



The True Costs Of Government Spending

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The Gillard government's recently released statement on the final budget outcome for 2011-12 shows the level of federal government spending keeps growing and growing in an undisciplined fashion. There is not enough focus on the damage this increased spending is doing to the Australian economy.

Under the last Howard budget the government spent \$272 billion in payments—equivalent to 23 per cent of the nation's output—a high price in itself for a government constitutionally bound to provide not a great deal more than defence and maintaining a customs and monetary union.

A few short years later the latest figures show commonwealth spending has ballooned to a record \$371 billion in 2011-12 or 25 per cent of GDP, an increase of almost \$100 billion.



Spending increases have managed to outstrip revenue growth under the current government, leading to a \$43 billion budget deficit, when the Australian economy is growing at trend, and a net debt standing at a staggering \$147 billion or roughly \$6,700 per resident.

From an intergenerational perspective the outlook for budgetary management looks at least as challenging as today, with the government proposing new spending programs whose costs will prove difficult to contain if implemented.

And despite what some proponents of larger government claim, taxpayers don't pay taxes voluntarily to government and they'll be forced to pay for the spending excesses committed under their name.

Most people would tend to think the cost of each taxpayer dollar acquired, and spent, by government is exactly one dollar, but this perception unfortunately understates the total burden of taxpaying.

The imposition of taxes imposes costs extending far beyond the amount of revenue collected by the government.

This is because taxes change economic behaviour, affecting the incentives of people to work, save and invest and thereby influencing the ability of economic participants to produce more output.

The term 'deadweight loss' refers to the additional cost on the economy due to behavioural changes induced by tax changes, and does not include administrative compliance costs such as record keeping and hiring accountants and lawyers to help fill out tax returns.

Estimates of the extent of deadweight losses posed by commonwealth government taxation vary, yet the Henry tax review conservatively suggests an extra dollar of tax revenue received by government may impose a deadweight loss on the economy in the order of \$1.20 to \$1.30.

As mentioned above, under Prime Ministers Rudd and Gillard a raft of new spending has either been promised, or is in the process of being implemented, which come with hefty financial price tags.

The Gillard government has conspicuously championed the implementation of a National Disability Insurance Scheme (NDIS) which will cost at least an additional \$7 billion per annum in 2009-10 dollars—and possibly much more.

Another big spending promise on the drawing board comes from the Gonski school funding review, which recommended an additional \$7 billion per annum (in 2012 dollars) for extra funding mostly directed at government schools across Australia.

Dwarfing these commitments is the National Broadband Network (NBN) announced prior to the 2007 election, an exorbitant piece of infrastructure which in all likelihood will be superseded by



new internet communication technologies.

The NBN is a financial behemoth, with an initial cost to lay out fibre optic cable over ten years estimated at \$43 billion (or about \$4 billion per annum) with federal taxpayers directly tipping in about \$28 billion (or about \$3 billion per annum).

Assuming rather bravely that the government's publicly-stated costings are accurate, Gonski, NBN and NDIS will conservatively cost the private sector between \$20 billion and \$22 billion per annum. This represents not just the direct financial ask of the programs but also the foregone economic output resulting from imposing distortionary taxes to fund them.

To the extent that it fails to account for the economic costs of its spending initiatives the Gillard government is biasing its policies towards greater spending of questionable value which poses only obstacles in the way of future economic growth.

Upon its election in late 2007 the Rudd government made much of its 'operation sunlight' agenda to improve budget transparency, but it is quite clear that the transparency agenda has not been extended to present the full costs of government spending for the benefit of the general public.

Prime Minister Julia Gillard should take one step further on the road to public transparency, and further differentiate herself from her immediate predecessor, by allowing the sun to shine on the economic costs of her government's spending programs.

All benefit cost analyses undertaken by government must consider the deadweight losses of taxation used to fund spending, and these analyses in turn should be published for public consideration and debate.

The government could further institutionalise such a reform, say under the Charter of Budget Honesty, by requiring all government budget documents publish the deadweight tax costs associated with public expenditure initiatives.

By documenting the full taxation costs of public spending, voters will be confronted with the knowledge that big government is expensive government and that politicians have been routinely understating the true burdens of taxpaying.

Highlighting the magnitude of deadweight losses of taxation used to fund expenditures should also reveal that not all expenditure programs are created equal, creating renewed impetus for reform, especially of the fiscal churn welfare state.

Additional information of this nature will also put additional heat upon special interests to explain to taxpayers just how it is that their pet programs to be funded by government will deliver economywide benefits.

Under this scenario a more informed electorate, rather than politicians and bureaucrats, would be in the driver's seat directing the country towards reducing the size of government and, as a result, greater economic prosperity.