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Can government be restrained?

Making the state small is a huge task

Des Moore

The 2007 election illustrated clearly how at both the federal and state levels the Labor Party has moved further away from socialism towards the centre of the political stream. In that sense the coalition parties can claim a 'victory', albeit a hollow one. But what can the opposition parties do now to differentiate themselves?

Michelle Grattan, recently wrote an article headed 'Liberals stripped bare' for *The Age* suggesting it would be difficult to find a new direction given the precedent set by the abandonment of WorkChoices and the acceptance of the apology and the Kyoto ratification. She might also have pointed out that the Liberal Party had already effectively abandoned its stated objective of small government.

Remarkably, the post-election debates about possible inflationary effects of the tax cuts promised by both sides have not elicited any critical comment (or indeed any comment at all) about the increased burden of federal taxation imposed by the coalition, even though this means Labor has been handed on a platter a substantial additional quantum of funds compared with when it was last in office. As pointed out in the January 2008 *IPA Review*, federal tax revenue increased by 2.5 percentage points of GDP between 1995-96 and 2006-07. Moreover, the 2007-08 budget estimates indicated that even with the promised pre-election (nominal) tax cuts of $31.5 billion there would be a further increase in the burden of taxation over the following three years. In short, the coalition affected no real tax cuts and sought to implement none in the future (a real tax cut requires a reduction in the proportion of real income paid in tax).

Why has this happened? Nobel Prize winner James Buchanan suggested in his 1990 John Bonython lecture that, while it took about a century for the widespread faith in socialism to die—from mid nineteenth century to sometime in between the early 1960s and the early 1990s—no widely shared organising principle seemed to have replaced it. Rather, the Leviathan of interest-driven politics had emerged, one which he opined as difficult to dislodge. Politicians of all party affiliations have not hesitated to buy votes through spending promises, particularly when the cost of the promises is relatively small per tax-paying individual.

Buchanan's conclusion was that 'if we know that politics fails and that its natural proclivity is to extend its reach beyond tolerable bounds, we may be led to incorporate constraints into a constitutional structure'. While this statement was doubtless related to measures in the US limiting governments' powers to borrow and spend, it also reflected more general concern amongst academic thinkers and others about the working of the democratic system. Interestingly, Australia has experienced one failed attempt—by the NSW government in 1994—to guarantee a balanced budget and the European Union has limits on countries' budget deficits, although these have not always been observed.

In reality, attempts to put constitutional constraints on taxes and borrowing reveal inherent practical difficulties. Term limits, on the other hand, may be both more practical and have potential, particularly at the state level, to reduce the capacity of politicians to 'fool the people' for a time. Recent revelations of 'cliqueness' within the NSW Labor government illustrate the problem. Term limits already exist of course for elected representatives in some US states and local governments—and for the President.

However, given that (relatively) Australia has one of the smallest government sectors—equal second with the US—a policy designed to move towards to an even smaller government here would require a change in the still widely shared culture of belief that extensive government intervention is needed. Although there are some indications that such a cultural change is happening, further substantive progress would require political leadership.

One development that might be drawn upon is the encouraging sign in Europe of movement in the direction of smaller government in circumstances where economic growth has been sustained for a lengthy period, albeit at only a moderate pace. Be-

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What next?

tween 1995 and 2007 growth in Euro countries averaged about 2 per cent per annum, even though almost all Euro countries reduced the size of government (as measured by the proportion of general government outlays to GDP). In fact, no less than 21 out of the 28 countries listed in surveys of OECD member countries made such reductions and eleven cut them by more than 5 percentage points of GDP, which suggests that they made reductions in discretionary outlays. Particularly noteworthy were the cuts by the Nordic 'big spenders'—Sweden (13 per cent), Norway (9 per cent), Finland (13 per cent) and Denmark (9 per cent)—as well as those by Canada (10 per cent), Czech Republic (11 per cent) and the Slovak Republic (12 per cent).

These countries have thus reduced the relative extent of government outlays by 15-20 per cent, resulting in much diminished 'Swedenisation'. The reasons for these developments in Europe are unclear, but they certainly suggest smaller governments have increasingly been favoured. Moreover, while one or two countries with relatively small government outlays have experienced relatively poor economic performances, some academic analysis suggests a favourable relationship between economic growth and the size of government.

In a survey of a wide range of academic studies of the effects of government size, economics Professor Denis Mueller of the University of Vienna concluded that, while too small a government sector can harm economic performance, beyond some point the adverse incentive effects from high levels of taxation and regulation outweigh its positive effects. All of the highly developed countries, Mueller argues, are beyond that tipping point. 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.

In any event, the case for reducing the size of government would not rest simply on the potential for improving economic performance. There is a broader philosophical case that increasing the role and responsibilities of individuals would enhance individual freedom and the functioning of society more generally. Particularly in today's more educated and wealthier society, a higher proportion of individuals have the capacity to make their own decisions on health, education and retirement.

This, in turn, should mean a reduced need for the provision of government assistance, particularly to higher income groups which currently receive about 30 per cent of various government benefits. 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.