

The Liberal Party –Where to Now?

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by Des Moore

Many reasons have been advanced for the federal Coalition's major election defeat. Indeed, after reading the large number of criticisms of Coalition policies – many using much hindsight - it would be easy to forget that Australia's economic performance under the Howard government was second to none internationally, with unemployment almost halved, inflation held below 3% and virtually no change in income distribution. But according to my favourite, impartial economist, Ross Gittins, the economy's good performance over eleven and a half years "rested more on good luck than good management".¹ The lucky country must have been extra lucky to perform so well given assertions such as that workers were so 'exploited' under Work Choices, that increases in interest rates caused a housing affordability 'crisis', that infrastructure was allowed to run down, that education and global warming were neglected, that immigration was badly administered and that Howard himself stayed too long.

However, not everybody was satisfied with the way the Coalition was defeated. David Marr, also one of Australia's prominent impartial journalists, and also as it happens a writer for the Sydney Morning Herald, complained that Kevin O'Keefe's performance on election night was "so passionless, so grey that it raises the terrible possibility that our new leader is not channelling John Howard but Philip Ruddock."²

Marr's comment indicates that the left has reacted to Labor's win much as the Greek King Pyrrhus did when, after losing too many troops in defeating the Romans, he said "one more victory like that and we are lost". Indeed there is a sense in which the Coalition could justify repeating Billie Snedden's much derided claim that "while we didn't win we didn't lose either".³

The Coalition can justifiably claim that, over the period it was in office, it made a major contribution to moving Labor away from the left to near the centre position in Australian politics. As the head of economic consultancy CRA international, Henry Ergas, has pointed out, "the Howard years, whatever their defects, achieved a change in the policy landscape that ... will be difficult to pave over ... [and] enabled a shift in the public /private balance that is still incomplete but no less significant for it".⁴

Although most Laborites would be the first to deny it, this change may have created a situation in Australia similar to that in America where there seem to be few

¹ Gittins, Ross, "Complacent John's decade of neglect", The Age, 3 December 2007.

² Quote from The Australian's Cut and Paste, 27 November 2007

³ Made by Opposition Leader Snedden after he lost the double dissolution called in 1974 after the Coalition blocked Whitlam's budget in the Senate. Whitlam was returned with a reduced majority.

⁴ Ergas, Henry, The Owl of Minerva, AFR, 30 November 2007

substantive differences between the two major parties. This is reflected in the “I’m a conservative” position taken by Kevin Rudd in the election campaign, in the many “me too” policies he adopted and, just as importantly, in the colleagues he appears to have persuaded to at least go along with centrist type policies.

The most important exception is workplace relations, where Labor’s proposals run counter to its increased support in recent years for a more competitive economy. Increased union influence and privilege, already holding back improvements in the operation of state services, will further reduce the job prospects of low skilled workers as labour markets become more protectionist.⁵

Of course, we still have to see how Labor performs in practice, but it does appear largely to have abandoned socialist, big government objectives and accepted the more limited role that government plays in Australia than in European countries. Moreover, this apparent acceptance of more limited spending and improved budget management policies extends to both the federal and state levels, to a depoliticised operation of monetary (and exchange rate) policy, and even to the growing inclination to accept privatisation of state-run authorities providing electricity, transport, ports and the like.

Where Does This Leave the Liberal Party?

If I am correct in thinking Labor has moved to the centre at both the federal and state levels, this poses a major challenge to a Liberal Party that also seems centrist itself. How can centrist Liberal parties distinguish themselves from centrist Labor parties that are now in government in every state? And can the federal Liberal party seek to advance policies that might differentiate itself sufficiently from a centrist federal Labor party?

At the state level one could sometimes be excused for thinking that the main current objective of Liberal parties is to hope that the Labor government will make major mistakes rather than to persuade the electorate that they have attractive alternative policies with substantive differences. And even when state Labor governments do make major mistakes, as in NSW and Western Australia over recent months, Liberal Oppositions seem unable to make any headway and all too often lapse into internal arguments and fights (you may be aware that one State Opposition leader even publicly threatened to right hook any internal challenger!).

My own experience in talking to current Liberal oppositions is that they are most reluctant to propose new policies that could create public controversy. Yet the longer they do that the longer they are likely to stay in opposition. By contrast, if substantive alternatives are to be proposed, time would be needed to explain the benefits to the electorate and to evoke sufficient public debate. The failure to allow enough time to explain the benefits of reduced labour market regulation was one of the reasons the WorkChoices legislation failed.

⁵ For further analysis, see my article “Who Is the Fairest of Them All? (With Apologies to Snow White’s Stepmother)”, in Policy, Centre for Independent Studies, Spring 2007.

Smaller Government?

One major issue is whether the Liberal party's avowed "small government" philosophy is any longer of significance or whether it is destined to die the death of Labor's former objective of the socialisation of the means of production, distribution and exchange. In current circumstances the temptation will be not to move forward but to retreat and present a more compassionate front.

During the Howard government, ministers (including the Prime Minister himself) consistently claimed not only that their objective was smaller government but that they had actually reduced its size relative to the economy and had also reduced the relative size of taxation. However, the reality was different. In practice the government followed what I call the "soft" approach of providing continued government handouts as a vote buying strategy.

I have circulated a page containing two tables, one showing the Government's version (Table 2) and the true version as shown in the national accounts data published by the Australian Bureau of Statistics (Table 1).

The claim by the Government is based on the data in Table 2 showing that between 1995-96 – the last year for which Labor can be held responsible - and 2006-07 outlays fell from 25.3% of GDP to 20.8% while taxation fell from 22.3% to 20.8% of GDP. However, this is comparing apples with oranges. Data for the years before 2000-01 includes large general revenue grants to the states and the taxes to pay for them whereas data for 2000-01 and subsequent years exclude from expenditure the GST payments now made in lieu of those grants and exclude from taxes the revenue from the GST itself.

Fortunately, the ABS national accounts adopt the correct approach of treating the GST as a federal tax and its payment to the states as federal expenditure. The data in Table 1 thus produces the accurate picture of what happened to government under the Coalition (and before). This shows that in the first full year of the Howard government – that is, 1996-97 – there was a reduction in total outlays of 1.0 percentage point of GDP. Outlays then moved even lower until the election year in 2000-01, when they reverted to above 1996-97 levels. But although 2006-07 levels were again slightly below those in 1996-97, and also significantly lower than in the last year of Labor, that was not due to any diminution of spending in discretionary areas. By "discretionary" I mean spending that is avoidable or alterable.

Thus, if interest is excluded on the ground that it is not part of discretionary spending, total outlays in 2006-07 were the *same* (relative to GDP) as in the last year of Labor. In reality, the whole of the 1.7 percentage point fall in total outlays over the period between 1995-6 and 2006-07 was due to the reduction in interest costs, mainly reflecting the reduction in debt from the proceeds of privatisations.

A major contributor to the continued high level of discretionary spending was the maintenance of high expenditures on social security benefits. This epitomizes the soft, vote buying approach and occurred despite the much stronger growth in average real per capita incomes over the period the government was in office – about 2.3 per cent pa – and the obvious reduction in need to assist middle and higher income groups.

What about taxation and the announcement of many tax “cuts”, which did include some reduction in marginal rates aimed at a top 40 per cent rate in 2012-13? Unfortunately, the overall burden of Commonwealth taxation (including the GST) actually *increased* by over 2.5 percentage points of GDP and at 24.9% of GDP in 2006-07 it was above the high reached under Labor in 1986-87. In effect, this increase not only financed the elimination of the budget deficit but also established a surplus of around 1 per cent of GDP. Under the Howard government Australians were thus “forced” to save through higher taxation.

It also needs to be understood that the outlays shown in the tables do not take account of what are called “tax expenditures”. These 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. In 2006-07 these tax expenditures amounted to no less than 4.0 percent of GDP and were estimated to increase to 4.5 per cent by 2009-10.

In summary, despite the continued strong growth in incomes and the drop in unemployment, the Howard Government effected no reduction in discretionary spending. Could it have done so? In 1989-90 discretionary spending by the Hawke-Keating government was about 2.5 percentage points of GDP lower than such spending in 2006-07, equivalent to lower spending of nearly \$28 billion in that year. Although the Keating government allowed outlays to increase again after 1989-90, the lower level reached in that year is a pointer to a feasible starting point for smaller government.

A final point about the Coalition’s attitude to size of government is that in the lead-up to the election it did not foreshadow the possibility of moving to a smaller government if re-elected. The forward Budget estimates and projections in Table 2, which include my estimate of the effects of election promises, suggest little change.

Overseas Trends

Some analysts argue that, as Australia already has one of the smallest government sectors, there is no basis for effecting a reduction. It is certainly true that the OECD’s latest estimates of total general government outlays (including those for state and local governments) show that at 34.0 per cent of GDP in 2007 the size of the Australian government sector was about 13% lower than the OECD average and the second lowest after Korea amongst the 28 OECD countries surveyed. These estimates also show that the total size of our government sector decreased between 1996 and 2007.⁶

However, although that decrease of nearly 8% was slightly greater than the OECD *average*, there were over this period much larger reductions in many OECD countries, including in previously very high spending Nordic countries. Sweden, for example, reduced its government sector outlays by over 16%, Finland by 19% and Denmark by 15%. While those reductions still leave most of those countries with bigger

⁶ Details of outlays are not published but it is likely that most of the reduction of 2.8 percentage points of GDP reflected the effect of lower interest rates.

government sectors than Australia, there has been a downward trend amongst OECD countries over the past decade (23 out of 28 fell) and one or two have moved close to Australia. Canada, for example, cut its government sector outlays by 16% to make them only 12% bigger and Ireland by 12% to be virtually the same as Australia.

The General Case for Smaller Government

If the Liberal Party has sufficient inclination and capacity to develop a policy approach based on reducing the extent of government intervention in the community, there is plenty of scope for it to do so at both the federal and state levels. For example, my 2005 report to the Australian Chamber of Commerce and Industry⁷ identified potential for reducing federal spending by about 2% of GDP and suggested arguments justifying the lower spending. They obviously included that higher employment and productivity are likely to flow from lower taxation, particularly if rates are flattened. It is interesting that Treasurer Wayne Swan is reported yesterday to have used this argument as one justification for adhering to Labor's election promise to cut income tax.⁸

My 2005 report also pointed out that there are strong arguments favouring reductions in government spending on social-type payments to higher income groups and that the politics of such action could be helped by using some of the resultant savings to reduce taxes on such groups. The report also pointed to political justification based on the anomaly that, despite the large increase in real incomes since the end of the 1980s, around 20 percent of the working age population still received income support compared with only 15 percent then. The trend should have been the other way, recognising that higher real incomes have increased the capacity of a now significant proportion of the population to finance more or all of their own spending on items such as education, health, welfare and old age. Although the Intergenerational Report circulated by Treasurer Costello in 2002-03 also provided justification for reducing welfare dependence as one way of increasing labour participation and productivity to deal with the ageing population problem, the follow-up was limited.

For example, while the large expansion of assistance to sole parents and disabled persons under the Coalition was clearly undesirable from both an economic and social perspective, action to deal with this was left until the number of recipients had increased to high levels of welfare dependence.⁹ The start on the tightening of eligibility rules was also modest.

At the state level, my 2006 report to the Queensland Chamber of Commerce and Industry¹⁰ concluded that, even though state taxes imposed by the Queensland Government were the lowest of any state, there was potential for reducing such taxes by 15-20% and for developing a program for the private sector to take over

⁷ "Commonwealth Spending (And Taxes) Can Be Cut – And Should Be", A Discussion Paper by Des Moore, May 2005.

⁸ The Australian, 8-9 December, "We will deliver tax cuts, Swan", p1. According to the report, Mr Swan said "they also have a very important economic function –lifting labour supply in an environment where we are having endemic skill shortages."

⁹ Between 1995-96 and 2005 the number on disability pensions increased from about 500,000 to over 700,000 and the number on sole parent pensions from 3334,000 to over 630,000.

¹⁰ "The Role of Government in Queensland", Report to Commerce Queensland, May 2006 by Des Moore.

responsibility for an increasing proportion of services then provided by the state government.

In addition to identifying possible cuts in government spending and taxation, this report pointed out that Australia's already larger than average sized private sector provides advantages waiting to be flaunted and used as a "model" for further development at the state level. For example, Australia is one of the few countries in the developed world to offer extensive choice in education and health services through large private sector agencies that compete with each other and the counterpart public sector agencies. The growing usage of such services indicates wide support for them in the community, with about one third of school students attending non-government schools and about 40% of patients treated in private hospitals.

Of course, their costs are subsidised by government, which provide about 60% of the income of non-government schools and 35% of the income of private hospitals. But as taxpayers do not bear the full costs there is a saving compared with government-run agencies and users benefit from a competitive system that is much less subject to restrictive union practices. Critics of Australia's relatively lower level of government spending in areas such as education and health need to be reminded that total Australian spending on them (that is, both government and private) is broadly in line with total spending in other countries with comparable income levels.

A similar approach is open for wider adoption in regard to state authorities. Considerable scope remains for privatisations, particularly at state level, and it is surprising that the benefits flowing from such action in Victoria have not been used by other state liberal parties. The establishment of a more competitive environment would reduce the scope for the widespread union restrictive practices that exist in these areas now. Labor's increasing acceptance of privatisation is highlighted by reports that the NSW government may be about to move to privatise its electricity authorities and this serves to confirm that Liberal parties are being left behind in an area where they should be leading.

Conclusion

In conclusion, I suggest two main points that the Liberal Party needs to address. First, the move by Labor to a centrist position in Australian politics has created a major challenge to a Liberal party that has itself been centrist in practice and now needs to reconsider both its philosophical and practical political positions. Second, there is in fact ample justification and scope for the party to change those positions by giving real meaning to its stated belief in small government and, more broadly, to a society in which individuals accept increasing responsibility for taking care of themselves.

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Howard Government's Spending and Taxation Record

**Table 1: Commonwealth General Government Outlays and Taxation
% of GDP**

	Outlays	Outlays Excl Interest	Tfrs to States	Social Security	Tax
1973-74	18.8	16.7	4.2	4.1	19.2
1975-76	24.3	22.2	6.7	5.8	21.1
1986-87	28.3	24.1	6.9	6.9	24.6*
1989-90	23.6	20.7	5.8	6.2	23.1
1994-95	26.1	23.3	5.4	8.3	21.7
1995-96	25.9	23.3	5.4	8.4	22.3
1996-97	24.9	22.6	5.3	8.4	22.8
1998-99	23.1	21.6	5.2	7.9	23.0
2000-01	25.3	23.9	6.4	8.6	24.3
2004-05	24.9	24.0	6.4	8.2	25.3
2006-07	24.2	23.3	6.2	7.8	24.9

Source: ABS Cat.No.5204.0, 2006-07 Time Series.

* The year 1986-87 had the highest proportion of tax to GDP pre 1999-00.

**Table 2: Commonwealth General Government Outlays and Taxation
% of GDP**

	Outlays	Outlays excl interest	Taxation
1975-76	24.3		20.7
1986-87	27.0		23.8
1989-90	22.4		22.8
1994-95	22.5		21.6
1995-96	25.3	23.8	22.3
2000-01	22.5	21.8	21.3
2004-05	21.2	20.9	21.0
2005-06	21.3	21.1	21.1
2006-07	20.8	20.8	20.8
2007-08 (a)	21.0	21.1	21.0
(b)	21.3	21.4	21.0
2008-11	21.0	21.1	20.7

Source: Mid-year Economic and Fiscal Outlook, October 2007 for 1975-75 to 2006-07 data. Data for years after 2000-01 are derived by accrual accounting and are not comparable with data for earlier years. For 2007-08 (a), Pre-Election Economic and Fiscal Outlook. Author's estimate for 2007-08 (b) and 2008-11 based on election promises by the Coalition.