



Status quo conservatism

The Coalition's taxing and spending record

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As a number of commentators pointed out in the lead-up to the election, at both the Federal and State levels, Labor has moved closer to the political centre. As a result, there seem to be fewer important differences between the major parties.

The 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 services in the States, will further reduce the job prospects of low-skilled workers as labour markets become more protectionist.

But, at least on the surface, Labor appears largely to have abandoned socialist, big government objectives and to have accepted that government plays a more limited role in Australia than it does in European countries. Such acceptance of more limited spending and improved budget management policies at both the Federal and State levels, of a depoliticised operation of monetary (and exchange rate) policy, and even the growing inclination to accept privatisation of State-run authorities providing electricity, transport, ports and the like, suggest that the Opposition will have to effect major policy changes if it is to distinguish itself from Labor.

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How small was the Howard government?

An important 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—the socialisation of the means of production, distribution and exchange. The temptation will be not to move forward, but to retreat and avoid controversy, which is what State Liberals seem to have done.

Although Howard government ministers (including the prime minister himself) consistently claimed to have reduced the relative size of government and the burden of taxation, they also followed the 'soft' government approach at the Federal level. Their claim was based on comparing apples and oranges. They compared pre-2000–01 data—which include large gen-

Table 1: Commonwealth general government outlays and taxation—% of GDP

| | Outlays | Outlays excl. interest | Transfers to states | Social Security | Taxation |
|---------|---------|------------------------|---------------------|-----------------|----------|
| 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.

eral revenue grants to the States and the taxes to pay for them—with data for recent years that excluded from expenditure the GST payments now made in lieu of those grants, and excluded from taxes the revenue from the GST itself. Fortunately, the ABS national accounts adopt the correct approach, treating the GST as a federal tax and its payment to the States as federal expenditure. This produces an accurate picture of what happened to government spending and taxing before and during the Howard government. (See Table 1)

As the Coalition took office in March 1996, the financial year 1995–96 provides the best baseline year against which to measure the fiscal performance of the Coalition government over its period in office to 2006–07.

As expected, the first full year of the Howard government—that is, 1996–97—produced 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.

Thus, if interest is excluded on the grounds 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 1995–96 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

Table 2: Commonwealth general government outlays and taxation—% of GDP

| | Outlays | Outlays excl. interest | Taxation |
|-------------|---------|------------------------|----------|
| 2000-01 | 22.5 | na | 21.3 |
| 2004-05 | 21.2 | 21.0 | 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 2000–01 and 2004–05 to 2006–07 data. 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.

benefits. This epitomises the soft, vote-buying approach and occurred despite the much stronger growth in average real per capita incomes over the period it was in office—about 2.3 per cent per annum—and the obvious reduction in need to assist middle and higher income groups.

Unsurprisingly, despite the announcement of many tax ‘cuts’ (which included some reduction in marginal rates aimed at a top 40 per cent in 2012–13), the overall burden of Commonwealth taxation (including the GST) increased by over 2.5 percentage points of GDP. In effect, this increase financed the elimination of the budget deficit and the build-up of a surplus of around 1 per cent of GDP. Under the Howard government, Australians were thus ‘forced’ to save.

The government also continued to offer a very large number of ‘tax expenditures’, totalling 4.0 per cent of GDP in 2006–07 and estimated to increase to 4.5 per cent in 2009–10 (but not included in budget figures). These ‘expenditures’ comprise the net cost of concessions, benefits or incentives provided through the tax system when compared 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 summary, despite the continued strong growth in incomes and the drop in unemployment from 8 per cent to just over 4 per cent, 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. Although not sustained by Keating, that suggests a feasible starting point for believers in smaller government.

Nor did the Coalition foreshadow the possibility of reducing the size of government if re-elected. Using the Budget data showing forward estimates and projections (the ABS does not publish such data), the following suggests a policy of keeping the level of spending and taxation stable.

The question now facing the Liberal Party is whether it is prepared to develop policies that are consistent with its small government philosophy. That would require some really hard work. But with a Labor Party that has apparently changed

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its colours and accepted the existing size of government, it may be its main hope of electoral success at both the Federal and State levels.

Of course, Australia already has one of the smallest government sectors, with the OECD's latest estimates showing our total general government outlays (including those for State and local governments) at 34.0 per cent of GDP in 2007, about 6 percentage points below the OECD average and the second lowest after Korea amongst the 28 OECD countries surveyed.

However, although the decrease in Australia's outlays since 1996 has been slightly greater than the OECD average, there have in fact been much larger reductions in most OECD countries, including in previously very high-spending Nordic countries. While those reductions still leave bigger governments than in Australia, there has definitely been a downward trend over the past decade.

The 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 one thing, our larger-than-average-sized private sector already provides advantages waiting to be paraded and used as a 'model' for further development. Australia is one of the few countries in the developed world to offer a large proportion of education and health services through competing private-sector agencies and the growing usage of such services indicates wide support for them in the community. Of course, their costs are subsidised by government to some extent, and it would be necessary to continue to meet the full costs of low-income groups. But, unlike State-run agencies, taxpayers do not bear the full costs of private schools and hospitals and users benefit from a competitive system that is much less subject to restrictive union practices. Critics of our smaller level of government spending in areas such as education and health need to be reminded that total Australian spending (that is, both government and private) on them is broadly in line with total spending in other countries with comparable income levels.

A similar approach is open for wider adoption by State authorities. Considerable scope remains for privatisations, particularly at the 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. As noted, even Labor is increasingly accepting privatisation, and this suggests that Liberal parties are being left behind in an area where they should be leading.

Other more general benefits from smaller government cannot be explored in detail here, but they obviously include lower taxation and the well-known benefits of higher employment and productivity likely to flow from that, particularly if rates are flattened.

Of course, that also requires lower spending. But, as indicated earlier, there is scope for reducing spending in ways that would not have adverse effects on lower income groups—that is, by focussing on reductions in social-type payments to higher income groups and providing those groups with some 'compensation' through accompanying tax reductions. Justifications for taking such action include arguments that increased 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. It is, for example, anomalous that, despite the large increase in real incomes since the end of the 1980s, around 20 per cent of the working-age population receives income support now compared with only 15 per cent then: the trend should have been the other way.

More broadly, with increased standards of health and education, and higher income levels, there is a philosophical challenge to be faced by the Liberal Party. Does it believe in individuals accepting increasing responsibility for taking care of themselves or does it support a continued Nanny State role?

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