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AUDITING THE AUDITORS

THE PEOPLE'S COMMISSION OF AUDIT

DAVID RICHARDSON
RICHARD DENNISS
& MATT GRUDNOFF

Melbourne Unitarian Peace Memorial Church

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David Richardson, Richard Denniss and Matt Grudnoff

TAI

Policy Brief

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Level 5, 131 City Walk
Canberra ACT 2601
Tel: (02) 6130 0530
Email: mail@tai.org.au
Website: www.tai.org.au

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The opinions expressed in this paper are those of the authors, as is the responsibility for any errors or oversight.

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Summary

Governments are not like businesses. They provide services because the citizens demand them, not because delivering them is profitable. They collect taxes from citizens, not charge prices from customers. While a business has a legal responsibility to maximise the dividends it pays its shareholders, it makes no sense for a government to generate a surplus from its own citizens.

Tony Shepherd's National Commission of Audit is a deeply flawed document, but its deepest flaw is its authors' belief that a government should systematically seek to collect more tax each year than it spends. That is, while the report talks about intergenerational equity, the most inequitable thing a government could do would be to collect surplus tax revenue from one generation in order to leave a subsequent generation lower levels of education and infrastructure and a slightly larger bank balance.

The Commission focusses on the need for the government to sustain public finances but barely discusses the role of government in sustaining the health of Australia's citizens, its communities and its environment. There is no doubt that governments must make sustainable long-run decisions about tax and expenditure. There is also no doubt that the decisions it makes about how to improve the sustainability of our finances can have significant impacts on the sustainability of the broader systems on which our economy is built.

Much is made in Australia of the 'burden of public debt' that one generation leaves to another, but a community is only given one chance to educate a child, one chance to care for those in need, and one chance to protect the natural environment before it is destroyed.

While as the former President of the Business Council of Australia Mr Shepherd may strongly believe that there are parallels between running a business and running a government, the notion that a government can, or should, extract a 'surplus' from its own citizens over a period of decades is absurd. Similarly, while companies can and do make profits for their shareholders by reducing the quality of the services they provide to their customers, such an approach makes no sense for an elected government.

This paper critiques the Commission of Audit on a number of levels.

First, it questions the Auditors' understanding of the organisation they have been asked to advise. For a government to aim to collect one per cent of GDP in tax each year over and above what they spend confuses the service delivery role of government in supporting its citizens with the objective of accumulating financial resources for some unstated future purpose. The Commission of Audit is silent on the purpose.

Second, the Auditors have chosen to focus on a narrow range of threats to future generations. While the potential 'burden' of public debt is much discussed, the economic and social burdens of failing to address climate change, invest in high quality education or failing to support families through times of stress and ill-health are virtually ignored. Children in Tasmania who are achieving the lowest rates of educational outcomes in Australia and Indigenous children who are suffering from preventable and treatable diseases will experience a far greater burden as a result of our failure to support them than they will from slight variations in levels of public debt.

Third, the Auditors have failed to present evidence to support the premise that Australia has high levels of debt, taxes or public spending. Indeed, a wide range of international evidence suggests that the exact opposite is true. Australia's current level of public spending is 24.5 per cent of GDP which, compared to the average level of spending under the Howard

government (24.1 per cent of GDP) suggests that spending is not at levels which should concern the government or the public.

Fourth, the Auditors repeatedly claim that an ageing population will place significant pressure on current levels of spending, levels which are low by international and historical standards. While this claim has become an article of faith in Australian debate, the Commission of Audit chose not to provide detailed evidence to support it. Most of the increase in spending that the Commission refers to is the result of the rapid population growth the Commission assumes will continue. However, despite population growth being the largest single driver of spending growth the Auditors not only ignore the issue, they do not even reveal its assumed rate of growth in the report's section on 'key demographic assumptions'. Furthermore, in building its case for the introduction of a co-payment for visiting a doctor the Auditors rely on evidence which states:

> *The Grattan Institute argues that 'increases in health expenditures are primarily driven not by an ageing population, but by people of all ages seeing doctors more often, having more tests and operations, and taking more prescription drugs, often employing new – and effective treatments. These changing practices are costing more per person'*

In outlining the case for a co-payment to reduce demand for GP services the Commission is silent on the fact that people living outside of major capital cities visit the GP far less regularly. No evidence is presented to support the idea that people living in regional Australia should face the same co-payment as those in major cities, especially given the fact that not only do people in regional Australia visit the doctor less often, but their average incomes are significantly lower. Bizarrely, if the Commission's recommendation on a co-payment is accepted the groups that are most likely to reduce visits to the doctor are the groups that are already the most likely to be underserviced. Similarly, the Commission also ignores demographic reasons for disparities in demand for GP services, for example, the requirement of women to see a GP to obtain a repeat prescription for the contraceptive pill.

Fifth, awareness amongst the Auditors of the political nature of their report is highlighted by their silence on the likely efficiency and effectiveness of the Abbott government's Direct Action policy. Despite being highly critical of the Commonwealth government's ability to allocate grant funding efficiently, and despite the overwhelming evidence that a carbon price is a more efficient mechanism to drive emission reductions, the Commission of Audit was silent on this large area of new government expenditure.

Sixth, the Auditors accept uncritically the notion that privatisation and deregulation lead to increased efficiency and lower costs to consumers. For example, the Commission provides no analysis of the policy failures which have led to the massive over-investment in 'poles and wires' in the Australian electricity market. Nor do they consider why, if privatisation does no more than lower the cost of service provision, the owners of companies like Australian Water Holdings would be willing to spend so many years, so many millions of dollars and risk incarceration simply to win a contract that would deliver primarily for their customers and the taxpayer. By failing to consider examples of when privatisation and deregulation have failed to deliver expected benefits the Commission of Audit provides no clear guidance to the government about better and worse classes of assets to privatise or better and worse ways of managing such a process.

Seventh, the evidence on which the Auditors rely is as partial as it is narrow. Despite the enormous length and breadth of the Audit the list of references it relies on is strikingly short and self-referential. Despite being tasked with generating new ideas, the list of references in the report is overwhelmingly published by the Australian Government itself. Issues such as the impact of introducing a GP co-payment have been widely considered in the international health literature, literature which is largely absent from the Commission of Audit's list of references.

Finally, the terms audit and Auditor have specific meaning in law, accounting and the public consciousness. The role of an Auditor is to provide an independent evaluation of an organisation. The Corporations Act imposes specific obligations on an Auditor to declare their independence and reveal any conflicts of interest. The Institute of Chartered Accountants' Code of Conduct requires Auditors to do likewise even when they are conducting an audit which is not covered by the Corporations Act.

The Business Council of Australia demanded in the lead up to the 2013 federal election that an audit of the nation's finances be conducted. The then BCA President Tony Shepherd was subsequently appointed to lead the Audit by the newly-elected Prime Minister Tony Abbott. The Secretariat of the Commission of Audit was headed up by the BCA's Chief Economist Peter Crone.

Many of the major recommendations of the Commission of Audit would deliver significant benefits to the BCA's membership. Yet, despite the lack of independence between the Auditor and the beneficiaries of the Audit, the report includes no statements by the Auditors about their independence, no declarations of their own personal investments, and no description of any process by which the Auditors sought to exempt themselves from decisions which could be seen to affect their personal or organisational interests.

Put simply, in no way can the 'Auditors' be seen as independent.

Five things you didn't know the Audit found

1. Even if Australia cuts corporate taxes, reduces unemployment benefits and cuts the minimum wage – interestingly the Commission of Audit was not asked to consider the minimum wage yet it deemed the issue important enough to recommend cutting it by ten per cent – the unemployment rate will never return to the rates experienced during the Rudd/Gillard governments. In fact, the Commission of Audit specifically assume that unemployment will remain at six per cent indefinitely.
2. The Commission of Audit does not talk about what assumptions it has made about the rise in the Australian population but the Australian Bureau of Statistics assumes it will rise to 48.3 million by 2061. The Commission of Audit makes no mention that rapid population growth is the major source of the increase in spending that the Commission seems so concerned by.
3. The Commission of Audit assumes that governments will cut income taxes each year and that the tax cuts will be even greater than those that would be necessary to take account of inflation. They also assume that the percentage rate of fuel excise will fall every year.
4. An ageing population is not a major driver of the cost of providing health. The Audit quotes the Grattan Institute (see above) which says growth in health expenditures are not driven by an ageing population. Despite stating this quite clearly in the section on the need to introduce a co-payment to see the doctor the report is replete with statements to the contrary. The introduction to recommendation 17 that deals with health care reforms says:

    > *Australia's health system is not well equipped to face future challenges such as an ageing population and rising health services costs.*

5. The size of government has not expanded in recent decades as shown in Figure 5. Despite this, nowhere does the Audit reject the premise in its Terms of Reference which state, quite explicitly, that the size of government has expanded significantly.

Five things the Audit ignored

1. The annual cost of tax concessions for superannuation will exceed the annual cost of the age pension in 2016-17, and while the cost of the age pension is growing at around six per cent per annum the cost of tax concessions for superannuation are growing at 12 per cent per annum. Treasurer Joe Hockey has admitted that despite the $35 billion annual cost of tax concessions in 2013-14 the proportion of people receiving the age pension will be no lower in 2050 than it is today.

   The Commission of Audit makes no recommendations about the need to reform these tax concessions.

2. Since 2001 the income threshold for the top tax bracket has increased threefold from $60,000 to $180,000 and, in turn, the proportion of taxpayers in the top tax bracket has fallen from 13 per cent to three per cent. Over the same period the top tax rate has fallen from 47 cents in the dollar to 45 cents in the dollar.

   Rather than draw attention to the enormous loss of revenue associated with tax cuts in the last decade, and rather than highlight how the top ten per cent of income earners had received more benefit from recent tax cuts than the bottom 80 per cent combined, the Commission of Audit focussed instead on the potential downsides of 'bracket creep' associated with a growing number of people entering the next tax bracket.

3. Discouraging people from going to the doctor will, according to international evidence, lead to the delayed diagnoses of treatable disease and, in turn, lead to both an increase in the cost of treatment and a reduction in the labour force participation of those who require more radical and extensive treatment. While a major thrust of the Commission of Audit was concern with rising health costs the report provided no estimate of the financial or personal costs that will be associated with successfully discouraging people from accessing early access to medical advice.

   Despite advocating that Australia move towards the American approach to providing health care in terms of both compulsory private health insurance for high income earners and co-payments for seeing a doctor the Commission of Audit presents no evidence to explain why the US spends a much higher proportion of GDP on health than Australia does and, in turn, why a shift in policy in that direction is likely to deliver benefits to groups other than the private health insurers and pharmaceutical companies.

4. The Commission of Audit is highly critical of the Commonwealth's ability to efficiently administer grant based funding programs. However, despite these concerns, the Commission is silent on the likely efficiency or effectiveness of the Abbott government's Direct Action and Green Army programs.

5. Australia's current level of tax collection is so low that, had former Prime Minister John Howard relied on such a level of tax collection his government would have overseen budget deficits in ten of the 12 years it was in power.

The strength of the Commission of Audit's conclusions is not supported by the depth of its evidence, and the breadth of its conclusions is not supported by the narrowness of its perspective.

Introduction

The National Commission of Audit (NCA), led by the former President of the Business Council of Australia (BCA), Tony Shepherd, was released on 1 May 2014. The Secretariat of the Commission of Audit was headed up by Peter Crone, the Chief Economist and Director of Policy of the BCA. Furthermore, other members include three former senior public servants; Dr Peter Boxall and Mr Tony Cole formerly of the Australian Treasury and Finance Departments respectively and Mr Robert Fisher formerly from the Western Australian Department of State Development; and a former Howard government Minister, Amanda Vanstone. The work of researching and drafting the report was undertaken by a Secretariat made up of public servants drawn from just three departments, Treasury, Finance and Prime Minister and Cabinet. Indeed, it was the Business Council of Australia which itself demanded in the lead up to the 2013 federal election that an audit of the nation's finances be undertaken[1].

The BCA represents the interests of Australia's largest 100 companies and their CEOs. While their name suggests that they represent Australian business interests, in reality they represent corporations that are often foreign-owned.

While in the commercial sphere foreign ownership of businesses operating in Australia is in no way problematic, by no means did the Commission of Audit confine itself to advising the Abbott government on the preferences of businesses in relation to corporate regulation or taxation. On the contrary, the Commission of Audit provided a platform for the BCA to advise the Australian government on both the optimal design of, and optimal level of funding for, a wide range of human services including health, education, aged care and disability services.

It is remarkable that a Commission which represents such a narrow range of expertise would be asked to advise on such a broad range of issues.

Further, questions of how much money a chronically ill person, a severely disabled person, or an age pensioner should live on are fundamentally questions of equity and fairness. While the cost of supporting such people must obviously be met, it is remarkable that the Abbott government would ask the representatives of a group whose stated objective is to pay less tax to advise the government on the 'fair' level of income support for the most vulnerable members of the community. Even the Secretariat for the Audit lacked breadth with Secretariat staff all coming from just three departments, the Departments of Finance, Treasury and Prime Minister and Cabinet.

Leaving aside the issue of whether the Commission of Audit lacked the expertise and breadth to offer up recommendations on topics as diverse as tax reform and the delivery of Indigenous services there is also the significant issue of the role, and responsibility, of an Auditor.

Section 307C of the Corporations Act requires auditors to state their compliance with the Act's independence requirements. According to the Institute of Chartered Accountants, even when audits are being conducted outside of the remit of the Corporations Act auditors should follow the Code of Conduct and communicate with their clients about issues impacting on the independence of the auditors. Indeed, the Institute of Chartered Accountants state that:

> *Even if the requirements of the Act and the Code do not make written communication of independence issues to clients mandatory, doing so still constitutes best practice for an auditor and their client*[2]

[1] BCA (2013) *BCA Budget Submission 2013-14: Towards Fiscal Repair*
[2] Institute of Chartered Accountants Australia, *Frequently Asked Questions.*

Despite the length of Mr Shepherd's Commission of Audit it includes no statement about the conflicts of interests that may arise from him being the immediate past President of the BCA and conducting an 'independent' audit on behalf of the Australian government. Readers of the report are provided with no information about Mr Shepherd's business interests or investments, nor are they provided with a declaration that no such interests exist. Similarly, given his role as former President of the pre-eminent lobbying organisation for the biggest businesses operating in Australia, readers may have expected to find a statement about how, if at all, Mr Shepherd sought to exclude himself from deliberations about recommendations that directly affect the companies he was previously paid to represent. The report contained no such statement despite the fact that the report made a wide range of recommendations which directly benefit the members of the BCA including:

Recommendation 1 – Keep the proportion of GDP collected as tax low and in turn reduce the future tax payments.

- This would benefit all BCA members.

Recommendation 17 – Require all high income earners to purchase private health insurance.

- This would benefit the big insurance companies in the BCA.

Recommendation 28 – Cut the minimum wage in real terms.

- This would benefit all employers.

Recommendations 43, 58 and 60 – Outsource payment, IT and property management services.

- To firms likely to be represented by the BCA.

Recommendation 57 – Privatise Australia Post and Snowy Hydro, among others.

- These are companies which currently compete effectively with BCA members.

While the Commission of Audit calls on the Commonwealth government to improve the transparency of the Commonwealth budgeting process through an increased reliance on 'sensitivity analysis' the Commission of Audit resisted the temptation to take their own advice. Sensitivity analysis improves the usefulness of long-run forecasts by showing how sensitive forecasts are to key assumptions. For example, if the economy grows slightly faster than expected then revenue growth will be substantially higher than if the economy grows more slowly. Sensitivity analysis typically presents a range of results for a range of key assumptions, but the Commission uses such an approach sparingly, for example they make the heroic and unlikely assumptions that:

- The unemployment rate will remain permanently at six per cent from 2014-15 despite the Reserve Bank of Australia (RBA) targeting an unemployment rate of five per cent.
- The terms of trade (ratio of import prices to export prices) will decline steadily between now and 2019 to the level they were in 2007 and then stay constant at that level indefinitely. This assumption is made despite the historically volatile nature of the terms of trade.

Despite its length, the Commission of Audit did not include sensitivity analysis around these key assumptions.

In addition to the absence of sensitivity analysis, some key assumptions have been concealed entirely. For example, despite the fact that the major driver of rising government spending is the rapidly rising population, and despite the fact that the Commission of Audit has a section dedicated to *'Key Demographic Assumptions'* there is no clear statement of the assumed rate of population growth or, in turn, sensitivity analysis around that assumption. The significance of this cannot be overstated.

Australia's population is growing at around 1.6 per cent per annum and, in turn, only spending growth above that level can in any meaningful sense be interpreted as a 'rising cost' of providing government services.

Finally, an audit report, like any well researched report, usually contains extensive notes, clarifications and references to external sources of data. For a document of its length and breadth, the Commission of Audit is sparsely referenced and, of greater concern for those interested in evidence-based policy, the references that are provided are overwhelmingly to publications by the government itself.

Such a self-referential approach to developing and evaluating ideas for reform is highly problematic. For example, the analysis of the National Disability Insurance Scheme (NDIS)[3] and subsequent recommendations for reform draw on only six references, all of which are published by the Australian Government, one of which is a speech by a Government Minister and none of which pre-dates 2011.

Similarly, the section entitled *'A pathway to reforming Healthcare'*, which ranges across the operation of the Australian health system and its funding, the rationale for government intervention in health, the operation of private health insurance, co-payment for GP treatment and the changing role of health professionals has only nine references to international research and, despite the Commission's recommendation of a co-payment for seeing the doctor, the Audit provides no detailed assessment of the health or equity effects of co-payments in other countries. Indeed, in making the case for a co-payment the Commission cites data which suggests that population ageing is not a major driver of rising health costs. However, despite relying on this research in building their case for the co-payment they ignore it throughout the report as a whole.

If the quality of the Commission of Audit's recommendations is judged by the independence of its authors, the transparency of their key assumptions, the quality of the data they rely on, and the report's internal consistency then Mr Shepherd's report is deeply flawed. If, however, the Audit is viewed in terms of delivering on a desire to represent the interests of the members the BCA then the alignment of the BCA's interests and the Commission of Audit's key recommendations would suggest it has been an overwhelming success.

The question for the Abbott government is now one of how much weight to place on the interests of the largest 100 companies operating in Australia.

Placing the Shepherd Audit into context

The Abbott government's National Commission of Audit follows what has become a well-established political tactic of incoming Conservative governments. Rather than simply announce new policy objectives and new mechanisms for achieving those goals, Conservative governments often rely instead on a Commission of Audit to propose new policy for a number of reasons including:

[3] Also known as Disability Care Australia.

- The term audit implies that the incoming government is searching for ‘inefficiency’ and ‘malfeasance’
- It is hoped that the recommendations of a Commission of Audit carry more weight than a Minister simply announcing they have different objectives and different ideas to their predecessor
- The recommendations of a Commission of Audit gives the new government an opportunity to both renege on pre-election promises and announce unpopular policy decisions after an election
- The recommendations of an audit can be used as ‘market research’ to assess the public’s response to propositions before making a formal decision about whether to implement them or not.

The Terms of Reference for the NCA are also framed in such a way that assume or assert the existence of underlying problems and, in turn, imply that solutions are needed before any evidence of a problem is presented.

The Terms of Reference of this Commission of Audit assume that:

- The ‘size’ of the government ‘has expanded significantly’
- The government is not living ‘within its means’ and needs ‘to pay down debt’
- Taxpayers are not getting ‘value-for-money’
- There is ‘wasteful spending’
- There is ‘duplication’ between the Commonwealth and other levels of government
- There are areas where Commonwealth involvement is ‘no longer needed’, is ‘inappropriate’ or ‘blurs lines of accountability’.

The membership of the Commission of Audit would find these assumptions quite comforting.

The lack of any formal representation from community, academic, union, non-government organisations or other groups with interest in government is as deliberate as it is poorly conceived. Proposals to increase the efficiency of service delivery need to be vetted by people who understand how systems work, not just what they cost.

The values that matter

Part one of this paper focuses on the macroeconomic aspects of the Commission of Audit such as levels of debt, deficits, taxation and spending. These variables have featured prominently in the case for the Audit and discussion of them has been used to frame the Audit’s Terms of Reference.

Part two of this paper discusses some of the areas of government responsibilities and the implications of both the Terms of Reference and the Commission’s recommendations.

Part three then examines the privatisation question which seems to be uncritically accepted as the best approach to running businesses that have been associated with government responsibilities.

The Terms of Reference for the Commission of Audit assume that ‘government should do for people what they cannot do, or cannot do efficiently, for themselves’. This is a narrow and contestable view of the role of the state and ignores the equity, regional development and risk pooling dimensions of public policy which have been important features of Australian policy development.

While representatives of the business sector may view government service delivery as a ‘necessary evil’ many in the Australian community see many advantages in the public delivery of health, education, transport and community services. While groups such as the BCA may see the main goal of government as being to reduce the ‘cost’ of such services, in a democracy the views of those who believe that we should invest heavily in such services should not be silenced. In structuring the Commission of Audit, however, that is exactly what Prime Minister Abbott has done.

Similarly, while the Audit Commissioners dedicate enormous attention to the need to make the budget 'sustainable' they pay virtually no attention to the need for Australia's greenhouse gas emissions to be similarly sustainable. Similarly, while the Commission of Audit is concerned about the impact of modest levels of public debt on future generations, they seem entirely unconcerned with the impact of the highest levels of greenhouse gas emissions in human history on those same generations.

On the economic front, government has a key role to play as an innovative, market leading dynamic performer with a 'mission-oriented' investment approach. The government also has a role to play in the social welfare of Australians which takes many forms, including; income support, health services, education and the environment.

In Australia there are many examples of industry development plans that worked, including in what where emerging industries, such as pharmaceuticals, biotechnology, information technology services, ship building (such as large catamarans) and heavy engineering. Projects like the NDIS or genuine high speed national broadband are inconceivable without a strong public sector. In the meantime the Australian private sector will not touch infrastructure projects unless the government guarantees revenue and high private rates of return, at least while some of the experiences of private tollways are fresh. In the meantime the government is obliged to build and operate most infrastructure or at least underwrite any private projects.

Rather than discuss the history of Australian government investment in and support for industry and infrastructure in order to draw lessons about success and failure the Commission of Audit simply asserts that all such activity is unnecessary and have recommended the abolition of billions of dollars' worth of research and marketing support. While there is no doubt that some of that industry support was either unnecessary or poorly targeted, there is also no doubt that the private sector in Australia has a long term track record of underinvesting in research and development by international standards.

While the distinction between economic and social spheres is problematic,[4] government in Australia also undertakes important functions in redistributing income through the tax-transfer system mechanism and for providing essential services in health, education and in-kind welfare services.

We need an innovative and imaginative government which can get things done. It should do this in ways that value democratic decision-making and good management as fundamental skills and capabilities that need to be fostered and cultivated. And we need to think about how to make Australia a more fair and just society.

Considering the explicit and implicit bias of the National Commission of Audit's Terms of Reference already outlined, the paper now considers the underlying assumptions made about the economy.

[4] The economic functions necessarily impact on people while any 'social' functions necessarily have economic impacts.

Challenging the myths: the real state of Australia's finances

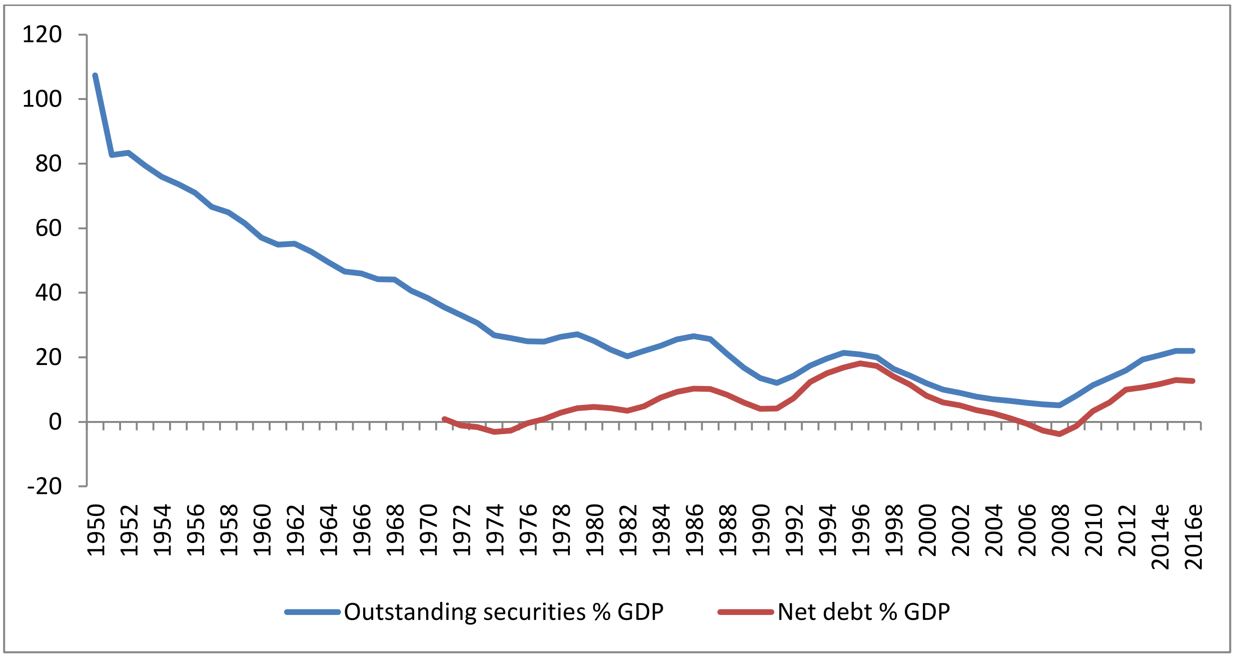
Many of the assumptions upon which the Commission of Audit rely to make their recommendations are false and lack compelling evidence. This part of the paper examines four myths underpinning these recommendations in turn.

Myth 1: Australian governments have a lot of debt

Australian politicians, business leaders and media commentators often claim that Australia has a ‘high’ or ‘unsustainable’ level of debt.

The idea that Australia’s debt is historically high is a myth. Figure 1 shows the level of Australian debt since 1950 as a share of Gross Domestic Product (GDP) which measures the total economy. Figure 1 uses two measures of debt, the series for ‘net debt’ or total financial liabilities less financial assets which go back to the early 1970s and outstanding government securities which is the value of the main financial instrument the government uses to raise funds in the market. Those figures go back to 1949-50. Both measures have been referred to in recent debates.

Figure 1: Australian government debt as a share of GDP

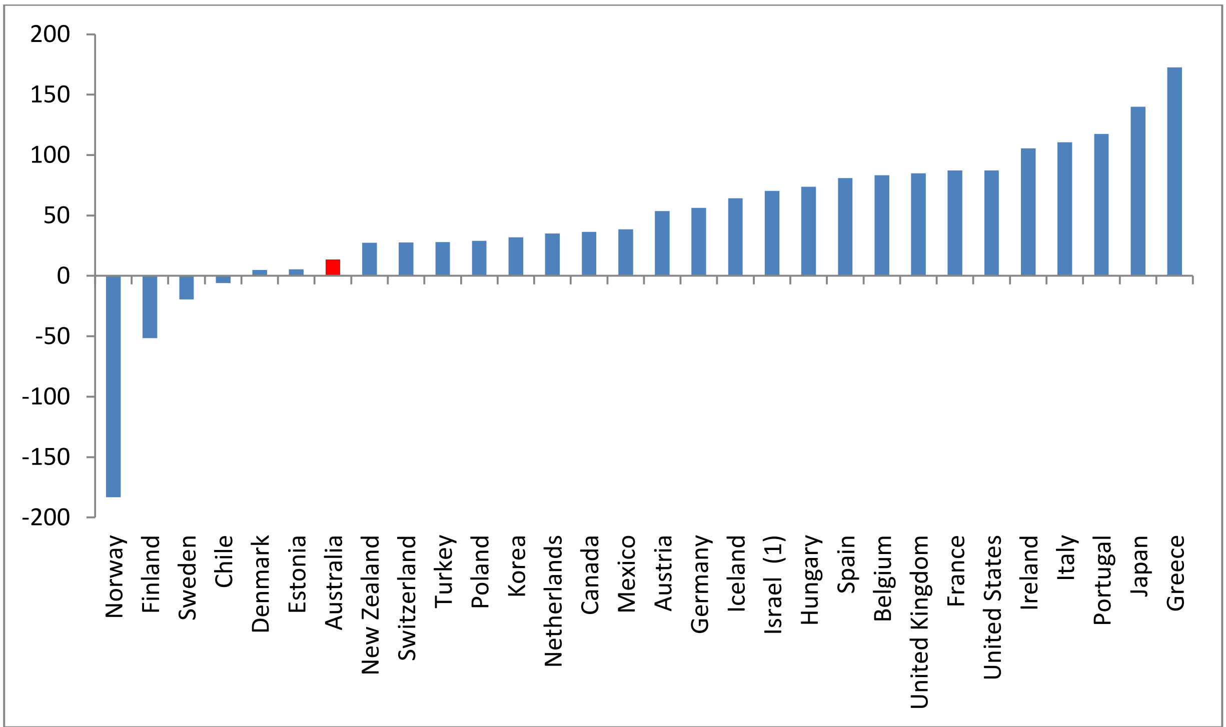


Source: Australian Government (2013) *Mid-year Economic and Fiscal Outlook* and RBA, *Historical statistics*.

Figure 1 shows that Australia’s present debt levels are historically small. In fact during the 1950s and 1960s, remembered now as Australia’s golden age when we had economic growth *and* full employment, debt was consistently 40 per cent or more compared with the expected peaks in 2016-17 at 15.7 per cent and 24.6 per cent for net and gross debt respectively.

Likewise there is no evidence to show that by international standards the Australian government has a high level of debt. Figure 2 compares Australia’s net debt with thirty OECD countries.

Figure 2: Net debt to GDP in OECD countries, 2013 (% GDP)



Source: International Monetary Fund (2013) *World Economic Outlook Database*.

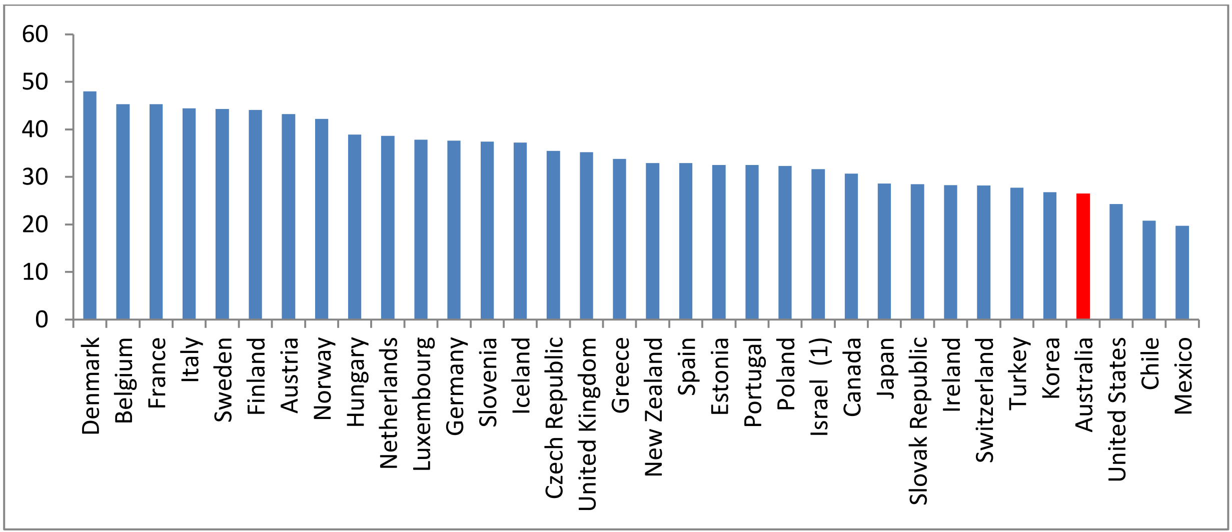
Figure 2 shows that of the 30 OECD countries for which data are available, only six had lower net debt to GDP ratios than Australia and that includes four countries with negative net debt.[5] For further discussion please refer to Appendix A. On the evidence of Figure 2 Australia is a low debt country.

Myth 2: Australia is a high taxing country

Like public debt, political and business figures often claim that Australia is a high taxing country. Such claims are not supported by international evidence. Figure 3 shows tax to GDP ratios and compares Australia with other developed economies.

[5] Norway, Finland, Sweden and Chile.

Figure 3: Tax as share of GDP in OECD countries (%)



Source: OECD Database.
Note: In most cases the latest figure applies to calendar year 2012 but in Australia's case it uses 2011.

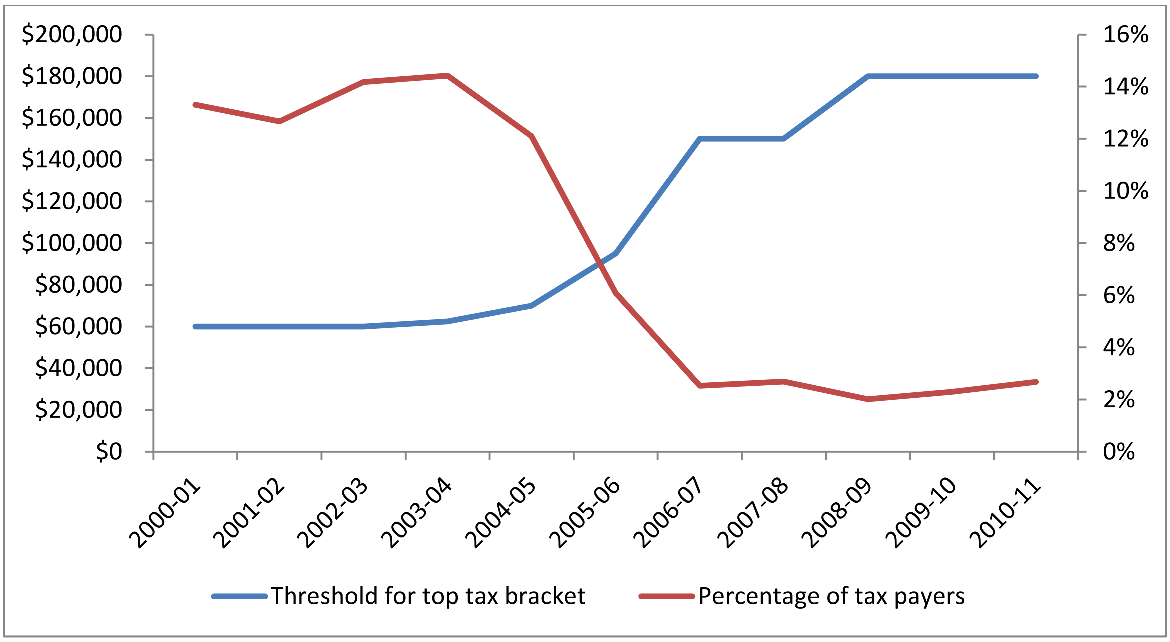
At just 26.5 per cent (which combines Commonwealth and state taxes) Australia *is the fourth lowest taxed country*. In 2012, total Commonwealth tax was just 22.6 percent of GDP. Most OECD countries have tax to GDP ratios of 30 per cent or more.

Despite having a comparatively low tax rate, Australia governments have actually made tax cuts over the past decade. The last budget of the Howard government and 2007 election promises from both major parties resulted in large income tax cuts under the ALP Governments (2007-13). In fact, the Australia Institute has estimated that the cumulative cost of the tax cuts introduced since 2005 are about $170 billion with the top ten per cent of income earners receiving more of that $170 billion than the bottom 80 per cent combined.[6]

The Commission of Audit has argued that inflation is steadily pushing people into higher tax brackets and that this is a significant problem best solved by annual tax cuts. However, as Figure 4 shows, such 'bracket creep' is a small problem compared to the 'bracket slashing' that has occurred in recent years. For example, since 2001 the top tax bracket has been increased from $60,000 to $180,000. Over the same period the proportion of taxpayers in the top tax bracket has fallen from 13 per cent to 3 per cent and the top tax rate itself has been cut from 47 to 45 per cent. The Commission of Audit provides no evidence to support its concern with the more recent increase in the proportion of people in the top tax bracket in the past couple of years.

[6] Grudnoff M (2013) *Tax cuts that broke the budget*

Figure 4: Decline in relevance of the top tax bracket

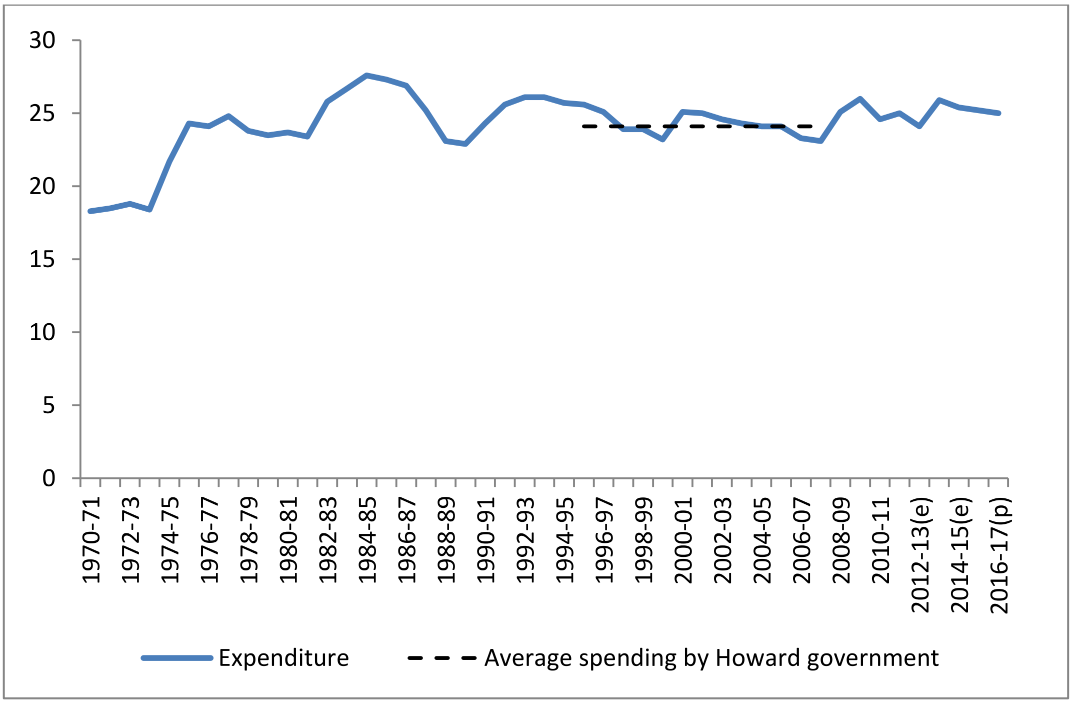


It is clear from the evidence above that problems like underfunded schools and TAFE colleges, crowded hospitals, poverty and poor public transport could be quickly and equitably solved by restoring the tax rates that existed during the long period of economic growth leading up to the tax cuts and by limiting access to the rapidly growing tax concessions for superannuation and capital gains which chiefly benefit a small minority of high income people.

Myth 3: Australia has a big spending government

The myth that Australian government spending is ‘out of control’ is widespread in public commentary from political and business figures and implied in the NCA Terms of Reference. However the idea that Australian governments spend a lot of money in ever-increasing amounts is not supported by historical evidence. Figure 5 shows government spending as a share of GDP since 1970-1.

Figure 5: Government expenditure (% GDP)



Source: Australian Government (2013) *Midyear Economic and Fiscal Outlook.*

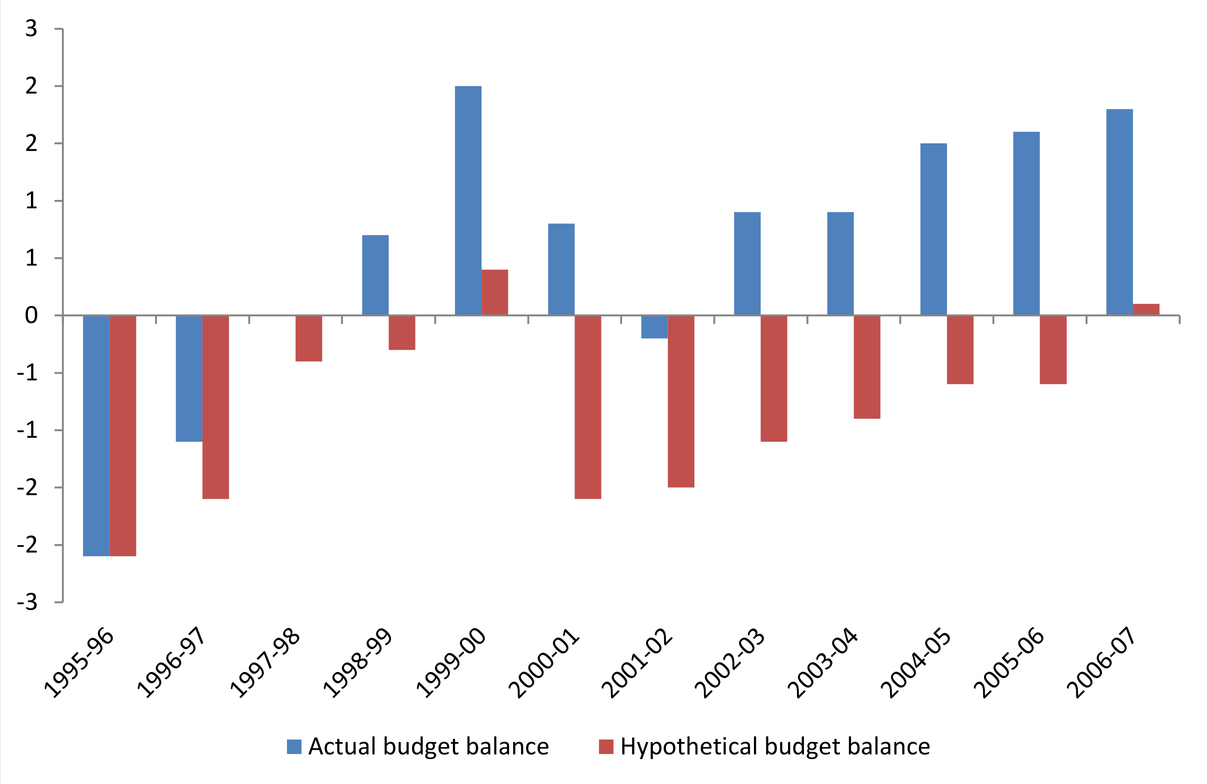
Figure 5 suggests that government spending increased substantially as a share of GDP under the Whitlam government and early Hawke government when governments were taking on major new responsibilities in health, education and income support to name a few. However since then government spending has tended to hover around 25 per cent of GDP. Clearly the view that government spending is out of control and increasing rapidly is not supported by the facts. The increase in spending in the 1970s which has continued since then is best interpreted as reflecting the view of the Australian electorate that the government needed to increase its activity in the areas such as health and education.

A variant of this particular myth is that welfare spending is out of control and will get worse. Treasurer Joe Hockey for example has announced that “we still have a major demographic bulge confronting our economy and budget”.[7] Health and the age pension are usually singled out as being vulnerable to pressure from an ageing population. Health and education are addressed further in the discussion below.

The easiest way to highlight that Australia’s current budget deficit is a result of tax cuts and not spending increases is to answer the question ‘what would the deficit have been under John Howard if he had relied on the current level of revenue collection?’. Figure 6 shows that if John Howard had overseen budgets with revenue of only 23.5 per cent of GDP his governments would have been in deficit for 10 of the 12 years for which he was prime minister.

[7] Kehoe J (2014) *Hockey signals pension age rise.*

Figure 6: Actual and hypothetical Budget balances (assuming revenue of 23.5% of GDP)

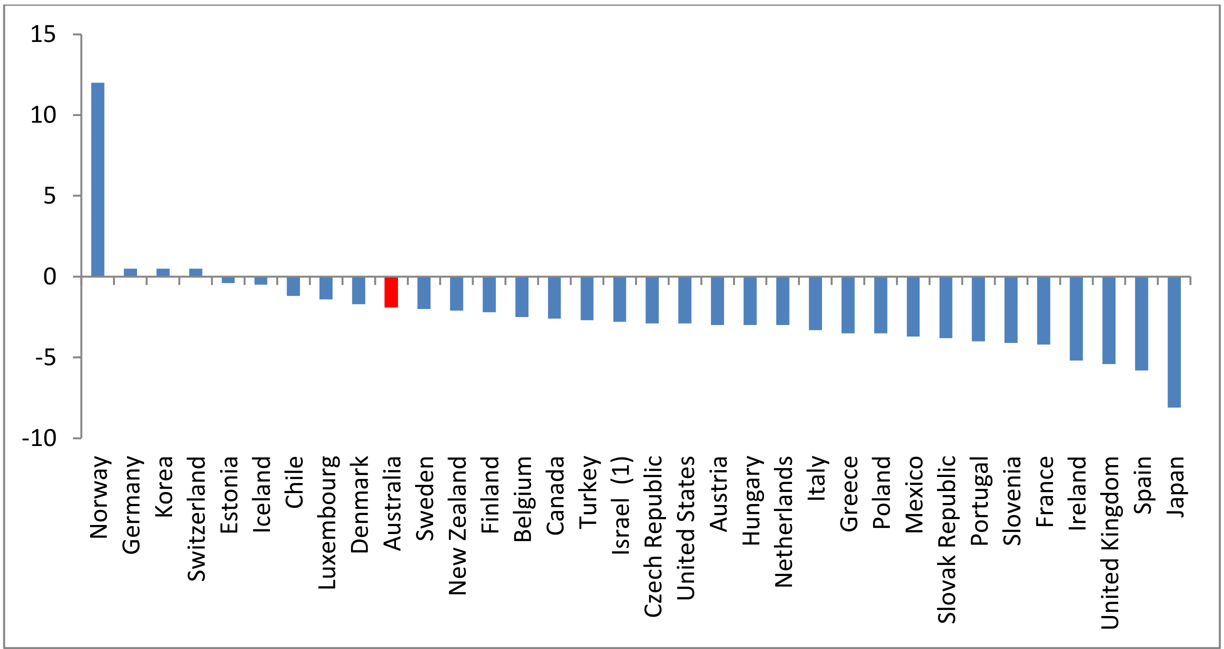


Source: Australian Government (2013) 2013-14 Budget Papers

Myth 4: Australia has a large deficit

The budget deficit refers to the difference between government revenue and government spending. While the budget deficit provides useful information on changes in the state of government finances it does not provide an accurate picture of the government's overall finances. Australia has a relatively small budget deficit by international standards as seen in Figure 7.

Figure 7: Budget Balance 2014 estimated (% GDP)



Source: The Economist (2014) *Economic and financial indicators*

Figure 7 shows Australia's budget balance expected for calendar year 2014 is around the middle to low end of the range of observations elsewhere in the world at 1.8 per cent of GDP. Of the 34 economies included here, 28 have deficits and of those, Australia is the sixth smallest. It is also not a large deficit in comparison with Australia's history and is more than explained by Australia's tax cuts over the past decade.

The claimed economic basis for the Audit can be refuted by examining the Australian economy within an historical and international context. This paper has provided this evidence and thereby exposed the questionable basis for the policy prescriptions presented in the National Commission of Audit.

Policy prescriptions of the National Commission of Audit

The NCA sets out a raft of recommendations designed to undermine the foundations of Australian society. This review considers recommended changes to key policy areas of welfare, health, education and the environment.

Welfare

The Treasurer, Joe Hockey has stated that:

> *The age of entitlement is over. The age of personal responsibility has begun.*[8]

The NCA in turn delivered recommendations to cut a wide range of income support programs. While the term 'welfare' is often used pejoratively to demean income support payments, the breadth of the payments captured by the term is highlighted in Table 1.

[8] Read more: Ireland J (2014) *Treasurer Joe Hockey says 'age of personal responsibility has begun*

Table 1: Expenses by function

	$million	Share of total (%)
Social security and welfare	138,145	34.7
Other purposes	73,560	18.5
Health	64,636	16.2
Education	29,742	7.5
General public services	23,023	5.8
Defence	22,045	5.5
Other economic affairs	11,283	2.8
Housing and community amenities	8,775	2.2
Fuel and energy	7,586	1.9
Transport and communication	6,453	1.6
Public order and safety	4,272	1.1
Recreation and culture	3,696	0.9
Agriculture, forestry and fishing	2,654	0.7
Mining, manufacturing and construction	2,431	0.6
Total	398,301	100.0

Source: Australian Government (2013) *Mid-year Economic and Fiscal Outlook*. Note 'Other purposes' is mainly general purpose payments to the States and Territories and public debt interest.

If we think of 'welfare' as including social security, health, education, housing and community amenities then 'welfare' makes up 62 per cent of Commonwealth government outlays. These are big programs that a lot of people depend upon for leading long, healthy, meaningful lives, satisfying caring relationships and access to the amenities of life. The threat of not being able to support an ageing population is used as a pretext for withdrawing services.

It is true that the population is ageing but it will be a gradual process. At June 2014 the share of over-65s in the population is expected to be 14.7 per cent. That will increase to 17.1 per cent in 2024, and then 19.2 in 2034, 20.2 in 2044 and so on in smaller and smaller steps.[9] A recent report by the Productivity Commission showed that there will indeed be some increase in age pension spending but that will be gradual and eventually settle down as a stable share of GDP.[10] In the meantime the intergenerational report predicts that over the next 40 years Australia's GDP per capita will grow by 1.5 per cent per annum [11] which means that in 40 years' time we will all be 'richer' by 81 per cent. We can easily afford to look after a modest increase in those eligible for the age pension.

According to the latest estimates by the University of Melbourne age pensioners are now substantially above the Henderson poverty lines; by 15 per cent for single pensioners and 16 per cent for couples. Unlike Newstart which has slipped well below the poverty line, the indexation of the pension to male average weekly earnings rather than the CPI has kept age

[9] These figures come from ABS (2013) *Population projections, Australia*.
[10] Productivity Commission (2013) *An ageing Australia: Preparing for the future*.
[11] Australian Government (2010) *Australia to 2050: Future challenges*.

pensioners above the poverty line. However, the National Commission of Audit has recommended that the age pension be indexed to either the CPI or the Pensioner and Beneficiary Living Cost Index until 2027-28 at which time the age pension will have declined to the lower standard, 28 per cent of average weekly earnings. From the Mid-year Economic and Fiscal Outlook published in December the official projections are that both real wages and real GDP per capita are expected to grow by 1.5 per cent into the future. Hence the Henderson poverty line can also be expected to outpace the CPI by 1.5 per cent in which case the NCA's recommendations would see the age pension be overtaken by the Henderson poverty line in early 2023 for both singles and couples. This is well before the time when the pension will again be indexed to a wage measure. By the middle of 2027-28 under these arrangements the age pension would be seven and six per cent below the poverty line for singles and couples respectively. The NCA recommendations amount to keeping the age pension permanently below the poverty line. Judging by the NCA's diagram it appears that the aim is to essentially cut pensions by 20 per cent below what they would otherwise have been.

The Commission of Audit sees the problem very differently. It believes that the ageing population should be seen as a burden which makes spending on welfare unsustainable. The Commission said:

> *This Audit identifies actions that can be taken now to ensure that Commonwealth spending is placed on a more sustainable long-term footing. It recognises the unfairness of saddling today's children with our debts. With an ageing population there will be fewer people of working age to look after the retired. They should not inherit our debt as well as the burden of looking after us.*

Accordingly they have recommended savage cuts to welfare spending including reducing the real value of pensions, unemployment benefits, disability and carers payments over the next 15 years. This would then cap these payments at lower levels. The Commission also recommends increasing the eligibility age for the pension and transition it to 77 per cent of life expectancy at age 65.

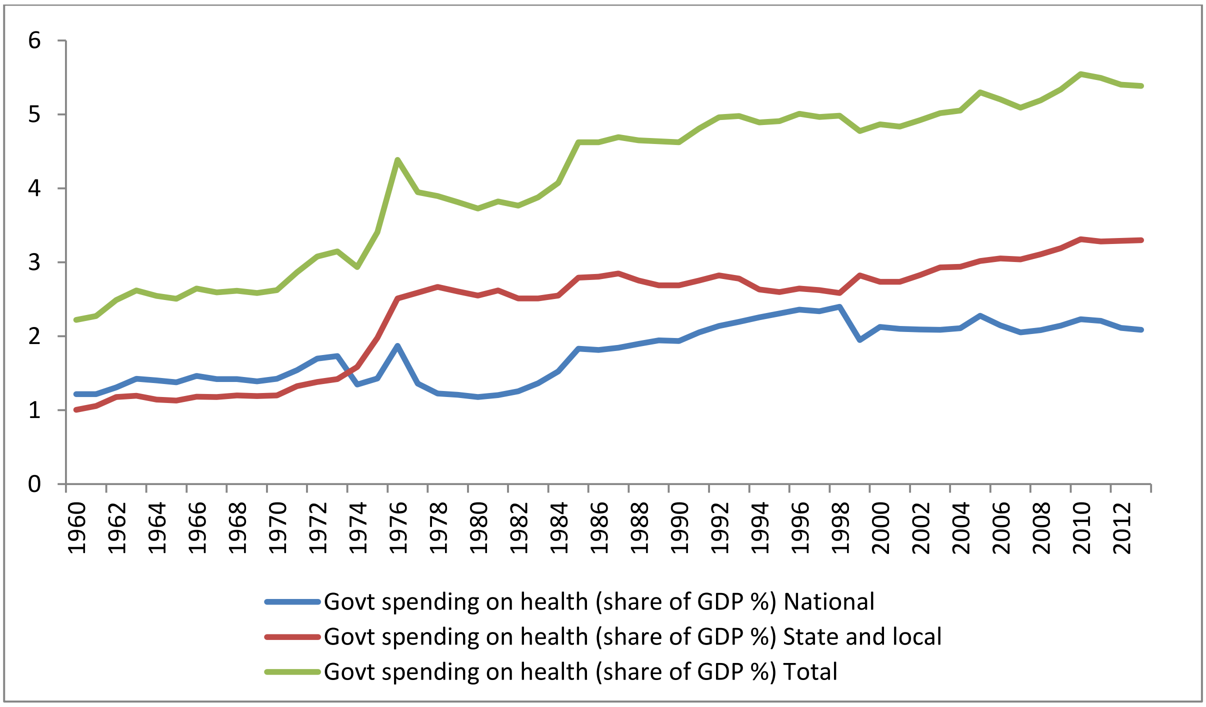
Young unemployed people have come in for particularly harsh treatment with single 22-30 year olds being threatened with having their support payments cut off if they are unwilling to move to an area with better employment prospects. With strict asset tests those on unemployment benefits first have to run down their savings, then after a year on benefits are supposed to be able to find the funds to move.

Health

The Minister for Health has described the health system as 'unsustainable'. Treasurer Hockey has gone further arguing that expenditure on health has been 'growing exponentially'.[12] Comments such as these seem to have been more frequent as the budget approaches and seem designed to suggest the inevitability of cuts in areas valued by the community. Certainly the trend in spending on health has changed over the years. Figure 8 plots health spending as a share of GDP.

[12] Martin P (2014) *Health, welfare and education: Tough choices loom for Treasurer Joe Hockey*.

Figure 8: Trends in health spending (% share of GDP)



Source: ABS (2013) *Australian system of national accounts.*

Figure 8 shows there is indeed an upward trend but a rather gentle one—over the last two decades total spending on health increased from around 4.9 per cent of GDP to 5.4 per cent while Commonwealth spending has been pretty constant at just over two per cent.

Australia's Medicare system is based on some fundamental principles which are now at risk. As Anthony Harris, director of the Centre for Health Economics at Monash University put it:

> *…a fundamental principle of Medicare is that we want the poor to have the same high-quality care and attention as the rich, paid for in a fair way. Health is not like other insurance markets because the poor need the same insurance against health risks as the rich, and the amount they need is not related to their income.*[13]

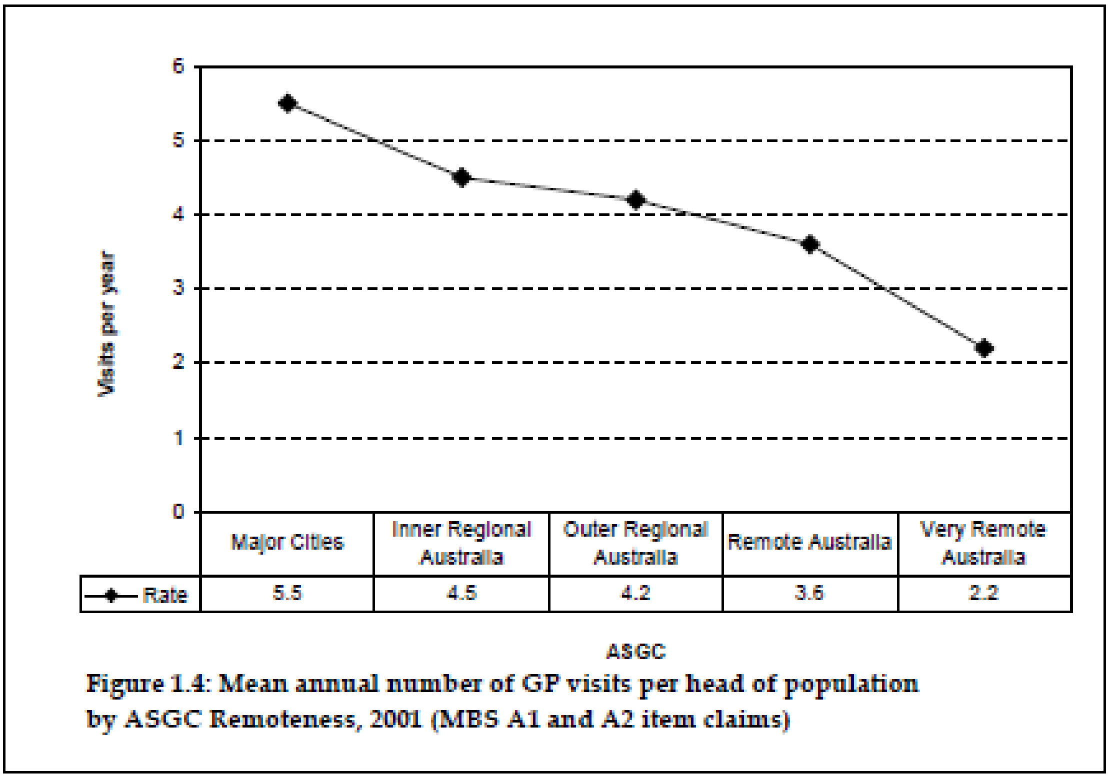
Significantly, while the Commission of Audit suggests that people are visiting the doctor too often it does not take account of regional circumstances. A wide range of evidence suggests that, compared to people who live in urban areas, those who live in rural areas visit the doctor less often, have less access to GPs and have poorer health outcomes as a result[14] (see Figure 9 and 10). Yet, despite the underservicing of health in rural areas, the Commission does not recommend any discount to the suggested $15 co-payment or make any recommendations about other ways to address underservicing of people in non-metropolitan areas.

In addition to ignoring regional disparities in the provision of health services the Commission is also silent on demographic differences in the demand for GP visits. For example, women seeking a prescription for the contraceptive pill are required to see a GP in Australia whereas in other countries such as repeat prescriptions can be obtained by seeing a nurse.

[13] Harris A (2014) *On being treated well: Reforming Medicare after 30 years*.

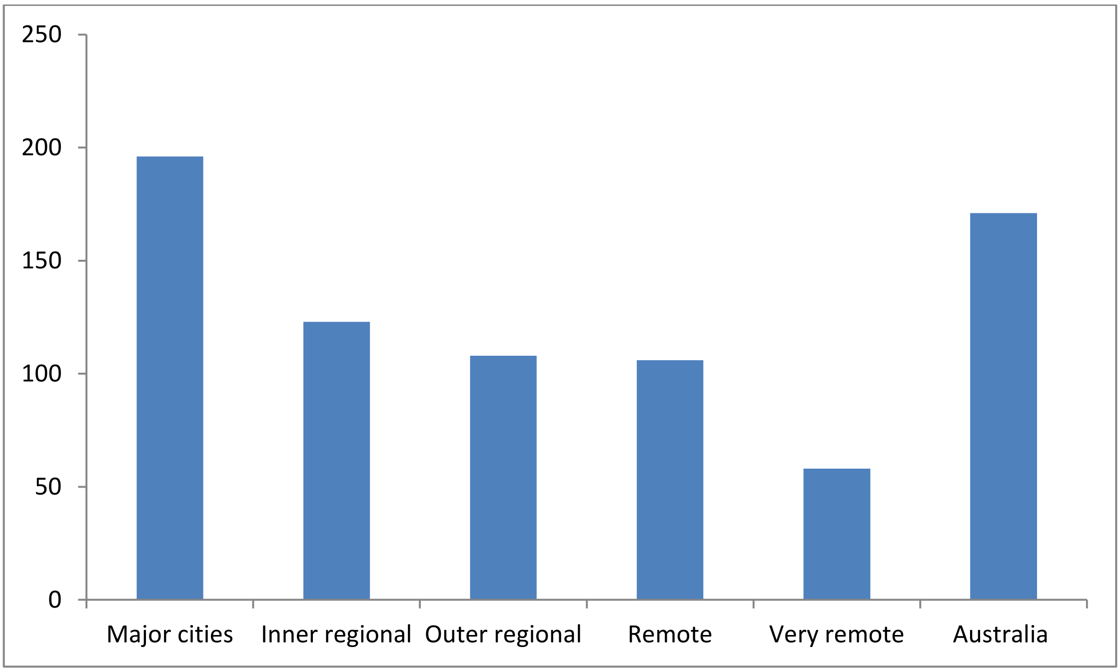
[14] Steering Committee for the Review of Government Service Provision (2014) Report on Government Services 2014.

Figure 9: Mean annual number of GP visits per head of population by region



Source: Australian Institute of Health and Welfare, *Locality matters The influence of geography on general practice activity in Australia 1998–2004*.

Figure 10: Number of GPs per 100,000 population by region



Source: Australian Institute of Health and Welfare, *Health and Community Services Workforce 2006*, 2009

The Commission of Audit report saw health care as a major fiscal challenge despite the reality that federal health spending as a percentage of GDP is relatively stable. The Commission of Audit said:

> *Health care spending represents the Commonwealth's single largest long-term fiscal challenge, with expenditure on all major health programmes expected to grow strongly to 2023-24 and beyond. Putting health care on a sustainable footing will require fundamental changes to all the components of the health system.*

Choosing to ignore that real incomes and GDP are expected to grow rapidly, and that, by world standards, Australian spending on health is quite modest, the Commission of Audit recommended large changes to the way health is both provided and rationed in Australia.

The most radical is a shift to an Obama-style system with compulsory private health insurance which will effectively end Medicare – or universal health care – as we know it. The Commission has also suggested introducing a co-payment of $15 to visit the doctor.

There are two reasons for taxing something; either because you want to discourage it or you want to raise revenue. Introducing a co-payment for GP visits is likely to make lower income groups less inclined to visit the doctor with obvious consequences that have been observed when services have been cut under European-style austerity programs.[1] There is evidence that people put off early intervention with the consequence that much more expensive care is required in the future.[1] Hence the modest savings are themselves at best temporary and likely to be problematic in the future – a 'poor health debt' on future generations.

The second reason to implement a tax is to raise revenue. Using sickness as a revenue base is very strange. There are far better bases to raise revenue from including personal income, wealth and profits.

Education

The Coalition went to the 2013 election promising to implement the Gonski reforms which address the needs of children with learning difficulties or low incomes. Prime Minister Abbott has said this commitment was only for four years after which education spending can be reduced.

The head of the International Monetary Fund (IMF), Ms Christine Lagarde, made it crystal clear that education is a social investment, "making sure there are equal opportunities for all is something where public money is needed. It's not a question of … entitlement." [15] The evidence confirms that education contributes to growth in national income. One study cited by the OECD came to the conclusion that an extra year of average education has in the past raised output per capita by around four to seven per cent across OECD countries in the long run.[16]

A functioning system of education also meets our need for a rich cultural diet of ideas to think with and play with.[17]

[15] Kwek G (2014) *IMF chief Lagarde backs quotas*.
[16] Bassanini and Scarpetta, 2001 cited in de Serres A , *Structural Policies and Growth: A Non-Technical Overview*.
[17] OECD (2003) The Sources of Economic Growth in OECD Countries.

The Commission of Audit has a different view, particularly of higher education.

> *The Commission considers that a rebalancing of the public and private contributions to higher education is warranted, reflecting the substantial private benefits that arise from higher education.*

The Commission proposed that students pay more for their degrees, increasing student contributions to 55 per cent while reducing the government's contribution to 45 per cent. They also called for the deregulation of fees of bachelor degrees, allowing universities to increase fees. They propose increasing interest rates on HELP debts as well as requiring payment to commence at the minimum wage.

They recommend the removal of all Commonwealth funding of vocational education and training including support for apprentices.

All these proposed changes push Australian education towards a US style user pays system. There are already user pays provisions in the Australian education system but Australians rightly believe that education should be based on merit and open to all people regardless of the wealth of their parents. These changes would help limit education to the wealthy and prevent social mobility. Over the long term they would make Australia a less equitable country.

Environment

While international agencies such as the World Bank, IMF and OECD are highly concerned about the economic, social and environmental consequences of climate change the Commission of Audit clearly were not. The long term state of the federal budget and its potential impact on future generations drives the apparent concerns of the Commissioners, but the state of the environment appears to be of far less concern, despite the likely negative impacts on the economy.

The Commission of Audit agreed with the government in its attempts to abolish the Clean Energy Finance Corporation; the Climate Change Authority and Low Carbon Australia Limited. While the Commission of Audit talked extensively about the sustainability of the budget it seems unconcerned about the sustainability of the planet.

Surprisingly, the Commission of Audit was entirely silent on the cost effectiveness of the Coalition's Direct Action scheme and the near consensus view of the economics profession that a carbon price would be a more efficient and equitable way to fund greenhouse gas emission reductions than taxes raised from the population more generally.

Other areas

The Commission of Audit recommended that the Commonwealth government hand over all responsibility for home affordability and homelessness to the states except for the payment of rent assistance. They also recommended that the Commonwealth government should offer to pay rent assistance to those in state public housing only if the states charge commercial rents on those properties.

Indigenous affairs were also targeted with the Commission recommending that the 150 Commonwealth Indigenous programs be consolidated into no more than seven programs. It also recommended an education voucher system requiring Indigenous people to navigate a voucher system in order to access education. This would add extra complexity to a disadvantaged group that already has low levels of attachment to the education sector. Voucher systems require people to be well-informed about all possible options. This means it is unlikely to offer better educational outcomes for Indigenous Australians, especially in remote areas.

Defence funding was left largely untouched except for calls to reduce the number of civilian public servants in Canberra. While the Commission called on the government to review its commitment to increase defence spending by two per cent of GDP (approximately $10 billion) it stopped short of saying that such an idea should not occur.

The poorest people of the world were not so lucky with the Commission recommending that all foreign aid targets be linked to GDP, and the millennium development goals, should be abandoned.

The almost $6 billion subsidy to industry in the form of the fuel tax credit scheme was left untouched, while reductions to some industry specific grants were recommended.

Privatisation

Privatisation is an objective of the present government and was a focus of the NCA Terms of Reference which specifically referred to the privatisation of Commonwealth assets. The Terms of Reference asked the NCA to consider "whether there remains a compelling case for the activity to continue to be undertaken; and … if so, whether there is a strong case for continued direct involvement of government". The head of the last competition review, Fred Hilmer, was recently reported as saying that privatisation was an "unfinished business and everything feasible should be privatised".[18]

Business groups claim, without relying on evidence to support them, that privatisation generates efficiencies although recent analysis of the potential profits associated with the privatisation of Sydney Water suggest that minimising costs to consumers may not always dominate the thinking of those in support of privatisation.

Tony Shepherd has had extensive personal experience with *Transfield*, a company whose board he once chaired. Transfield has been involved in supplying facilities to government and has recently been awarded the right to operate Australia's overseas detention centres. The NCA has seemingly ignored the large body of research literature that highlights the often adverse impact of privatisation on the public purse.[19] Recent examples of the problem of privatisation include:

[18] Coorey P and Khadem N (2014) *Review could mean price hike*.
[19] Some of this literature is summarised in, for example, Quiggin J (2014) *Electricity privatisation in Australia: A record of failure;* and Aharoni Y (2000) *The performance of state-owned enterprises*

- Private prisons, such as those operated by Transfield, have been extensively analysed in Australia, the US and the UK.[20] The claimed benefits are not in evidence. A significant problem has been security.[21]
- The Australia Institute has examined electricity privatisation and corporatisation designed to make electricity more competitive. The results point to massive inefficiency as a result of privatisation, in particular the rapid rise in the cost of marketing and management.[22]

Prior to the release of the Commission of Audit the government had already announced its intention to sell Medibank Private and the Treasurer Joe Hockey has assembled a shopping list of more than $130 billion in privatisations at the Commonwealth and State levels.[23] The Commission of Audit supported such an approach suggesting widespread privatisations including.

The Commission of Audit included a list of privatisations in **Recommendation 57**.

Short term:

- Australian Hearing Services
- Snowy Hydro Limited
- Defence Housing Australia
- ASC Pty Ltd (Australian Submarine Corporation*)*

Medium term:

- Australian Postal Corporation
- Moorebank Intermodal Company Limited
- Australian Rail Track Corporation Limited
- Royal Australian Mint
- COMCAR (Commonwealth vehicle fleet)

Long term:

- NBN Co Limited

Providing a list of assets that should be sold the Commission of Audit provides scant evidence that such privatisations would deliver lower costs to consumers or increase the efficiency of the markets that they operate in. Of even greater concern the Commission of Audit provides no effective guidance about the kinds of assets that are most suited to privatisation and the kinds that are not, nor does it provide meaningful guidance about the best process by which different kinds of assets should be privatised. Despite empirical evidence to the contrary, the Commission of Audit simply seems to believe that any privatisation is good privatisation.

None of this is to suggest that government undertakings are always perfect. Indeed, there are a number of issues that might be addressed to assist governments better undertake their responsibilities while being more responsive to community needs and concerns. Governments need to make decisions that reflect human rights, social justice and equity

[20] See Roth L 92004) *Privatisation of prisons*.
[21] Murdoch L (2013) *Escapes blamed on Serco cost-cutting*.
[22] Richardson D (2013) *Electricity and privatisation: What happened to those promises?*.
[23] Massola J and Hartcher P (2014) *Treasurer Joe Hockey earmarks $130 billion in government-owned assets potentially for sale*.

considerations and those goals need to be given priority above notions of economic efficiency.

Conclusion

Despite the National Commission of Audit's length and breadth, the list of references it relies upon reveals how shallow and narrow the evidence base for recommendations are. Rather than draw on extensive data and analysis from around the world on issues as complex as the role of price signals in the provision of health care or the optimal design of child care policies the Commission of Audit has instead provided a long list of largely recycled recommendations without bothering to provide a compelling empirical case for any of them.

Where they have used data, such as in projecting future spending and public debt levels, they have used that data to support rather than examine the preconceptions of those who drafted the Terms of Reference. Perhaps such a lack of scrutiny is explained by Mr Tony Shepherd's combined role in calling for the Audit and subsequently conducting it.

Australia faces significant challenges in the coming decades, but in facing those challenges we start in an enviable position. Australia is one of the richest countries in the world and, from a material point of view, we live at the richest point in world history. We have low levels of public debt, taxes and unemployment.

The main reason that government spending is expected to rise is because Australia's population is expected to rise. The Commission of Audit is silent on this main driver of rising spending, preferring instead to make living longer and healthier lives something to fear rather than something to celebrate.

As one of the richest countries in the world Australian people have the potential, when working together, to do anything they want. But, we cannot do everything we want. Australia will need to make choices and it is our choice whether we want to:

- have the world's best education and health systems or the world's lowest taxes
- continue to outspend our neighbours on defence or underspend on tackling climate change
- increase the incomes of the elderly and the sick or to cut the taxes of our wealthiest residents.

But rather than reveal such choices and discuss the trade-offs inherent in all of them, the Commission of Audit seeks to conceal them. Lacking in the confidence or evidence to win a genuine debate, its authors simply seek to scare people into pursuing the policies preferred by the big business lobby group that called for and effectively ran the inquiry.

It is obvious why the owners and representatives of predominantly foreign companies would like to pay low levels of tax in Australia and why those same groups would be indifferent to the opportunity to improve the lives of millions of Australians through genuine improvements in our social and environmental policies. But it is not at all obvious why an Australian government would share such objectives.

The strength of the Commission of Audit's conclusions is not supported by the depth of its evidence, and the breadth of its conclusions is not supported by the narrowness of its perspective.

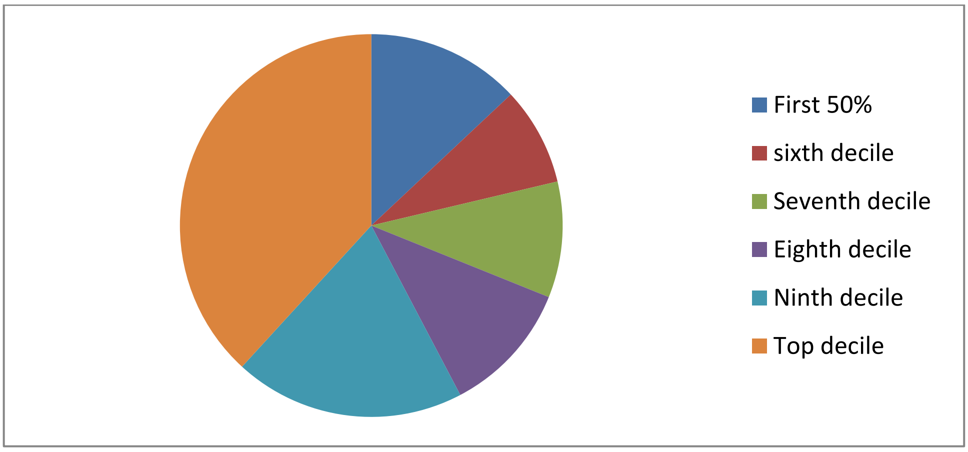
Appendix

Who benefits from the tax cuts and concessions that pushed the budget into deficit?

The benefits of the Howard/Rudd tax cuts that were introduced at the end of the mining boom flowed almost entirely to the highest income earners. Indeed, the top ten per cent of income earners received more of the $170 billion cost of those cuts than the bottom 80 per cent combined.

Likewise the massive benefits of the superannuation tax concessions go heavily towards the rich as is shown in Figure 11 based on Treasury analysis.

Figure 11: Super tax concessions by income groups.



Source: Treasury (2012) Distributional analysis of superannuation taxation concessions, Prepared for Superannuation Roundtable 23 April

Figure 11 clearly shows that the benefits of super tax concessions go disproportionately to the top 10 per cent of income earners who receive almost as much as the bottom 80 per cent combined.

It is often argued that tax concessions for superannuation are an investment not an expense as they 'take pressure off the age pension budget', however, Treasury figures make clear that the major beneficiaries of the tax concessions for superannuation are so wealthy that they would never have been eligible for the age pension. Indeed, Treasury estimate that around 30 per cent of the cost of tax concessions flow to the top 5 per cent of income earners. Bizarrely, the lowest income earners receive 'negative tax concessions' on their superannuation as they are required to pay more tax on their compulsory superannuation contributions than they do on their ordinary incomes. Those were addressed by the low income superannuation contribution but that is now due to be cut by the Abbott Government.

Who wins and loses from further tax and spending cuts?

The data presented above make clear that Australia is neither a high taxing nor high spending country and that previous rounds of tax cuts have delivered benefits primarily to the top ten per cent of income earners. As the following section demonstrates, it is possible, in aggregate, to estimate the likely winners and losers of further rounds of spending and tax cuts.

Government spending at all levels of government was estimated by the ABS to reach $578.6 billion in 2013-14. That is $24,800 per person. In return we pay taxes including two

Commonwealth taxes, taxes on individuals and the GST. A good deal of government is also financed by company taxes, excise duties and other taxes, fees and charges. But we try to keep things simple here and ask how much do you have to earn before the value of what you receive from government equals the value of what you personally contribute to government.

So for every single Australian (without dependents) by the time we count income tax the Medicare levy and the GST you get more than you contribute at lower incomes and probably break even when you reach an income of over $80,000. Above that you pay more in tax than on average someone gets out of the system. That puts you roughly in the top 25 per cent of income earners. But for a two earner family of four (two adults and two children) you break even at a combined income of around $234,000 – two adults on equal incomes would have to be in the top 7 per cent of earners. And a one earner family of four (two adults and two children) breaks even at an income of around $240,000 which means you earn in the top 1.5 per cent of the income distribution.

So if you cut government services and use that to reduce taxes you may benefit singles in the top 25 per cent of earners but among families you will likely only benefit two earner families where each adult earns in the top seven per cent or one earner families where that earner is in the top 1.5 per cent!

These are very crude estimates and actual figures depend heavily on individuals' circumstances but the orders of magnitude are important. Generally cutting expenditure and giving tax cuts benefits only the rich and only the very rich in the case of families with children.

The Commonwealth deficit would be in surplus today were in not for the large tax cuts granted in 2005, 2006 and 2007 by John Howard and Kevin Rudd. Equally the deficit could be almost completely eliminated by abolishing the tax concessions going to superannuation and capital gains (excluding the family home). Clearly, when discussing the 'means' that the government is arguably living beyond the potential tax as well as actual taxation base of the government should be included.

However, even talking into account the capacity of the government to raise additional revenue by closing tax loopholes and concessions the whole notion that governments should return a surplus in every period ignores modern thinking (and experience) which demonstrates the importance of counter-cyclical fiscal policy. Counter-cyclical fiscal policy involves going into deficit to try to offset recessions and going into surpluses to try to offset episodes of overheating. The real point is that the deficit has to be considered in context and with the end of the mining boom Australian unemployment is increasing and there is a strong case for at least maintaining the present fiscal settings. Indeed, there is probably a good case for additional stimulus spending. The last thing a government should do when faced with a slowing economy is to try harder to balance a budget as revenues slow.

Finally, before leaving this section we are told almost as a moral imperative that the government should aim to get back to a surplus as soon as possible and aim for a surplus of one per cent of GDP.[24] That is also the position put in the Terms of Reference to the National Commission of Audit.

There is a notion that public debt has to be paid off at some time. That is foreign to the private sector as we saw in the case of BHP Billiton which still has $60 billion in outstanding debt despite being in existence for well over a century. In the corporate sector debt is just the amount that happens to reflect a set of decisions about how to best manage the company's finances and exactly the same applies to running an economy.

[24] For example, the BCA submission on the government to 'achieve a substantial average surplus position over the medium term'. BCA (2014) *Budget submission 2014-15*.

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