CEDA REPORT SNAPSHOT

Sustainable budgets: underwriting Australia's social compact

The federal budget is a key component of connecting people to the benefits of Australia's economic progress. It does this through a tax system that delivers the right incentives for a modern workforce and by the delivery of critical services important to the wellbeing of individuals and the community, such as health, education and infrastructure.

As we face considerable uncertainties, very significant demographic, economic and technological challenges and increasing community expectations, achieving long-term budget sustainability underpinned by a strong tax base will be central to ensuring we have the services and infrastructure we need and want as a progressive society.

While there have been recent improvements in the federal budget position, which should be welcomed, there are real risks to maintaining a surplus in coming years and paying down debt.

That is why CEDA has identified options that can help deliver long term equitable and sustainable federal budgets while also increasing transparency, and therefore community trust, in the federal budget process.

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budget pressures

Loose purse strings: the risk of accelerating expenditure

Our research shows that expenditure discipline immediately following an election is rare. At present the budget factors in a 0.6 per cent increase in payments next year. In the fiscal year after each of the 17 elections held since 1972 only three have resulted in real payments growth at this rate or slower.

If spending grew just 0.4 per cent more on average over the forward estimates it would be enough to wipe over $16.5 billion from the underlying budget balance and place the 2019-20 budget surplus at risk.

After deficit, debt remains

Once the Commonwealth Government emerges from deficit, it faces a long decade of paying down debt. The current annual interest on net debt is equivalent to the cost of the pharmaceutical benefits scheme, highlighting the ongoing burden. The government must reduce debt to build up budget resilience to weather any future economic shocks and ensure we do not unnecessarily constrain future budget choices.

Investment needed: pressure to increase spending in critical areas

While spending discipline is important, at the same time there are key areas where spending has been too low and new investments are needed such as Newstart and vocational education.

Economic uncertainty and pressure on households

Global economic growth is slowing and Australia confronts an uncertain economic environment. Australia's company tax base is heavily dependent on the fate of relatively few companies. The four major banks and two major miners account for a quarter of company tax revenue.

At the same time households are under increasing pressure from weak wage growth and growing debt. Australian households' debt to income ratio has tripled in the last three decades, rising from around 63 per cent to 190 per cent and is one of the highest in the OECD.

Intergenerational spending pressures have not abated

If both levels of government grow health expenditure at rates experienced over the last decade, they will be confronting a cumulative funding challenge equivalent to over six per cent of GDP in 2054–55.

the solutions

Shoring up Australia's tax base

Rebalancing the tax burden will be central to achieving long-term budget balance and maintaining Australia's social compact. This requires reining in tax concessions to begin to broaden Australia's tax base. Tax concessions that should be reduced include:

- Dividend imputation credits – an increasingly unsustainable tax arrangement in light of the increasing numbers of Australians subject to concessional tax treatment in retirement.
- The capital gains tax discount to better align tax rates across different savings.
- Work-related expense deductions to simplify administration and compliance.

Australia should also move to a more consistent volumetric system of taxation for all alcohol.

Delivering trust and transparency

Delivering on intent – legislated five yearly evaluations for all government programs

Government has a poor track record on evaluating and meeting program targets across major portfolios. Compulsory evaluation of major government spending programs every five years would provide greater surety scarce taxpayer dollars are being well spent and that where programs fail, lessons can be applied to future programs and money redirected.

Keeping government fiscal policies in check

We should introduce regular independent reporting on the suitability of government fiscal strategies and fiscal rules. Continuous revisions to budget projections, such as repeated promises of achieving a budget surplus, have depleted community confidence in budget forecasts. We need to bolster Australia's fiscal frameworks.

Making sure government locks down spending growth

We should lock in rules to keep spending growth in check. History shows that keeping spending growth below GDP growth as long as economic circumstances permit is critical to keeping the budget in good health.

Targeted tax relief to boost the economy

Most of the heavy lifting of budget repair has been done by the most economically damaging taxes – on work and investment. These are also more volatile in the face of economic fluctuations. Increasing average tax rates through bracket creep are impacting all Australians, particularly low and middle-income earners. Recent international analysis also shows that Australia's effective tax rate on investment is higher than most other economies.

In the absence of comprehensive tax reform, the government should continue to deliver personal income tax relief over time, with a focus on low and middle-income earners. The company tax rate should also be reduced. As a stopgap measure, Australia will need more generous allowances for new business investment.

Delivering **value for money**

We should deliver better value for money across spending on industry assistance, the Pharmaceutical Benefits Scheme (PBS) and healthcare.

Over the last two years the government has experienced shortfalls against its savings targets from the PBS through price disclosure and plans to reduce transparency of achieved savings. This transparency needs to be reinstated along with a focus on further savings to continue recent momentum.

There are still questions as to whether the $5.3 billion of annual assistance to industry is genuinely going towards activity that would otherwise not be undertaken, there needs to be stronger assessment and evaluation of industry assistance.

To achieve sustainable budgets we need to get the right changes to the health system. The Productivity Commission estimates that health reform could save $140 billion over 20 years.

the solutions

Remembering the **states and territories**

Federal-state funding that supports innovation

Re-booting reform of federal-state funding agreements to support innovation and flexibility in service provision has the potential to deliver significant long-term gains for budget sustainability but prescriptive agreements on tied Federal funding is restrictive. There has been a proliferation of tied grants, but this hampers states' ability to innovate and tailor policy responses for funding and service delivery.

Health reform at COAG

If we are to realise some of the savings estimated to come from health reform it will be important it is back on the COAG agenda.

A new more independent IGR

We need to introduce a whole-of-federation intergenerational report (IGR) prepared by the Parliamentary Budget Office (PBO) in close coordination with State and Commonwealth Heads of Treasury.

The quality of the IGR has diminished over time. Moving responsibility to the PBO would reassert its independence. The states and territories also need to be better represented. Often reforms deliver savings at one level of government but impose costs at another. These interdependencies require a whole of federation approach.

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