

2 January 2014

Ms Lyn Beverley
Committee Secretary
Senate Select Committee into the Abbott Government's Commission of Audit
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Dear Ms Beverley

Senate Select Committee – Inquiry into the Abbott Government's Commission of Audit

Thank you for your invitation to provide a submission to this inquiry.

In November 2013, Grattan Institute published a report on options for balancing budgets. The report, *Balancing budgets: tough choices we need*, surveys all realistic proposals that could contribute \$2 billion a year or more to Australian government budgets. It identifies reforms that are big enough to make a difference but do not have unacceptable economic and social effects.

Balancing budgets identifies a reform package that could add \$37 billion a year to the budget, while spreading the burden of change across society – rich and poor, workers and retirees. It would broaden the GST to include fresh food and private spending on health and education; raise the age of access to superannuation and the Age Pension; remove the exemption for owner-occupied housing from the assets test for the Age Pension; and limit tax concessions on superannuation contributions.

The report examines 20 policy options that might help balance budgets, as well as considering a number of other budget-related issues of relevance to this Inquiry. Given the Inquiry's terms of reference, the Committee may be particularly interested in our framework for evaluating budget choices on the basis of their economic and social side-effects as well as their budgetary impact. They may also wish to note our review of the history of budget repair, which shows that successful repair efforts result from a package of measures that shares the burden of reform fairly across the community.

I attach a submission summarising our findings, as well as a copy of *Balancing budgets* and the *Supporting analysis* underpinning the report. If Grattan Institute can be of further assistance to the Inquiry, please do not hesitate to contact me.

Yours sincerely

John Daley
Chief Executive Officer

Grattan Institute submission to the Senate Select Committee into the Abbott Government's Commission of Audit – January 2014

Australian governments must make tough choices to balance their budgets. They face a decade of deficits, the result of big ticket spending initiatives, rising health costs, pressure on welfare budgets and an inevitable fall in the terms of trade. Collectively these could lead to deficits of 4 per cent of GDP, or \$60 billion in today's terms, within a decade.

Tough choices cannot be put off indefinitely. Deficits impose heavy costs on the next generation in terms of debt and high interest payments. Government budgets cannot simply grow out of trouble, and the next decade may well be economically more difficult than the last.

In November 2013, Grattan Institute published a report on options for balancing budgets. The report, [*Balancing budgets: tough choices we need*](#), surveys all realistic proposals that could contribute \$2 billion a year or more to government budgets. It puts a priority on reforms that are big enough to make a difference but do not have unacceptable economic and social effects.

Balancing budgets examines 20 policy options that might help balance budgets. These choices, their budgetary impact, and their side-effects are summarised in Table below.

One reform package could add \$37 billion a year to the budget. It would broaden the GST to include fresh food and private spending on health and education; raise the age of access to superannuation and the Age Pension; remove the exemption for owner-occupied housing from the assets test for the Age Pension; and limit tax concessions on superannuation contributions. The burden of these changes would be spread across rich and poor, workers and retirees. While all these reforms are unlikely to occur at once, it will be hard to close the looming budget gap without tackling any of them.

Substantial budget repair almost always involves tax reform. Although the National Commission of Audit's terms of reference are focussed on government expenditure, it is important that any budget reform takes both sides of the balance sheet into account. It is difficult to identify spending reductions alone that are large enough to fix current deficits.

Balancing budgets follows [*Budget pressures on Australian governments*](#), published by Grattan Institute in April 2013, which showed the scale of the budget problem Australian governments face. **Chapter 2** of *Balancing budgets* outlines and updates this analysis.

Chapter 3 considers the best approach to balancing budgets. It draws on examples from Australia and overseas

to show how repair can only succeed if politicians and the populace have the right mindsets and approach, and how a Commission of Audit can best contribute to reform. History shows that governments that successfully repair their budgets do so through a package of measures that shares the burden of reform fairly across the community.

Chapter 4 outlines a framework for evaluating budget choices on the basis of their budgetary impact, and social and economic side-effects.

Chapter 5 indicates how the key reforms might be packaged together so that the burden of reform is spread fairly across the community.

Structural reform of benefits and tax exemptions for older Australians offer many of the best opportunities for budget reform. They are the least-well targeted parts of our tax and welfare system, with some benefits going to people that don't need them. These are discussed in **Chapter 6** of the report.

Chapter 7 discusses reforms to the tax treatment of assets, including owner-occupied housing and investment property.

Chapter 8 looks at other tax exemptions, introductions and increases that may help to repair budgets. Increasing fuel excise in line with inflation would raise significant revenue, although it hits those with low incomes particularly hard. Higher rates of existing taxes could raise large revenues.

Raising the GST and municipal rates would slow economic growth less than other tax increases.

Chapter 9 covers spending cuts. Plausible reductions in spending on transport infrastructure, industry support, school class sizes, higher education subsidies, pharmaceuticals, health services, and defence could collectively improve budget positions by \$23 billion per year. But the execution risks are high – there would be unacceptable economic and social effects unless the cuts were executed unusually well. By contrast, the oft-cited cuts to the public service and 'middle class welfare' can do relatively little to improve budget balances. While changes to federal financial arrangements might improve the Commonwealth budget position, leaving shared areas of responsibility wholly to states would only put pressure on their budgets instead.

Chapter 10 looks at the role of asset sales in budget repair.

Finally, **Chapter 11** discusses institutions that promote budgetary discipline in the longer term.

Further detail on each of the 20 budget choices is contained in the accompanying report [*Balancing Budgets: Supporting analysis*](#).

Sustainable budgets depend on governments making tough choices. None will be politically easy, but making some of them is vital to Australia's prosperity.

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Table 1: Summary of impact of budget proposals over \$2 billion

Theme	Proposal	Value (\$2013 bn/year)	Social, economic and distributional impacts
Super and pensions	Age Pension and super access age	\$12b	Neutral
	Super contribution tax concessions	\$6b	Moderately negative
	Super earnings tax concessions	\$3b	Moderately negative
	Age Pension assets test	\$7b	Positive
Housing and capital gains	CGT discounts	\$5b	Neutral
	Owner-occupied housing and CGT	\$15b	Very negative
	Negative gearing	\$2b	Positive
Other tax exemptions	GST base	\$13b	Negative
	Payroll tax threshold	\$6b	Very negative
	Fuel tax credit	\$3b	Negative
New taxes	Fuel excise indexation	\$3b	Moderately negative
	Federal royalties export tax	\$3b	Negative
Tax rate increases	Corporate tax rate	\$10b	Very negative
	Income tax rates	\$10b	Very negative
	GST rate	\$10b	Negative
	Property tax rate	\$10b	Negative
	Payroll tax rate	\$10b	Very negative
	Stamp duty rate	\$10b	Very negative
	Bracket creep	\$16b	Very negative

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Theme	Proposal	Value (\$2013 bn/year)	Social, economic and distributional impacts
Spending cuts	Transport infrastructure costs	\$6b	Moderately negative
	Industry support	\$5b	Moderately negative
	Private health insurance rebate	\$3b	Negative
	Pharmaceuticals spending	\$2b	Positive
	Cost effectiveness of treatments	\$2b	Neutral
	Defence spending	\$2b	Neutral
	School class sizes	\$3b	Moderately negative
	Student subsidies for higher education	\$3b	Neutral

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Further reading

Grattan Institute: Budget pressures on Australian governments. April 2013

<http://grattan.edu.au/publications/reports/post/budget-pressures-on-australian-governments/>

Grattan Institute: Balancing budgets: tough choices we need. November 2013

<http://grattan.edu.au/publications/reports/post/balancing-budgets-tough-choices-we-need/>

Grattan Institute: Balancing budgets: tough choices we need: Supporting analysis. November 2013

<http://grattan.edu.au/publications/reports/post/balancing-budgets-tough-choices-we-need/>

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Grattan Institute contributes to public policy in Australia as a liberal democracy in a globalised economy. Our work is independent, rigorous and practical. We foster informed public debate on the key issues for Australia, through both private forums and public events, engaging key decision makers and the broader community.