of agency costs is considered appropriate – est saving $25 mn

DEFENCE

Although the armed forces have their own internal efficiency improvement programs, Defence is exempt from the 1.25 per cent efficiency dividend. One major spending program involves the replacement of the F-111s in 2012 by the purchase of the JSF fighter but, in the meantime, an upgrading of the F/A 18 fighter.

- Remove the efficiency dividend exemption – est budget saving $120 mn

- Slow expenditure on the program for upgrading of the F/A18 fighters – est saving $50 mn

TRANSPORT AND COMMUNICATION

Telstra

Although the Commonwealth Government's policy is to sell its 51 per cent holding in Telstra, there has been a long delay in implementing that pending an upgrade of rural services. Rural dwellers should not, however, expect phone and associated services to match metropolitan standards any more than they should expect to have metropolitan standards for other consumer services. As there appear to have been significant improvements in rural phone services, privatisation should proceed in 2005-06. Competition in the (heavily regulated) market would then determine further improvements in service standards. With expected sale proceeds of over $30 billion, sufficient could be allocated to reduce Commonwealth debt to minimal levels and any remaining proceeds invested to reduce unfunded superannuation liabilities (see further below)

- Sell Telstra – net saving (reduction in annual interest on Commonwealth debt less loss of annual dividends of $1.6 bn) - $ nil

SPP Grants to States for Transport

SPP grants under the Auslink program are estimated at $1,146 m in 2005-06. These grants, which are scheduled to operate until end 2008-09, are to assist the States with land transport, mainly roads. The Commonwealth fully funds national highways (such as the Hume) and shares the costs with the States of roads characterised as roads of "national importance" (such as the Pacific Highway). States retain ownership of the roads and are responsible for ensuring the roadworks are done. Grants are also provided for a road safety "Blackspots" program and to Tasmania for subsidies to shippers transporting passengers and freight between Tasmania and the mainland (partly on the ground that this is in lieu of grants for a Bass Strait "road").

- Reduce roads element of SPP grants by 20 per cent on the basis that States should be expected to finance a much higher proportion of "national importance" roads through private sector toll roads, but also on the basis that the "Blackspots" program should be a State responsibility – est saving $248 mn pa

Return to Budget the Scoresby Allocation Offered to Victoria for a No Tolls Road

As the Victorian Government is clearly proceeding with a toll road, there is no basis for retaining this in the Budget.

- Remove Scoresby budget provision – est saving $110 mn

Regional Partnership Grants

See below under Local Government.

Fuel Sales Grants Scheme

Following the introduction of the GST this scheme was introduced to subsidise the sale of petrol in country areas to offset a supposedly insufficient cut in the excise on fuel.

- Although this scheme is scheduled to finish in 2006-07, there seems no reason why it could not finish next year – est (one off) saving $265 mn

RECREATION AND CULTURE

The rationale for government assistance to the arts is that there are benefits from having a greater proportion of resources devoted to cultural pursuits than would be the case if these pursuits were left to "the market". It is argued, in particular, that "the market" would not by itself produce artistic excellence and that such excellence contributes importantly to "the quality of life" and is a matter of national (or State) prestige.

However, while there may be some validity in such arguments, they have to be balanced against the increasing difficulty of justifying continued high levels of funding in circumstances where "the arts" is now a well- established and growing industry in Australia. The services of this industry are increasingly being used by Australian businesses and well-to do individuals, not to mention foreign tourists for whom visits to galleries, museums, and the like, have become an essential (but heavily taxpayer subsidised) occasion. Indeed, while they have been assisted by government subsidies, all branches of the arts industry have demonstrated that they are now well able to compete in the international market place and with little or no subsidy. Many Australians now make good livings from the industry and, while there are also many who strive to become artists but do not succeed, that should not be a matter for the taxpayer any more than it should be in the case of would-be champion athletes.

As living standards rise, the arts should look increasingly to the market and private patronage, and taxpayers could reasonably be expected to be relieved of most of the burden of support. Particularly as the "users" of the arts come to a large extent from middle- and upper-income groups, and as many such users get spin-offs of more than one sort from their involvement in and enjoyment of the industry's services, it seems reasonable to look to such users to fund a much higher proportion of "artistic excellence".

Accordingly, as with assistance to other established industries, it would now be appropriate to implement a large reduction in Commonwealth "cultural" assistance and to leave the achievement of artistic excellence largely to the private sector.

Public Broadcasting and Television

Despite the rapid expansion in commercial broadcasting and television (including increased channels) on a free to air basis, over $1 bn pa is now being spent on funding public broadcasting through the ABC and SBS. Neither of these bodies is subject to the efficiency dividend and both reveal a tendency to be "captured" by minority viewpoints. If the two channels were privatised, the services they presently provide would then have to compete directly in the commercial sector.

However, if judged necessary, arrangements could be made to ensure continuation of "unique" services with the help of subsidies. The SBS, which already raises income from advertisements, could be offered for sale, for example, on the basis of a licence requiring it to maintain a certain proportion of its services specifically to non-English speaking Australians on a subsidised basis.

Alternatively, if it was judged that privatisation would cause "unique" ABC/SBS programs or areas of "high" culture to be "unduly neglected", privatised licence holders could be offered subsidies for the operation of such programs and commercial (including ex-ABC, ex-SBS) interests could be invited to tender for them on a competitive basis.

If some form of privatisation is not acceptable, there is a strong case for implementing a large cut in the allocation of funds to public broadcasting and TV, as the British Government has recently implemented with its large cut to the BBC's allocation. In the US public TV's funding from government is down to 15 per cent. A large cut to ABC/SBS funding would require management to give priority to programs they judge are inadequately provided by the private sector. Options are:

- Privatise the ABC and the SBS but introduce competitive tendering for "unique" services that would not otherwise be provided and offer subsidies for part of the cost of such services - est net saving $737 mn

- Lower interest from reduction in Commonwealth debt – est saving $39 mn

Or

- Require ABC/SBS to prioritise their programming by reducing funding by 20 per cent – est saving $184 mn

Film Industry

Although the Commonwealth has now been funding for about thirty years what was once an "infant" industry, most Australian films have attracted limited audiences even in Australia. In 2004 Australian movies took their lowest share ever of the annual box office – 1.3%.

- Shut down the Australian Film Commission and provide future assistance through the Department, limiting the availability of subsidies to producers of high-budget films (now 12.5 per cent) and requiring removal of the protectionist requirement that location/production must be in Australia – est saving $ 40 mn

Assistance to Museums, Orchestras, Opera and Ballet

Commonwealth expenditure on arts and cultural heritage (incl on the film industry) is estimated at over $800 mn in 2005-06 which is nearly 13 per cent higher than two years earlier. These outlays are being undertaken in a context where most households are nowadays themselves able to afford to spend a moderate proportion of their incomes on cultural goods and services. The various cultural institutions funded by governments are also able to attract increasing support and/or sponsorship from corporations and individuals – in 2000-01 businesses gave $70 m to arts and cultural activities.

In these circumstances there should less need for government "supervisory" bodies to hand out grants and, with the extensive use of art museums and extensive attendances at orchestral, operatic and ballet performances by middle and higher income groups (and overseas visitors), less need for free access except for students and the broader community at certain free times.

- Reduce assistance to cultural institutions by 20 per cent and use part of the savings to provide more generous tax concessions for donations and bequests to a range of philanthropic activities (such as those now provided for research and development). Investment in live performing arts and other cultural activities should be boosted by general reductions in the burden of capital gains tax, as suggested by ACCI. Also, make assistance to art museums and the like conditional on them charging higher admission prices except at certain times and on them not under-pricing sale products that are also sold commercially – est saving $50 mn

- Abolish the Australia Council and provide assistance through the Department – est saving $6 mn

Sport

The large estimated increase (from $169m to over $224 m) in Commonwealth funding for sport and recreation in 2005-06 reflects a substantial grant to Victoria to assist with the Commonwealth Games in 2006. This and other sports funding provide considerable benefits to sportspeople, some of whom become professional or semi-professional. As with cultural activities, increased contributions to sports programs should be sought from corporate sponsorship/ advertisements and government assistance should be provided on the basis that, pensioners and health card holders excepted, ticket prices should be set at market rates rather than allocated by ballots. Those sportspeople who benefit professionally should also be expected to return some of the investment made by taxpayers.

- Reduce funding for sports programs not subject to existing commitments by 20 per cent – est saving $30 mn

- Introduce a HECs type scheme whereby part of the assistance to those sportspeople identified as having potential would take the form of loans – est saving $ nil

INDUSTRY ASSISTANCE (COVERING AGRICULTURE, FORESTRY AND FISHING; AND MANUFACTURING AND MINING)

Although the Coalition supports the reduction of protection, it continues to provide extensive industry assistance, estimated by the Productivity Commission to be equivalent to over $11 bn in 2003-04, of which budgetary assistance was an estimated $4.3 bn. Direct financial assistance of $2.3 bn was provided to 30 industry groupings, including $645 m for primary industries, $780m for manufacturing and $514 m for service industries.

With improved rates of economic growth and lower unemployment, the need for such widespread assistance should now be much reduced even for industries, such as dairying, which are judged to require assistance to “persuade” them to rationalise (or, as the Budget Paper No. 1 puts it, to improve their “efficiency and effectiveness”). However, as illustrated by the response of the dairy industry, the provision of rationalising assistance often seems to result in a very slow response from those reluctant to change. The lesson of the 1980s reductions in protection is that industries will perform best if exposed to market competition. If extensive welfare and health reforms are being implemented, a major reduction in industry assistance would also be timely and appropriate.

- Reduce funding for industries by an across the board cut of 20 per cent to budgetary outlays – est saving $457 mn

- As found by the Government’s Review of Business Taxation (RBT), the Fringe Benefits Tax (FBT) treatment of car usage is concessional, mostly favouring those on the top marginal tax rate and open to misuse. The TES estimates that this concession is costing $1.1 bn pa and it does not seem to provide assistance to the car industry per se. If the statutory car formula was increased in line with the recommendations of the RBT, that would still provide not inconsiderable concessionality – est addition to revenue $570 mn

- The tax offset for “entrepreneurs”, announced as part of the 2004 election program, provides for a 25 per cent reduction in tax for businesses with a turnover below $50,000. The measure does not appear to be specifically targeted to entrepreneurs and, by being available to only the smallest of businesses, discriminates against other entrepreneurs. If the offset were not to proceed, that would add to revenue available for a general tax cut, which would promote entrepreneurial activity for all businesses and individuals – est saving $290 mn

OTHER ECONOMIC AFFAIRS

Labour Market Assistance to Job Seekers and Industry

In addition to the Newstart Allowance, SPPs to the States for vocational education, and direct expenditure on vocational and industry training, the Commonwealth provides assistance to job seekers (particularly those unemployed for long periods) and industry for training and other expenses perceived as helping to obtain a job. In 2005-06 such expenditure is estimated to cost $1.8 bn. However, while training programs may help at the margin, they are generally a poor substitute for on-the-job training and have had limited success in adding to employment.

- Taking account of other similar expenditure and workplace relations reforms, cut such programs by 5 per cent – est saving $90 mn

Australian Industrial Relations Commission

The indication by the Government that it will introduce "extensive" reforms of workplace relations suggests that employers and employees will have greater freedom to negotiate employment contracts and that the AIRC will have a more limited role to play in prescribing employment conditions and "settling" disputes. Whether or not this is the outcome, a significant reduction in the number of commissioners (who are not judges) would be justified to reduce the inherent interventionism of the tribunal.

- Reduce the number of AIRC Commissioners and finance one-off redundancy payments from the proceeds of the Telstra sale –est initial net budgetary cost nil but est ongoing savings $0.5 mn

OTHER PURPOSES

Grants to Local Government and Regional Partnerships

State Governments determine how many local governments there should be, the division of functions between them and State governments themselves, and also provide funding assistance.

Despite this, the Commonwealth itself provides extensive assistance to local governments for both general purposes and local roads (est $1.6 bn in 2005-06). This assistance is paid through State departments and State bodies determine its distribution as between individual councils. Commonwealth funding is indexed to increase in line with national population growth and the CPI. The effect is to reduce the rates that local residents would normally be charged for local services - but to increase other taxes.

The Commonwealth does not require the States to fund any particular level or proportion of total assistance to local government ie it leaves it to the States to determine how much *they* should provide and it may well be the case that the proportion of total funding to local governments provided by the States has been declining.

In addition to this "regular" assistance, a $408 m regional partnership program (RPP) is providing numerous grants to local groups for roads and other "special" local projects. Fifty-six Area Consultative Committees, which were started by Labor as precursors to its envisaged establishment of regional governments, operate under the RPP and also provide grants for local activities "to find local solutions to local problems".

- Taking account of the regional partnership program (RPP) grants and those provided by ACCs (which should be abolished), and the fact that "regular" grants to local governments are distributed by State bodies that can take account of the local benefits of RPP grants, the regular grants should be cut by 20 per cent and put on a more efficient basis (from the general taxpayer viewpoint), with the States required in future to contribute a certain proportion of total "regular" assistance to local governments – est saving $322 mn pa

Government Bond Market & Future Fund

As a result of privatizations and the achievement of cash surpluses of more than $30 bn since 1995-96, net Commonwealth debt has been reduced from $95.8 bn in 1995-96 to an estimated $14.2 bn in 2005-06 and, with further privatizations and surpluses, is projected to be a *negative* $22.0 bn by 2007-08. This has led to proposals designed to maintain a market in Commonwealth interest bearing securities and to allocate part of future surpluses to a Future Fund.

However, a continuing market in Commonwealth bonds does not appear necessary to having a structure of domestic interest rates that would include a range of risks and, if the Government has excess funds available, these might best be invested to help reduce the Commonwealths' unfunded public service superannuation liabilities of over $90 bn. The Public Sector and Commonwealth Super Schemes already have a good record of managing investments totalling about $13 bn funded from contributions by public servants and there seems no reason why, perhaps with additional staffing, the PSS/CCS Board could not manage larger investments. In a super fund industry that is growing quite strongly and has assets totalling about $650 bn, the NSW Government fund (SAS Trustee Corporation Pooled Fund) already manages over $24 bn, Unisuper $12.4bn and MLC Moderate some $8.6 bn. Annual Commonwealth cash surpluses averaging, say, $5 bn should be capable of being handled by a PSS/CSS fund without distorting the investment market.

Suggestions that budget cash surpluses could be used directly to finance infrastructure investment overlook three important points. First, superannuation funds are already doing that through equity investments to the extent that the private sector is involved in such investment. Second, if public investment is judged appropriate/necessary that should be done before striking the surplus. Third, the public sector's record in regard to investment does not encourage confidence in its ability to undertake economic projects ie whether through a Future Fund or the PSS/CSS Board, it would be highly desirable that such investments continue not to be subject to direct government decisions or influence.

- Abandon any idea of special action to maintain the market in Commonwealth securities and invest future surpluses through an independent agency to reduce unfunded superannuation liabilities. Est saving $ nil (but more productive investments).

GENERAL PUBLIC SERVICES

Aboriginal Affairs

Although the Government has indicated that the abolition of ATSIC is not designed to reduce overall spending on assistance to Aboriginal communities, the increasing recognition that a considerable proportion of expenditure by ATSIC was wasted should enable an increase in the efficiency of delivery of services. There is also a strong case to stop providing housing and other infrastructure to small remote communities (say, those with fewer than 200) that have very limited prospects of obtaining modern living standards, particularly in education (in Canada the Government has adopted a policy of providing such assistance only to larger communities). The Community Development Employment Program, which is in effect a work for the dole arrangement but largely on public work type projects, should also be discontinued in remote communities and, instead, increased wage and transport subsidies should be provided to encourage Aborigines to move to areas where there are labour markets.

- Improved efficiency in delivery of services following abolition of ATSIC – est saving $100 mn pa

- Cease the funding of infrastructure and CDEP in remote communities and encourage the voluntary movement of residents by using saved funds to subsidise the costs of moving to larger communities and/or centres with operative labour markets – est net saving $ nil

ENDNOTES

1 Howard, John, *Spirit of Menzies' liberalism tradition remains*, The Australian, 12 April.

2 The situation is also complicated by the different treatment of the GST revenue. Whereas the ABS treats the GST as a Commonwealth tax and its payment to the States as part of Commonwealth expenditure, the Commonwealth Government excludes both GST collections and the equivalent payments to the States from the budget figures.

3 I am indebted to Mr Saul Eslake, Chief Economist at the ANZ bank, for drawing my attention to this. The data obtained from national account statistics, however, required adjustments to convert it into a form that is usable for purposes of this report.

4 Some of this increase reflects decisions by governments to provide benefits more overtly by paying them to recipients rather than providing tax rebates or deductions causing revenue to be lower than otherwise.

5 In several European countries payroll taxes contribute a higher proportion to total taxes than income taxes.

6 See, for example, Wolf, Martin *Why Globalization Works*, Yale University Press, 2004.

7 Australian National Audit Office, *The Management of Performance Information for Specific Purpose Payments – The State of Play*, February 1999.