What next?

A s 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.

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Outlays</th>
<th>Outlays excl. interest</th>
<th>Transfers to states</th>
<th>Social Security</th>
<th>Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>18.8</td>
<td>16.7</td>
<td>4.2</td>
<td>4.1</td>
<td>19.2</td>
</tr>
<tr>
<td>1975-76</td>
<td>24.3</td>
<td>22.2</td>
<td>6.7</td>
<td>5.8</td>
<td>21.1</td>
</tr>
<tr>
<td>1986-87</td>
<td>28.3</td>
<td>24.1</td>
<td>6.9</td>
<td>6.9</td>
<td>24.6*</td>
</tr>
<tr>
<td>1989-90</td>
<td>23.6</td>
<td>20.7</td>
<td>5.8</td>
<td>6.2</td>
<td>23.1</td>
</tr>
<tr>
<td>1994-95</td>
<td>26.1</td>
<td>23.3</td>
<td>5.4</td>
<td>8.3</td>
<td>21.7</td>
</tr>
<tr>
<td>1995-96</td>
<td>25.9</td>
<td>23.3</td>
<td>5.4</td>
<td>8.4</td>
<td>22.3</td>
</tr>
<tr>
<td>1996-97</td>
<td>24.9</td>
<td>22.6</td>
<td>5.3</td>
<td>8.4</td>
<td>22.8</td>
</tr>
<tr>
<td>1998-99</td>
<td>23.1</td>
<td>21.6</td>
<td>5.2</td>
<td>7.9</td>
<td>23.0</td>
</tr>
<tr>
<td>2000-01</td>
<td>25.3</td>
<td>23.9</td>
<td>6.4</td>
<td>8.6</td>
<td>24.3</td>
</tr>
<tr>
<td>2004-05</td>
<td>24.9</td>
<td>24.0</td>
<td>6.4</td>
<td>8.2</td>
<td>25.3</td>
</tr>
<tr>
<td>2006-07</td>
<td>24.2</td>
<td>23.3</td>
<td>6.2</td>
<td>7.8</td>
<td>24.9</td>
</tr>
</tbody>
</table>

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

Des Moore is Director, Institute for Private Enterprise.

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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 ex-
cluded from taxes the revenue from
the GST itself. Fortunately, the ABS
national accounts adopt the correct
approach, treating the GST as a fed-
eral tax and its payment to the States
as federal expenditure. This produc-
es an accurate picture of what hap-
pened to government spending and
taxing before and during the How-
ard 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 dis-
cretionary areas.

Thus, if interest is excluded on
the grounds that it is not part of dis-
cretionary 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 per-
centage 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 con-
tinued high level of discretionary
spending was the maintenance of
high expenditures on social security
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 includ-
ed 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 expendi-
tures’, 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 stan-
dard 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 govern-
ment 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 gov-
ernment if re-elected. Using the Budget data showing forward estimates and pro-
jections (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 re-
quire some really hard work. But with a Labor Party that has apparently changed

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

<table>
<thead>
<tr>
<th></th>
<th>Outlays</th>
<th>Outlays excl. interest</th>
<th>Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-01</td>
<td>22.5</td>
<td>na</td>
<td>21.3</td>
</tr>
<tr>
<td>2004-05</td>
<td>21.2</td>
<td>21.0</td>
<td>21.0</td>
</tr>
<tr>
<td>2005-06</td>
<td>21.3</td>
<td>21.1</td>
<td>21.1</td>
</tr>
<tr>
<td>2006-07</td>
<td>20.8</td>
<td>20.8</td>
<td>20.8</td>
</tr>
<tr>
<td>2007-08 (a)</td>
<td>21.0</td>
<td>21.1</td>
<td>21.0</td>
</tr>
<tr>
<td>(b)</td>
<td>21.3</td>
<td>21.4</td>
<td>21.0</td>
</tr>
<tr>
<td>2008-11</td>
<td>21.0</td>
<td>21.1</td>
<td>20.7</td>
</tr>
</tbody>
</table>

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.
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.

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?