# The Election Choice: Who Can Stem the Spending Tide?

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*'The people are difficult to govern because those in authority are too fond of action.'*

—The *Tao Te Ching*, circa 500 BC

THE public debate on taxes and government spending gets hotter in an election year. Voters want to know how much of their income they will be allowed to keep and how much governments will spend for them. Lobbyists want to know how much of taxpayers' money they are going to get through government spending programmes.

Both political parties at the Federal level are holding out hopes of some tax relief without blowing the budget. This ought to mean decreased spending but, unsurprisingly, there are no serious proposals for this.

History sounds a loud warning.

## THE INEXORABLE GROWTH IN THE GOVERNMENT TAKE

A long-term view of government revenue and spending offers no comfort to those who would like more freedom to dispose of what they earn.

Table 1 shows how much all the governments in Australia (Federal, State and local) raised in revenue and spent in the last year of each of the last four decades.

To illustrate the total presence of government in our economy, we have included all government activities, including government business enterprises (except government financial enterprises). Their revenues and outlays are expressed as a percentage of total national income (GDP). The 1999/00 figures must be treated with caution, as there is a break in the data series from that year, but the overall trends remain valid.

Governments have clearly had their hands deeper in our pockets every decade.

Their take has grown from about one-quarter of our income 30 years ago to more than two-fifths at the end of the century. The economy grew rapidly—by about 180 per cent in real terms—but real government revenue grew much faster—almost twice as fast. Governments took more, and individuals got less, of the growth dividend they had collectively earned. The increase in the government take continued strongly over the 1990s.

**Table 1 : Growth In Total Government Revenue and Outlays**

| | 1969/70 | 1979/80 | 1989/90 | 1999/00 |
|---|---|---|---|---|
| Revenue : % of GDP | 27.5 | 31.3 | 36.3 | 43.9 |
| Increase in government share | | 3.8 | 5.0 | 7.6 |
| Outlays : % of GDP | 30.4 | 36.0 | 38.1 | 40.6 |
| Increase in governmentt share | | 5.6 | 2.1 | 2.5 |

*Source:* Government Finance Statistics ABS 5512 and unpublished ABS data.

There are signs that the revenue share (but not actual revenue) is now receding a little; but it seems likely to remain over 40 per cent.

While revenue has grown steadily, government spending has grown more erratically but still very strongly. The figures in Table 1 do not show the significant surges in government spending that occurred in the mid-1970s, mid-1980s, early 1990s and again last financial year. Over the 30 years, until recently, spending was generally well ahead of revenues.

Bringing these spending surges under control has been a preoccupation of government in Australia for the three decades. Restraint was partly brought about by cost-cutting and charging for services. There was privatization of public enterprises in the transport, communications and energy sectors. When public finances became disastrous, governments were simply booted out.

Over the three decades total revenue slowly overhauled total spending. The horrific borrowing requirements of the late 1970s and mid-1980s, and the associated financial scandals, are behind us for now. Recent Australian governments have generally opted for financial prudence.

But it was revenue that caught up with spending. Thus the excesses of spending were largely validated. In other words, the people dug the government sector out of the mess; government did not dig itself out.

**Table 2 : Growth In Government Expenditure By Category**

| PURPOSE | % of GDP 1969/70 | 1979/80 | 1989/90 | 1999/00 | % real growth over 10 years to 79/80 | 10 years to 89/90 | 10 years to 99/00 | 20years to 99/00 | 30 years to 99/00 |
|---|---|---|---|---|---|---|---|---|---|
| General public services | 2.6 | 2.7 | 2.7 | 2.6 | 45.7 | 39.8 | 35.5 | 89.4 | 176.0 |
| Defence | 3.2 | 2.3 | 2.1 | 1.7 | 0.8 | 27.6 | 13.9 | 45.4 | 46.6 |
| Public order and safety | 0.8 | 1.2 | 1.4 | 1.5 | 110.5 | 63.1 | 50.8 | 145.9 | 417.5 |
| Education | 3.7 | 5.4 | 4.6 | 5.1 | 104.8 | 19.1 | 56.0 | 85.7 | 280.4 |
| Health | 2.8 | 4.3 | 5.1 | 5.9 | 115.5 | 65.8 | 62.8 | 169.9 | 481.6 |
| Social security and welfare | 4.2 | 7.5 | 7.6 | 9.7 | 150.5 | 41.7 | 79.6 | 154.4 | 537.4 |
| Housing and community amenities | 1.8 | 1.5 | 1.3 | 1.6 | 17.1 | 21.2 | 73.2 | 109.8 | 145.3 |
| Recreation and culture | 0.6 | 0.9 | 1.0 | 1.3 | 110.5 | 55.3 | 82.9 | 184.1 | 498.0 |
| Transport and communication | 4.2 | 3.9 | 3.9 | 5.5 | 30.3 | 39.8 | 98.4 | 177.4 | 261.4 |
| Other(including industry,debt interest) | 6.5 | 6.2 | 8.5 | 5.6 | 33.8 | 91.7 | -7.3 | 77.7 | 137.8 |
| TOTAL | 30.4 | 36.0 | 38.1 | 40.6 | 66.1 | 47.9 | 49.9 | 121.8 | 268.6 |
| GDP | | | | | 40.3 | 39.8 | 40.7 | 96.7 | 176.0 |

*Source:* Government Finance Statistics ABS 5512 and unpublished ABS data.

## WHERE DID ALL THE MONEY GO?

With the economy growing strongly through much of the 30-year period and governments grabbing a bigger slice, there has been room for very substantial real increases in government programmes.

Over the whole period, government has increased its share of spending by more than 10 per cent of GDP (or $63 billion of current GDP). Government spending has grown much faster than the economy in every decade.

Table 2 provides another snapshot at the end of the last four decades for the main functional categories of spending.

While all programmes show strong real spending increases, the breakdown shows major shifts in policy emphasis.

*General Public Services*, which contains the spending on our public administration, has grown along with the economy. It is tempting to conclude from this that all the efforts over the years to deliver our public services more efficiently have failed.

*Defence* spending has grown in real terms but declined as a share of GDP. This is a natural development over a long period of relative peace. As defence spending is by definition an economic dead loss, we should always keep it to the minimum to deal with perceived threats to national security.

The relatively strong growth of spending on *Public Order and Safety* seems to contradict the public assumption of neglect of this function. It would be helpful to know how much of the additional funding went on administration rather than more policing. Has the public had value for money?

The three social programmes, education, health and welfare have increased massively over the last 30 years from 11 per cent to 21 per cent of GDP. This growth absorbs the whole net increase in the government share over the 30-year period.

All of the relative growth in *Education* spending occurred in the 1970s, but that area still recorded strong real growth in each decade. Moreover, the switch to private schools may have masked stronger growth in the 1990s. Greater participation in tertiary education would also be an explanation for growing expenditure. The net result is that the taxpayer subsidy to this sector increased significantly.

*Health* spending has almost quadrupled in real terms and more than doubled as a share of GDP. This is a pattern evident in all developed nations. It contradicts the generalized allegations of government neglect levelled by various interest groups, including the medical profession itself. Maybe we are not spending effectively. Perhaps the profession should look inwards before asking for yet more from the public purse.

*Welfare* payments have more than quadrupled in real terms and more than doubled as a share of GDP. This might be taken as a success or a failure. We have diverted a much larger proportion of national income towards the poor by defining new areas of poverty and expanding welfare programmes. But we have enlarged welfare dependency, which is increasingly seen as a corrosive influence in society.

What is clear is that the talk of 'gutting' the social programmes is nonsense. As a whole, they have received a very generous share of the growth dividend—all of the net increase in the government share, and certainly proportionately much more than the individuals who earned it.

The figures show that the attempts to persuade Australians that their charitable efforts of the past decades are inadequate and ungenerous are either ill-informed or self-interested.

*Recreation and Cultural* activities have also been well favoured, with a growing share of income devoted to them. There are large subsidies to those who wish to follow their preferred creative and sporting occupations, but for whom the public would not pay voluntarily. Moreover, these subsidies are sometimes inequitable, going to individuals who are not in need, and supporting activities that are of interest only to small groups.

So what is going on here? We hear daily that there are 'funding' crises everywhere. Our defence is full of holes. Our police services are swamped by a tide of criminal activity. There is a crisis in nursing and general medical practice. There is a crisis in teaching. Social welfare programmes are said to be 'seriously under-funded'. Our infrastructure of roads and telecommunications is either crumbling or requiring massive new investment. We are on the brink of environmental disaster. Regional areas need to share more in our prosperity. Arts and culture are at the mercy of the Philistines. We must spend much more on Knowledge Nation. Local community amenities must be upgraded. And so on.

The common theme of such protests is that, despite the huge growth in spending racked up over the past three decades, much more government (that is, our) money is needed for everything.

Much of this 'noise' should be seen as a beat-up to create an atmosphere of urgency and crisis in specific areas to soften up any opposition to new spending. Proponents generally take the high moral ground that their particular programme is much more worthy than others, and certainly more worthy than any purpose for which individuals might spend voluntarily if given the chance. Neither the proponents nor their intermediaries in the bureaucracies directly bear the cost of their proposals. Against this relentless spending pressure, the principles of budgetary restraint and value for money are in retreat.

The fact is that someone has to make choices between priorities. Someone has to decide on the important question of how big government should be (see *Box 1*). Reconciling these tensions is what parliaments are for. Their long-term bias patently favours the spenders. The central choice between public and private spending is increasingly made by default.

## WHICH LEADS—TAXING OR SPENDING?

If revenue and spending both grow so irresistibly over the long term, it is worth asking which of the two is the driving force.

The conventional wisdom would be that spending is the driver. There is pressure both inside and outside government for more spending on countless programmes.

In the 1970s, for example, the rapid growth in spending and deficits had most of its impetus from the Whitlam Government's promises. There was another surge in spending and deficits under the Hawke/Keating Government in the mid-1980s, until the 'Banana Republic' brought about more fiscal responsibility. In both cases, spending dragged revenue up to a higher plateau.

We observed a litany of broken promises as governments desperately sought new sources of revenue. The Coalition abandoned indexation of income-tax scales when it proved too much of a straitjacket on spending. Labor's promise not to tax superannuation was broken not once, but repeatedly, as the Hawke/Keating and Howard Governments dragged forward future years' tax revenues out of private savings and into current budgets. And there were many promises not to levy a GST.

This thesis, however, can be stood on its head. Although new programmes do drive spending (and this drives revenue) there is a degree to which the reverse is also true.

The fact is that the interaction of economic growth and bracket creep automatically provides the Federal government with a fiscal dividend. This dividend causes the government's *share* of the national income to grow automatically. Large lumps of new spending can be accommodated without the need for formal democratic consultation and consent to new taxes. Over the last three decades, the fiscal dividend has been worth tens of billions of dollars.

This is where the interests of politicians and the people can, and

### Box 1: Is Government the Right Size?

The size of the aggregate budgets of all our governments is determined by thousands of small and large decisions made largely by politicians and officials. There is constant pressure to feed off the budgetary 'commons'. There is little informed public debate on the broad question of how much of our money we want to keep, and how much to surrender to our representatives. But surveys of the mood of the nation do not suggest that we believe we are in a crisis which requires more government.

The size of government is important. There is the obvious implication that personal control over income is diminished. This ought to be of concern to a society that seeks to give the individual citizen the maximum individual choice.

Moreover, our institutional framework is increasingly permeated by regulations which undermine its responsiveness and vitality.

Corollarily, government intervention and control are increased. That is a theme for another paper, but suffice it to say that both the deadweight economic costs and the oppression of the individual associated with big government remain as pertinent now as at any time in the past century.

regularly do, diverge. Governments generally just take most of the fiscal dividend without consulting the people. If any is given back, it is announced as a tax cut. It is not. A tax 'cut' is no more than a refund for overcharging.

Conversely, the fiscal dividend itself, which effectively is a new tax, is never announced at all, much less debated. The silence of parties in opposition on this matter join them to the conspiracy, from which they will benefit when their term in office comes around.

It could be said that this process merely accommodates more spending, but does not drive it. Yet this presupposes that, in the absence of the fiscal dividend, governments would have been prepared to raise *new* taxes. Past experience suggests they would not—the political cost is too high.

Consider Federal budget policy last year. This is not easy to track, because of the dishonest treatment of the GST in the Federal budget (see *Box 2*). In 1990/2000, the Federal government received $4.4 billion revenue more than it had budgeted. By mid-year of 2000/01, revenue had blown out again by $4 billion. The Government reacted promptly. New spending programmes, that will grow to $4.6 billion, were announced.

It is highly improbable that the Government would have introduced $4.6 billion of new taxes to finance such programmes.

Nor is it any justification that this is an election year, and that Labor would have promised to spend the windfall if the Government had not. Apart from the cynical indifference to principle that this notion displays, it simply confirms that all parties are in the same game. It is all a clear affirmation of the adage that if there is money in the till, government will find ways to spend it rather than giving it back.

So it seems that increased spending drives revenue and revenue windfalls drive spending. The proverbial double-whammy.

Finally, this also illustrates the futility of the present debate on tax cuts. There is now little room to cut taxes unless spending is cut. Who can believe that this will happen when the Democrats, who hold the balance of power in the Senate, always want to spend lots more and nobody else wants to spend less?

### Box 2: GST—The Orphan Tax

The GST does not appear in the Commonwealth budget. Peter Costello has asserted that it is not a Commonwealth tax, as it is paid in its entirety to the States. The States treat it as a grant. So one of the most substantial government levies in Australia, worth $27 billion this year, is nowhere recognized as a tax in government accounts.

This raises some interesting questions, mostly for the Commonwealth. Commonwealth officials under a Commonwealth Act of Parliament raise and administer the GST. Amendments to the GST provisions will all be dealt with in the Commonwealth parliament.

At the best we could say that this is a hypothecated tax, that is, a tax raised for and applied entirely to a specific purpose such as the Medicare levy (which was once intended to be spent on health) and petrol surcharges by the States (which were to be spent on roads). But no-one pretends that the Medicare levy was a tax raised by the hospitals, or that the road-builders raised the fuel levy.

The reverse side of the tax concealment is that the Commonwealth is forced to omit the GST grant to the States from its accounts.

One is tempted to say that, if the Commonwealth were subject to the same accounting rules as companies, its accounts would be rejected by the official regulators as not giving a true and fair representation of its financial situation. It is not enough to include GST as a footnote to the accounts.

## WHAT CONCLUSIONS CAN WE DRAW?

What can we conclude from these long-series data on government finances?

One obvious point is that, with occasional pauses and retreats, government just keeps on growing. Over the long term, taxes go steadily up, not only in money terms, not only in real terms, but also as a share of our incomes. The public debates give the impression that we can control how much our governments take from us. History says that we haven't done so.

*It follows that the recurrent debates on tax cuts have all been illusions*.

It also means that despite all the blathering about privatization and the 'loss' of public assets, *the public sector has managed to increase its share of the economy by a very significant percentage over the past three decades*.

It also means that, despite further blathering about the meanness of government and the Australian people in failing to fund various worthy causes espoused by various pressure groups, *we have substantially increased real spending under all the main categories*.

Although all areas have seen solid real gains in spending, some areas of especially loud bleating such as *education, health and welfare have been particularly favoured*.

This is not the age of small government. It is the age of the biggest government in our history.

It may go some way to explaining the widespread public disillusion with all political parties and with government generally. The complaints, and the denigration of existing efforts, are ceaseless. The tax burden on the populace increases, but the demands for more are insatiable. The public can be forgiven for wishing 'a plague on all their houses' when no effort seems to be enough.

As Lao Tzu said 2,500 years ago, where governments are too fond of action the people are unhappy.

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