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Australian Council of Social Service

Balancing the Budget

Submission to the Commission of Audit, November 2013

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Executive summary

ACOSS welcomes this Commission of Audit. As the peak body for the community sector, and the national voice against poverty and inequality in Australia, we strongly support a courageous yet carefully considered audit of what government is trying to achieve, and whether its roles and responsibilities are being fulfilled effectively and efficiently.

The Audit is of major significance to the Australian community which holds significant expectations of government. However, the Audit is particularly important to the 2.3 million people - including almost 600,000 children - who are currently living in poverty and the over 700,000 people who are unemployed.

Our fiscal challenge is real. Whilst we remain a low spending nation (37% of GDP, the 3rd lowest in the OECD), with funding on unemployment payments down 4% in real terms over the last decade, other expenditure is rising rapidly. Since 2002, health expenditure has grown by $42B, the strongest growth being in hospitals at $18B. The costs of the Age Pension are up by $13B. These costs will only continue to rise with the ageing population.

However, the key driver of our structural deficit is our major decline in revenues. Community expectations on government are to pay less tax. Yet, we have already had eight successive tax cuts over the last 10 years. We are a low taxing country and public revenues continue to fall. Since 1999, personal income tax takings have shrunk from 12 to 10% of GDP (2010) at the same time that the cost of tax expenditures have grown rapidly. Since 2002, tax expenditures have gone up from 4.1% to 7.6% of GDP, including a rise from 2.4% to 4.6% of GDP for super tax concessions (the same cost as the age pension). Negative gearing and capital gains tax expenditures are also rising.

We talk of rising cost of living pressures and look to government to fix these. Yet, the data shows that, in fact, most of us are enjoying living standards better than ever before. Since 2000, our disposable income has risen by 43% for the top 20%, by 34% for the middle quintile and 29% for the lowest quintile.

We need a new debate about community expectations.

How do we respond to pressing social and economic challenges that were neglected in the boom years, including population ageing, housing affordability and rising poverty. There is a core group of people who are struggling to survive, and that group is growing, including amongst our children. These are people predominantly relying on working age income support payments, including single parents, people with disability, carers, Aboriginal and Torres Strait Islander people and the growing number of people who are long term unemployed (over a year). This last group has risen by 75% since the GFC. The single rate of Newstart is just $35 a day. How can we not afford to lift up the living standards of the people who are most vulnerable? How can we not afford to open up job opportunities for the people who are most disadvantaged in the labour market?

This will require tough choices and trade-offs. It requires some members of the community being prepared to give up things they do not need (e.g. superannuation tax concessions for those who are well-off, or part-pensions for couples with assets of over $1 million) or which have unintended consequences (e.g. negative gearing which contributes to house price inflation) to make room for essential expenditures.

In future, how can Governments continue to provide health and aged care for an ageing population if less than one in five people over 64 years pays any income tax? Will those who can afford private health insurance forego a rebate for ‘extras cover’ so that Governments can extend access to basic dental health services for all? Will people give up tax breaks on housing investments to give future generations a better chance of securing affordable housing?

The Audit should identify the big questions, but not all the answers, given its time constraints. It should build on existing work, including the Henry Tax Panel recommendations, and provide advice about processes to use to continue its work. We need to bring us all along on this vital work. Pending these debates, the Audit should be driven by some key principles about scope, effectiveness and efficiency. We have identified several areas where we believe effectiveness and efficiency can be significantly improved, including in retirement incomes, early childhood education and care, family payments, health and income support. We make some proposals regarding the relationship between government services and the community and private sectors.

In the absence of a comprehensive assessment of both unmet needs and potential savings, we propose that in the short to medium term, expenditures be capped at the level of revenue obtained (25.1% of GDP) before the GFC, and that tax revenues be restored to that level. This would enable the Government to restore the Budget to surplus as the economy grows without cutting essential programs. Much of this additional $23 billion in revenue could be collected simply by not offering another income tax cut until the budget is restored to surplus. On the other hand, it would be a travesty for Governments to cut essential essential services today to make room for tomorrow's tax cut. Within this expenditure cap, spending should be re-ordered to prioritise areas of unmet need and reduce spending on programs that are poorly designed. In this way, progress can be made to restore the budget and close service gaps at the same time.

Given the very short time available for the Commission's work, it should avoid detailed recommendations on individual programs. Further, it should inform but not overrun the broader reform of federal-state financial relationships and tax reform to the forthcoming White Papers on those topics. 'Front-loading' too much reform into a single Budget is risky and counter-productive.

Our key recommendations

1. Restore government revenues to pre-GFC level (25.1% of GDP) and keep expenditures below this level,[1] as a short term goal whilst the economy is growing at or above trend.
2. Protect the people who are the most vulnerable from further government retreat.
3. Affirm primary role for government in securing essential services and invest more in prevention.
4. Include social infrastructure and job opportunities for people disadvantaged in the labour market in participation and productivity-enhancing policies.
5. Target income support to those in need.
6. Close major gaps in the social safety net of payments and services as a high priority.
7. Realign poorly targeted expenditure to these priorities.
8. Close tax loopholes and shelters that benefit high income earners.
9. Commence national dialogue on community expectations.
10. Work with business, unions, and the community sector to strengthen productivity and sustain economic growth so that the economic 'pie' grows larger.

1 Scope of Government

There is no simple economic 'limit' to the size of government (see attachment). The agreed scope of government directly informs how big or small government needs to be. Scope depends on the role that government agrees to take in meeting both its responsibilities and community expectations. However, it is clear that major structural reform of expenditure and revenue is needed if governments are to meet reasonable community expectations for benefits and services, and balance their budgets. Over the next decade, budgetary pressures will only intensify as the terms of trade decline, the population ages, and necessary investments are made to strengthen key services.

The fiscal challenge is real

The source of the Australian Government's fiscal problems can be traced to well before the global financial crisis. Abstracting from the effects of the budget cycle and mineral prices, the budget has been in structural decline since the early 2000s. Governments 'spent' the revenue windfall from the housing and mining booms of the 2000s on eight successive income tax cuts and a range of cash bonuses and poorly targeted programs.

After the economy slowed and the terms of trade began to decline at around the end of the decade, the Australian Government was left with a large fiscal deficit. Compared with their average levels over the decade prior to the GFC in 2008, revenues had fallen by 3% of GDP (equivalent to $40 billion in today's dollars) and expenditures had risen by 2% of GDP ($27 billion). Due to the legacy of personal tax cuts and a sharp decline in company income tax and capital gains tax revenues, three fifths of the budget deterioration occurred on the revenue side (see Appendix 2).

[1] In 2007-08, just before the GFC, federal revenues were 25.1% of GDP while they were estimated to reach 23.6% of GDP in 2013 in the Pre-Election Fiscal Outlook (PEFO). The difference is 1.5% of GDP or approximately $23 billion.

Beneath these cyclical trends lies a set of deeper problems that must be resolved to put the budget on a sustainable course. The structure of government expenditures, including tax expenditures, is out of balance in at least three ways. First, at a time when population ageing is about to sharply increase demand for health and aged care services, less than one in five individuals over 64 years of age pays income tax. Second, in many areas of expenditure such as health and employment, there is too much focus on cure and too little on prevention. Third, while during the boom governments over-spent on public assistance for people who arguably had no need of it, they missed the opportunity to repair the gaps in the safety net.

The latest official estimates indicate that the Commonwealth Budget is in deficit by $18 billion or 1.2% of GDP in 2012-13[2]. The deficit is projected to fall to $5 billion or 0.3% of GDP in 2015-16. To put the government's budgetary position in context, public debt as a proportion of GDP is very low by OECD standards, at around 22% compared to 100% of GDP for the OECD as a whole.[3] Nevertheless, the size of the deficit at this stage of the business cycle is cause for concern. Given Australia's still favourable terms of trade the Budget should be strongly in surplus by now. This is problematic because economic conditions are unlikely to be as favourable in future years. Governments should build up a fiscal reserve to deal with the next economic crisis and also the likely decline in mineral prices. They also need to close a number of yawning gaps in the social safety net of benefits and services identified above.

Size isn't everything

However, we should not *assume* that the problem is the size of government. We need to agree the scope (responsibilities and roles) of government first. What do we want our governments to do? Australia is already a low taxing country. The total expenditures of Australian Governments amounted to 37% of GDP in 2010, the third lowest in the OECD.[4] The main reason for this is that we have the most tightly targeted social security system in the OECD, spending 8% of GDP on payments compared with an OECD average level of over 12% (see Appendix 3). Care should be taken that fiscal tightening does not undermine economic growth when it is below trend. This year, we have seen a Reserve Bank board member warn against further cutting of spending due to below trend economic growth and weak employment outcomes.[5] More recently commentary from the US has highlighted how spending cuts reduce economic growth.[6]

It is the effectiveness and efficiency of both revenue and expenditures that affect fiscal, economic and social outcomes, not simply their overall size. Far from being a dead weight on the economy, well-designed expenditures (e.g. education and training, health social services and housing and transport infrastructure) underpin productivity and economic growth.

Recommendation: Fiscal goals and targets

As a short-term goal to help restore the Budget to sustainability, we propose that while the economy is growing at or above trend, Australian Government revenues should be restored to their pre-GFC level (25.1% of GDP) and expenditures kept below this level.[7]

Responsibilities and roles

The overall responsibilities of the Australian Government are sourced both from our constitutional framework and international obligations. For example, the Commonwealth has a clear, ongoing responsibility to ensure people have an adequate standard of living to the maximum of our available national resources.[8] However, roles played in meeting these responsibilities may change over time, and may be a mix of:

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[2]Treasury 2013, Pre-Election Fiscal Outlook, underlying cash deficit.
[3]OECD Revenue Statistics
[4]OECD Revenue Statistics
[5] AFR (29 July 2013), *RBAs Edwards to Rudd: cuts, tax rises risk economy,* Accessed 26.11.2013, http://www.afr.com/p/national/rba_edwards_to_rudd_cuts_tax_rises_1Wd5PEY2SF8xEoAyoMQxAP
[6] Business Insider (24 October, 2013) *The Real Economic Growth Killer? Government Spending Cuts….,* Accessed 26.11.13, http://www.businessinsider.com.au/government-spending-cuts-2013-10
[7] In 2007-08, just before the GFC, federal revenues were 25.1% of GDP while they were estimated to reach 23.6% of GDP in 2013 in the Pre-Election Fiscal Outlook (PEFO). The difference is 1.5% of GDP or approximately $23 billion.
[8] International Covenant on Economic, Social and Cultural Rights (ICESCR). This responsibility is reflected in the Prime Minister's acceptance speech that 'no one would be left behind'.

- Commonwealth, State and Territory and/or Local Government
- Community and/or private sector.

Who performs what role should be determined by tests of effectiveness and efficiency, not ideological bias. However, some presumptions are proposed (see further below). The Australian Government has a continuing overall responsibility to enable these roles to be performed effectively and efficiently.

National debate on community expectations (revisiting the 'age of entitlement')

In Australia, community expectations have played a major part in determining the appropriate roles of government. In general terms, community expects government to ensure access to some essential services for everyone (e.g. health and education services, defence and public infrastructure). This means in practice that Governments meet most of the overall cost, that all receive some level of subsidy, and that their whole cost (or the vast majority) is met for those who are unable to pay. Community debates about level of support for people on different incomes are very much alive today (e.g. parental leave and child care). In other areas, community expectations have typically been lower, with targeted assistance only for people who are disadvantaged (e.g. in housing and employment).

Similarly, the community expects that people who are not in a position to adequately look after themselves will receive targeted income support and that the social security system will 'insure' people against life course risks such as the costs of children and retirement. However, the targeting of some payments has been loosened in recent years (e.g. family payments and the age pension) and over time community expectations have grown, fanned by political rhetoric of a 'cost of living' crisis. Expectations have been built up that, above and beyond essential services and benefits, Governments will step in to 'guarantee' steadily rising living standards when these are perceived to be under threat. This is not a reasonable community expectation. A growing number of people believe that they are entitled to assistance even when they are not disadvantaged (e.g. School Kids Bonus up to $120 000 and Child Care Rebate which disproportionately benefits high income earners).

Finally, the community also expects that government will keep taxes low.

Taken together, these community expectations are no longer realistic or sustainable. A new consensus is required. What are we prepared to give up? Will people who can, pay more? Like the NDIS, is there a consensus that dental health services should be universal or targeted or a combination of both, and if so, how should this be funded? Will people give up tax breaks on housing investments to give future generations a better chance of securing affordable housing?

In the timeframes of this Audit, it is impossible to build a new consensus about community expectations on government. However, the Audit can begin a new debate. The Audit can best inform this discussion by defining the scope of the fiscal problem including emerging pressures on spending such as population ageing, and recommending a set of goals and targets for fiscal reform. These should, in turn, be informed by a clear exposition of the purposes of Government, and a set of principles for identifying gaps in service provision (where governments have not done enough) and areas of poorly targeted or inefficient expenditure (where governments have over-reached). This should cover both direct and tax expenditures. Given the very short time available for the Commission's work, it should avoid detailed recommendations on reforms to individual programs. Further, it should inform but not make specific recommendations about broader reform of federal-state financial relationships and tax reform to the forthcoming White Papers on those topics. 'Front-loading' too much reform into a single Budget is risky and counter-productive.

Recommendation: National debate on community expectations

The Audit should set in train a new community debate about the reasonable expectations of government, with a focus on some of the most expensive areas, or those that impact on productivity, including:

- Reasonable retirement income support expectations
    - We need to reopen debates about adequacy and targeting of superannuation and the aged pension systems together
- Making secure, affordable housing available for all
    - This is probably the most urgent infrastructure challenge we face

- Caring services and supports, including paid parental leave, child and out of school hours care, and caring roles
    - Should these services be universal, or targeted, and how should they be funded, given their significance to both social and economic participation?
- Health and aged care services
    - How do we fund these into the future, and invest more in prevention rather than cure?
- How much tax are we are prepared to pay for meeting these expectations and how?

Some of these debates can progressed in more details through specific forthcoming public policy processes, including:

- The White Paper on Tax Reform;
- The White Paper on the Reform of the Federation; and
- Productivity Commission on Child Care.

Key principles for determining scope

Government should have primary role in delivering essential services

Services that are widely regarded as essential, have broad public benefits, and cannot be provided fairly and effectively unless governments take primary responsibility for them, should be provided or funded by government for the whole population (see Appendix 4 for a table outlining an appropriate targeting regime for benefits and services). Examples include primary and acute health care, childcare and aged care, and public educational institutions.

Concerns that people on higher incomes also benefit from these services miss the point that they have positive spill-over effects, disproportionately benefit low and middle income earners, and help cement compliance with tax obligations. These services are a vital part of the social compact between governments and the people and meet our obligations. If they are not extended on an equal footing to people on high incomes, pressures will emerge to subsidise private provision in less transparent and efficient ways, for example through poorly targeted subsidies for private health insurance.

In some cases demand for these services can be more effectively regulated if the users contribute to their cost. However, governments should meet the overall majority of the cost, and the whole cost in cases where people are at risk of poverty. Out of pocket expenses for health and education services are already above OECD-average levels and many people are avoiding visiting the doctor or the dentist when they need to because they cannot afford to pay. Further, extra public subsidies to cover 'gap payments' often undermine the purpose of user charges in the first place by fuelling inflation in the cost of services.

Governments also have a role to play in assisting people who face substantial barriers to full social and economic participation through subsidies and services. Examples include disability services and social housing for low income households. These services may not be needed by everyone at some stage in their lives, but without them a significant minority of the population would be excluded in a significant way from society. As with universal essential services, it is appropriate in some cases to require recipients to contribute to their cost, but great care should be taken to ensure that this does not close off access for those who need them.

Productivity and participation-improving measures should include social infrastructure and transitional jobs for people disadvantaged in the labour market

Budgets are a zero-sum game as long as the economy is not growing, and increases in participation and productivity are the key ingredients to growth. ACOSS agrees that we face a challenge in lifting productivity rates. The Audit needs to consider the role of government, including in infrastructure and supporting innovation in Australian workplaces. ACOSS encourages the Audit to consider the benefits of effective investment in social infrastructure, including affordable housing and care services and employment assistance, to boost participation, productivity and labour mobility. Employment participation policies should also focus on people who have been left behind in the labour market, including older workers, people with disability, carers, single parents, people from CALD (Culturally and Linguistically Diverse) backgrounds and Aboriginal and Torres Strait Islander peoples. Long term unemployment is on the rise. Whilst our overall unemployment rates are lower than comparable countries, with an ageing population we need to support the engagement of these groups in the workforce. For the most disadvantaged jobseekers this requires investments in transitional jobs as well as better work experience and training. We face a grave risk of driving people out of the workforce by a simplistic focus on ‘efficiency’ (working harder, faster, longer) when it is in innovation and the empowering of workforces that we will drive real innovation. Diversity is key. We caution against rolling back the role of government in these areas, whilst we continue to look at effectiveness.

Prevention is better than cure

In Australia, we still have a service system which is skewed towards the crisis responses rather than investing in prevention and early intervention as a high priority. This is both socially and economically very costly. There are new efforts to try to prosecute this case, for example through employment assistance, Justice Reinvestment in the criminal justice area, and the Social Determinants of Health, showing how poor social and economic outcomes directly impact on life time health outcomes (and costs). There is significant frustration that despite a growing evidence base, it remains difficult to shift funding priorities. The reasons are complex, but include barriers to cross-portfolio analysis and modelling, a lack of integration of data sets, short term political pressures and strict fiscal rules such as requiring new spending to be found from savings within portfolio when often the savings are to be made in other portfolios, or even in another layer of government in our federated structure.

Income support should be targeted where it is needed

One of the most important functions of governments, and one by which the fairness of a society can be judged, is the prevention of poverty. This is done in a number of ways.

Firstly, government assists households to smooth their incomes to protect them from poverty, especially in the two stages of the life course when most households are most financially vulnerable: childhood and old age. Most OECD countries governments insure people against these life cycle risks through publicly run social insurance schemes and child payments (through either social security payments or tax rebates). In the absence of social insurance, Australian governments provide ‘life cycle’ income support payments such Family Tax Benefits during childhood, and Age Pensions and mandatory tax-assisted superannuation to protect people in later life.

Secondly, government provides ‘safety net’ income support payments to protect against possible vulnerabilities. They include working-age income support payments such as Newstart Allowance and Disability Support Pension. Due to their flat maximum rates and income tests, these payments are among the most ‘target efficient’ in the OECD. That is, it would cost much less to eliminate poverty among households lacking paid employment in Australia than in almost any other OECD country. Nevertheless poverty levels among recipients of working age social security payments are rising and glaring gaps have emerged.

The Audit must ensure that the people who are the most vulnerable are protected from further government retreat.

Major gaps in the social safety net should be filled

The Audit also cannot ignore some of the glaring gaps in our social safety net that need to be filled now. Recently, the universal support for the National Disability Insurance Scheme (NDIS) demonstrated a significant shift in community expectation finally aligning with our international obligations. The NDIS is aimed to fill a major gap in our current social safety net. It is more than a ‘good cause.’

Other glaring gaps include:

- Individually tailored supports for people with severe disabilities so they can realise their potential to participate fully in the community;
- A schools system that fails to match funds consistently and equitably with student needs, especially for those from low-income backgrounds;
- The severe poverty experienced by those who must rely on the lowest income support payments such as Newstart Allowance, and inadequate family payments for those with dependent children;
- A lack of job opportunities and intensive employment assistance and training for people unemployed long-term and those at risk of it;

- The housing and energy affordability crisis particularly for people on low incomes, especially those renting privately;
- Closing the gaps in health, education, employment and living standards between Aboriginal and Torres Strait Islander communities and the rest of the community; and
- Mental and dental health services that are out of reach for large numbers of people especially those on the lowest incomes.

See Appendix 1 for further detail. The Audit should focus on how to address these gaps including by:

- Maintaining expenditures allocated to the NDIS and providing support for people with disabilities and carers to assist them to choose the services they need;
- Delivering the funds required for schools reform, and ensuring that it is targeted to schools based on need
- Increasing the single rate of Newstart by at least $50 per week, linking indexation to wages and preserving the $4 per week Supplementary Allowance;[9]
- Maintaining total funding for the family payments system (including the funding for the Schools Kids Bonus), but re-targeting that funding to people on lower incomes to reduce child poverty rates. [10]
- Strengthening employment assistance to people who are unemployed long term or disadvantaged in the labour market ;[11]
- Increasing direct government investment in affordable housing stock and incentives to stimulate institutional investment in affordable housing, increasing Commonwealth Rent Assistance and maintaining funding for homelessness services at current levels;
- Targeting investment to support community development and build capacity in Aboriginal and Torres Strait Islander community-controlled organisations;
- Increasing investment in mental and dental health services for those on low incomes; and
- Preserving the Low Income Super Contribution to support the retirement incomes of those on low incomes.

Poorly targeted expenditures and tax expenditures should be realigned to improve effectiveness

A significant number of expenditures (including tax expenditures) are poorly targeted and inefficient in delivering government responsibilities and agreed national priorities. Indicators of poorly targeted or designed program include: a lack of a clearly identified public purpose, disproportionate benefit for high income earners, programs that inflate costs, and programs that are inefficient in meeting their intended purpose. Funds should be better targeted within policy areas to improve effectiveness. Examples of poorly targeted expenditures and tax expenditures which should be realigned include:

- Child Care Rebate
- School Kids Bonus
- Private health rebates.

Tax loopholes and shelters that benefit high income earners should be closed

Whilst the Audit is not focused on tax reform per se, its work would be incomplete if it ignores the cost and effectiveness of tax expenditures (discussed further below) which have similar impacts to direct expenditures but arbitrarily fall on the revenue side of the Budget. More broadly, there are structural flaws in the tax system which undermine revenue and reduce the fairness and efficiency of the tax system. With broad agreement of a fiscal challenge, we must be courageous in finally closing or redirecting the worst shelters and loopholes in the system so that people who could afford to contribute more to the provision of community services do so. Some of the most obvious examples include:

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[9] For more information, see ACOSS, *Surviving not Living*, Submission to Senate Employment Committee on the adequacy of allowance payments, ACOSS Paper 192, August 2012, at http://acoss.org.au/images/uploads/Allowance_Adequacy_Submission_Final.pdf.
[10] See ACOSS, *Back to Basics: Simplifying Australia's family payments system to reduce child poverty,* 2013, at http://www.acoss.org.au/images/uploads/ACOSS%20Back%20to%20Basics%20FINAL.pdf.
[11] For more information, see ACOSS, *Partnerships for Participation*, Submission to Minister for Employment Participation on reform of employment services, ACOSS Paper 200, March 2013 at http://acoss.org.au/images/uploads/ACOSS_Partnerships_for_Participation_Employment_Services_Submission.pdf

- Superannuation tax concessions;
- Private discretionary trusts; and
- Housing tax concessions, including negative gearing and Capital Gains Tax.

2 Examples of scope for improved efficiency and effectiveness of government expenditure

The Audit should focus on either cutting or realigning inefficient or ineffective expenditure, particularly to fill the flaring gaps in the social safety net, and reduce the structural deficit in the budget.

Recent growth in public expenditures has focussed on hospitals, age pensions, and family payments while spending on payments for unemployed people has declined (see appendix). While social security payments are sometimes branded 'middle class welfare', the reality is that Australia has the most tightly targeted income support systems in the OECD. 'Waste' in the budget is more likely to be found elsewhere, as the examples below illustrate.

Some specific examples are set out below in a range of policy areas where government has responsibility and a clear role. Some comments are also made about the effectiveness and efficiency of government services, and the role of the community and private sectors.

Assistance for older people after paid working age

As the population ages governments will face increasing, and legitimate, demands on health and aged care services. Yet less than 20% of individuals over 64 years pay any income tax. This is not sustainable. We need a national conversation about how to equitably pay for these costs. The Age Pension and superannuation tax breaks together form a system of public support for retirement incomes. The need to examine these two issues together is illustrated by New Zealand's decision to introduce a universal pension in return for the abolition of superannuation tax breaks.

The original intent of superannuation was to boost retirement incomes and reduce the cost to government of providing financial support to people after working age, by encouraging people to save for their own retirement. Savings are encouraged through compulsory employer contributions, while individuals can also make contributions above this amount (up to a cap), with employer contributions taxed at a flat 15% (instead of the individuals marginal tax rate). This is unfair and poorly targeted, because high earners can save over 30 cents in tax per dollar contributed by employers, while those below the tax free threshold pay the same flat rate as those on higher incomes. Indeed, some receive more from government in tax exemptions than they would receive if they were receiving the full amount of the pension, while, in the absence of the Low Income Government Contribution, those on the lowest incomes are penalised for saving. ACOSS advocates replacing the current system of contribution taxes with a capped annual rebate to improve fairness and target efficiency. Reform of tax expenditures in the contributions phase could be revenue neutral, with revenue re-allocated to pay for higher tax breaks for low income people.

Since the Age Pension is a 'life cycle' income support payment, it is not as tightly targeted as other social security payments. This is not well understood. A good way to put the targeting of Age Pensions into perspective is to compare its incidence with its main complement: superannuation tax concessions. While the majority of the value of Age Pensions goes to the bottom half of individuals of pension age and almost none of it goes to the top 10%, this is reversed in regard to tax breaks for superannuation, over 30% of which go to the top 10% and only 20% goes to the bottom 50%[12]. However, in recent years Age Pension entitlements have extended to a cohort of older people who arguably do not need them, through an excessively generous easing of the asset test in 2006. A home-owning couple with a million dollars in investment assets other than the home can still qualify for a part pension. This entitles them a range of pensioner concessions, which in general terms are poorly targeted.

Of greater concern is the erosion of public revenue from tax breaks for people of retirement age who arguably could afford to pay income tax; including the Seniors Tax Offset for those not on a pension, the Transition to Retirement arrangements which enable people to churn their wages through super accounts and reduce their tax rates to 15%, and the non taxation of super fund earnings in the 'pensions phase'.

[12] Treasury estimates.

Early childhood education and care

Assistance with the costs of early childhood education and care should be provided to all families, as this a public good providing an important educational foundation for children and strengthening workforce participation. However, there is a strong rationale for financial assistance for early childhood education and care to be targeted such that a higher benefit is paid to low and middle income families. These families are more likely than high-income families to be discouraged from employment if the costs of education and care are high.

The Child Care Benefit is an example of a well-targeted program that provides means tested assistance with the costs of childcare. A family with a very low income - below $38,000, receives the full amount of the Benefit, while families with incomes above $38,000 receive the Benefit on a reducing sliding scale as income increases. By contrast the Child Care Rebate is an example of a program that is poorly targeted and adds complexity to childcare financial assistance arrangements. The Rebate covers 50% of out of pocket childcare expenses incurred by families, up to a maximum amount per child per year, in addition to benefits received through the Child Care Benefit. It effectively covers the gap between the two payments. Families with higher incomes receive less means tested Child Care Benefit, and therefore receive more from the Rebate. It disproportionately benefits high income earners, undermining the targeting of the Child Care Benefit.

Pending the Productivity Commission Inquiry into Child Care, the Child Care Rebate and the Child Care Benefit should be integrated into a single Child Care Benefit, without reducing overall expenditure. Families at all income levels would be entitled to a minimum level of the Benefit, while low and middle income families would receive more.

Family payments

Family payments for middle-income families are not 'middle class welfare'. They are the simplest and fairest way for governments to take account of the extra costs of children in the tax transfer system. The extension of family payments to middle income families also supports workforce participation and contains growth in wages. In the absence of modest family payments for middle-income families, pressure would grow to support families with the costs of children in less equitable ways through the tax system. Nevertheless, some family payments are poorly targeted or lack a clear rationale. ACOSS has argued that the Baby Bonus, Schoolkids Bonus and Family Tax Benefit Part B for couples with older children should be redirected towards by higher family payments for those at risk of poverty without reducing overall expenditure on family payments.[13]

Supporting healthy communities

As the country becomes wealthier and medical technologies improve, it is desirable and legitimate for governments to devote a higher proportion of GDP to improving public health. However, the present structure of health expenditure is not sustainable because too little is invested in prevention and primary care while expenditure on acute care, especially hospitals, is growing out of control.

Further, in recent years, a number of poorly targeted and poorly designed subsidies for health services have emerged, which inflate the costs of care. Whether a public subsidy constrains or inflates fees depends a great deal on subsidy design. Simple capped rebates that cover a proportion of service costs often curb increases in fees (e.g. Medicare rebates). However, governments have at times succumbed to pressures to subsidise part of the 'gap' as well, as with the Extended Medicare Safety Net. These double 'subsidies' are also more likely to be inflationary.

The Extended Medicare Safety Net provides financial assistance for high costs for out-of-hospital medical services that attract a Medicare benefit. The Safety Net covers 80% of the 'gap fees' or out of pocket expenses remaining once the standard Medicare benefit has been claimed for individuals whose gap fees exceed a certain threshold amount per year. Between 2003 and 2009, for every dollar spent by the government on the extended safety net, doctor's fees rose by almost 80 cents.[14] The program also disproportionately benefits high-income earners, who consume more expensive services than other people and are more likely to reach the threshold that entitles them to the rebate. Rather than provide a separate program to cover gap fees that is only accessible to some consumers, 'schedule fees' for the standard Medicare Benefit should be increased, as needed.

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[13]ACOSS, *Back to Basics,* 2013.

[14] Van Gool, Kees (2009), The Medicare Safety Net: review and response. Economics Research and Evaluation (CHERE), University of Technology, Sydney Survey No 14.

There are also savings that could be made in private health insurance. For every dollar paid for private health cover up to an annual cap, the government rebates policy-holders 30 to 40 cents, depending on their age. This includes hospital cover and ancillary or 'extras' cover. The policy intent of the extension of the Rebate to ancillary health cover is not clear. The intention of the Rebate is to reduce public hospital costs; however ancillary health care does not include hospitals. Furthermore, this aspect of the Rebate benefits higher income earners who are more likely to hold private health insurance, while lower income earners that do not have private health insurance struggle with the costs of services (particularly dental) which do not receive the Medicare benefit. A better approach would be to subsidise essential health services such as dental on a universal basis. The Rebate should be removed from 'extras' cover and limited to hospital treatment.

Oral and mental health are both areas in which there is strong and extensive evidence to show that needs are unmet (especially among people with the least resources) and that adequate and appropriate early intervention, can relieve the burden of unnecessary hospital admission and of chronic and acute conditions on people's health. For example, National data on access to dental services shows that large numbers of people on low incomes are routinely treated in hospital settings, having been on public waiting lists for over two years, by which time preventable oral health problems such as decay have developed into acute or chronic conditions requiring removal of teeth.

Governments continue to fund an ever-growing health budget based on rising demand for hospital services while failing to invest in effective, locally or regionally-coordinated community health. The most reliable estimate available suggests that public health expenditure (which includes preventive health activities) is 1.6% of overall annual health expenditure.[15]

Delivering income support efficiently and effectively

Safety net income support payments are one of the most urgently in need of reassessment to make sure that they are efficiently delivered, well targeted to people who need them, and effective in meeting their core purpose. As noted above, the glaring gaps in the adequacy of the base working age payment, the Allowances (including Newstart) must be urgently addressed. Further, recent policy changes have resulted in significant expenditure on programs which restrict social security recipients' decision-making autonomy without demonstrating positive social outcomes. The primary example is compulsory income management, which automatically applies to long-term recipients of some payments and certain other people in the Northern Territory. It has also been extended to five 'trial sites' in other States.

Income management is extremely expensive. It is estimated that income management costs $6,600-$7,900 per person per annum in remote areas[16], and $4,700 in the five trial sites.[17] This is around half the Newstart Allowance. It is estimated income management for the period 2005–06 to 2014–15 will cost the Commonwealth around $1 billion.[18]At the same time, the official evaluation of 'New Income Management' in the Northern Territory made the following findings:[19]

- 'Taken as a whole there is not strong evidence that, at this stage, the program has had a major impact on out-comes overall.'
- 'There is little evidence to date that income management is resulting in widespread behaviour change, either with respect to building an ability to effectively manage money or in building 'socially responsible behaviour' be-yond the direct impact of limiting the amount that can be spent on some items.'

Funds currently spent administering compulsory income management should be redirected towards building local community solutions and funding intensive case management services.

[15] Australian National Preventative Health Agency *State of Preventative Health Report 2013*
[16] Australian National Audit Office (2013), Administration of New Income Management in the Northern Territory, p17.
[17] The $4,700 figure is calculated as follows. $117.5 million has been allocated to the 5 trial sites over 5 years. The sites will be capped at 1,000 people per site. (See Budget Paper No. 2 (2011-2012) at p183.) $4,700 = $117.5 million / 5 / 5 / 1,000.
[18] Buckmaster L, Parliamentary Library (21 June 2012), Income management: an overview, p34.
[19] Bray J R, Gray M, Hand K, Bradbury B, Eastman C & Katz I (2012) *Evaluating New Income Management in the Northern Territory: First Evaluation Report – July 2012*, at xvii – xxiv.

Government services and funding for services

The Australian Government does not provide many direct services. This Audit squarely asks if more services could be privatised, or ways to make existing services more efficient.

Centrelink

Some of the most important services that are directly delivered are those delivered by Centrelink. Outsourcing the delivery of Centrelink functions to private providers such as Australia Post is not likely to deliver benefits for two key reasons.

First, social security legislation is prescriptive to a high level of detail. This means that there is limited scope for providers to innovate to deliver services more efficiently or effectively. It should not be assumed that efficiency can be achieved by outsourcing unless there is a clear understanding of what can be done differently to achieve such efficiencies. The prescriptive nature of the legislation also means a high reporting burden would be placed on providers, imposing equally high compliance costs on government. Such tight control would duplicate work and increase transaction costs.

Second, decisions about what payments clients are entitled to are not currently made on the basis of a simple administrative process. Instead, they depend on a careful assessment of the client's needs and their capacity to meet certain activation requirements. Such judgements are often made in the context of a client's complex personal circumstances, including relationship changes (e.g. relationship breakdown and family separation), sickness or death in the family unit, domestic violence, mental health issues, homelessness and unemployment. It is the expectation of Parliament that public entitlements will be delivered in a fair and consistent way, with minimal wasted expenditure, and hence adequate investment in the capacity of staff to make fair and reasonable judgements is paramount.

Further, outsourcing some aspects of Centrelink's services – such as the authorisation of payments once client assessments have been made, is likely to be duplicative and inefficient, and risks errors being made as information is transmitted between stages of the process.

As part of its Service Delivery Reform process, the Department of Human Services has been progressively moving Centrelink services online. The Commonwealth Ombudsman's Annual Report 2011-12 noted that online servicing carries a risk of vulnerable people missing out on their entitlements, and noted that online service delivery may have a tendency to shift responsibility to its customers to "seek out and check the information that Centrelink is using to calculate their entitlement". Vulnerable clients who struggle to understand their entitlements through online information are at risk from these arrangements. Furthermore, clients of Centrelink are being asked to independently complete increasingly complex tasks online, leading to risks of under-payment or penalisation of clients for claiming over-payments.

Community and Private Sector

As noted above, while government has a critical role in direct service delivery in a number of key areas including in the delivery of universal and targeted essential services and the provision of income support, not-for-profit and private organisations are playing an increasing role in service delivery. While more effective and efficient delivery of services can reduce expenditure, the greatest value lies in improving outcomes for the people and communities relying on those services. Government funding of social services needs to be driven by values that promote effectiveness as much as efficiency; and to recognise the central role of locally-based relationships and understanding in securing both these outcomes. This is where the role of community-based social services is most critical, in providing an understanding not just of local problems but of how best to address them, to ensure efficient and effective services. Too often we see assumptions of cheaper delivery through outsourcing drive decisions about government spending. Indeed, these decisions increasingly assume little or no difference between not-for-profit community-based organisations and private sector providers. Yet the local knowledge of a community-based organisation is a significant and unique value that is at the heart of why governments outsource social services in the first place.

The effectiveness of social services is undermined by program and funding design that devalues or ignores the importance these relationships and understanding at the local level. One such example is the competitive tendering process for funding to establish Medicare Locals. This was a reform that could have alleviated the growing pressure from acute needs on health budgets, by providing an effective network of preventive health services. The effectiveness of Medicare Locals, therefore, depends upon strong connections between medical, health and community services in local communities. The competitive tendering process directly fractured existing relationships and undermined the capacity to develop collaborative models as part of the funding bid, despite that face that Medicare Locals were expected to build community relationships as the first step in their establishment.

The NFP Sector makes a significant economic contribution. Broadly, the NFP sector contributes five per cent of GDP and makes up eight per cent of employment nationally, with continued strong growth forecast compared with other local industries.[20] For example, in 2013, the Community Services and Health Industry Skills Council projected that the health and community services sector will grow by at least 35% over the next 10 years.[21] As the economy continues to shift towards service delivery as the key driver of growth, the role and contribution of this sector will become increasingly important. As such, it is critically important that adequate levels of investment in training and development for the sector are maintained to ensure its capacity to manage significant rapid growth both in its workforce and in the demand for high-quality services. A 2010 Productivity Commission publication *Contribution of the NFP Sector* found that government contracts with NFP organisations usually cover approximately 70% of the full cost of service delivery and recommended that governments should full fund services considered to be citizen entitlements or core components of the social safety net that they would otherwise provide directly.[22]

In addition, the policy settings that underpin the way the Commonwealth currently funds community services are neither clear nor consistent. This is in contrast to other jurisdictions, for example Western Australia, where a funding formula provides some certainty about government funding, particularly wage and indexation arrangements. A similar situation exists in Victoria.

Whilst contestability has its place, tendering of services driven principally by profit margins fails to place an appropriate value on the key drivers of effective social services, including collaboration and coordination across services and giving priority to people who may require the most intensive support and assistance.

We support the submission from Community Council for Australia, affirming the important role for a national regulatory body to improve the effectiveness and reduce the overly burdensome reporting environment that social services operate in; the critical role that community organisations play, to improve the lives of people and communities, in policy and program design as well as delivery; the need to set a coherent framework around how government engages with social services, including through contracting; the importance of performance monitoring against desired outcomes, not contracted outputs; and the poor capacity of competitive tendering to meet the combined objectives of appropriate risk management and effective delivery of services to the communities that need them.

3 Fiscal targets

Fiscal targets should be based on a careful assessment of gaps in the community's safety net as well as identification of areas of poorly targeted expenditure. The deficit is more a product of revenue erosion rather than a lack of expenditure control, though as shown above some programs are poorly designed and targeted. So the first step should be to restore revenue. The second step is to make savings in poorly targeted programs to offset the cost of spending required to close service gaps. In many cases, such as health care and child care as discussed in the next section, this trade off can be made within categories of expenditure.

It is vital that the Commission identifies areas requiring additional investment and areas where savings can be made or it will produce an unbalanced view of the state of the budget. If the focus falls entirely on savings, then both expenditures and revenues are likely to be cut below the levels necessary to meet the public's reasonable expectations. This creates fiscal risks. Governments will come under pressure to dramatically increase expenditures,

[20] Productivity Commission (2010) *Contribution of the Not-for-Profit Sector*, Research Report. Australian Government, Canberra at 68.
[21] Community Services and Health Industry Skills Council (2013) *Environmental Scan: The Care Industry – A Time for Action*, accessed at http://www.cshisc.com.au/media/171360/Environmental_Scan_2013__2.7mb.pdf, accessed on 26/11/2013.
[22] Productivity Commission (2010) *Contribution of the Not-for-Profit Sector*, Research Report. Australian Government, Canberra at 290.

or overturn expenditure cuts, and if revenues are not increased to match the higher outlays fiscal deficits could widen.[23]

Public revenue should be adequate to finance expenditure on average across the business cycle, so that public debt levels reduce and do not increase over the medium to long-term, except to finance infrastructure that benefits future generations or yields a future income stream for governments. This implies that when the economy is growing at or above trend, public revenues should exceed expenditures, in order to make room to finance fiscal deficits brought about by recessions and other economic shocks such as a decline in the terms of trade. Surpluses are not desirable for their own sake. Under normal circumstances, the purpose of government is to provide services and benefits and economic infrastructure, not to save on behalf of the community. So governments should allow their budget to remain in deficit if to do otherwise would jeopardise economic growth.

As a short-term goal to help restore the Budget to sustainability, we propose that while the economy is growing at or above trend, Australian Government revenues should be restored to their pre-GFC level (25.1% of GDP) and expenditures kept below this level. This modest increase in revenue, which could be achieved by a combination of maintenance of existing personal income tax rates and thresholds and reductions in poorly targeted tax concessions, should be sufficient to restore the budget to surplus in the short term and to begin to close the gaps in the safety net identified above.

Direct v tax expenditures

Tax expenditures are public subsidies that take the form of exemptions, rebates or other forms of 'special treatment' under tax law. Although they reduce public revenues instead of increasing outlays their effect is usually the same. However, they are less transparent, attract less scrutiny in the budget process, and have risen well in excess of economic growth over the last decade, from 4.1% of GDP in 2001-02 to 7.6% in 2011-12.[24] For these kinds of reasons, the OECD has suggested that tax expenditures that are comparable with direct expenditures should be included within any public expenditure 'ceilings'.[25]

The following guidelines were developed to deal with these problems:

- 'Under nominal or structural deficit or operating/current balance rules tax expenditures should either be included in the total expenditure cap that is set every year during budget preparation or in a special tax expenditure cap.'
- 'All tax expenditures should be reviewed in the same way as regular expenditures in the annual budget process. They should be reviewed by the financial staff of spending ministers and the budget bureau in the same way as regular expenditures.'[26]

In the absence of fiscal rules such as these, governments can undermine the intent of these expenditure targets by converting expenditures into tax concessions. It is noteworthy that the 1996 Australian Government Commission of Audit closely examined tax concessions, especially those for superannuation, which are highly inequitable and inefficient. The Treasury's annual Tax Expenditures Statement offers guidance on the range of tax provisions that could properly be classified as tax expenditures. There is also an emerging academic literature on the topic in the United States.[27]

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[23] For example, many of the expenditure cuts in the 1996 Federal Budget were subsequently restored when service gaps or excessive costs to the public were identified, including reductions in Medicare subsidies, higher education funding, and dental health services for people on low incomes. Fortunately these expenditures were restored during an economic boom when public revenues were rising strongly.

[24] Treasury, Tax Expenditures Statement 2013, at http://www.treasury.gov.au/PublicationsAndMedia/Publications/2013/TES-2012.

[25] "Tax expenditures may cause a problem for the proper functioning of the budget, for two reasons: i) tax expenditures may escape the budgetary control of the prevailing fiscal rule and thereby hamper the macro-economic and allocative/distributive functions of the budget; and ii) tax expenditures are typically the responsibility of the Minister of Finance …this may impede the trad- offs required by the allocative/distributive function and the control of cost efficiency (p4)." See OECD 2004, 'Best practice guidelines, off budget and tax expenditures.' GOV/PGC/SBO(2004)6 at 4.

[26] Ibid at 13.

[27] Marron & Toder 2011, 'Tax policy and the size of Government,' 104th annual conference on taxation, Louisiana, November 17-19, National Tax Association.

Flexible whole-of-Government budgeting

For some years now, the Budget expenditure review process has been characterised by a line-by-line examination of large and small programs across all portfolios, followed by a more cursory treatment of tax expenditures. Ministers in 'spending' portfolios are usually required to offset any requests for additional outlays with savings from their own portfolio. While these processes may be adequate for purposes of minor fiscal housekeeping they are not well suited to the major restructure of budget expenditures and tax expenditures which is now needed. This is because they impede Budget flexibility since de-facto expenditure caps are imposed on expenditure within each portfolio when a major restructure of spending calls for trade-offs between portfolios.

The Audit should provide guidance for a major restructure of budget priorities and programs. This requires a 'whole-of-government' approach to expenditure revenue which:

- cuts across the divide between expenditure and revenue sides of the Budget;
- takes a longer term approach to fiscal pressures, risks and savings;
- focusses on major programs where change will make a major difference; and
- shifts the emphasis from 'curing' problems to preventing them.

The Commission lacks the time and consultative mechanisms to undertake this task directly. It could either take the form of a one-off review or an ongoing adjustment to the budget review process. If an ongoing 'whole-of-government' approach to budgeting an ongoing adjustment would be too resource-intensive, another option is to use a one-off review to trial new approaches to expenditure planning.

4 A roadmap for fiscal reform

The next six months

Given the need for major changes in the structure of budget expenditures and programs, it is very important that the Commission involve and engage the wider community in its work as far as possible. Therefore, in addition to its call for submissions, we suggest the Commission should:

- Release an early issues paper outlining problems to be resolved and the Commission's purpose and approach to reform;
- Promptly release submissions on its website;
- Prepare both phases of the Commission's report prior to the Budget, so that the Government can make these documents public in enough time for stakeholders to respond within the budget cycle; and
- Commission and publish statistical reports on budget programs and trends, including on expenditure to GDP trends for different direct and tax expenditure programs; and information on who benefits from major programs (including distributional analysis where possible).

Short to medium term actions, over the next three years

We propose the following steps be taken over the next three years to restore the budget to sustainability and meet the community's essential needs:

- As a short-term goal, while the economy is growing at or above trend, restore Australian Government revenues to their pre-GFC level (25.1% of GDP) and keep expenditures below this.
- Remove, reform or replace poorly targeted and wasteful programs on both the direct and tax expenditure sides of the budget, to make room for action to close the worst gaps in the social safety net.
- Use the proceeds of this 'spring cleaning' effort to reduce budget waste to begin to close the major gaps in the social safety net identified above.

Longer term actions

We must not blink on the longer term goals:

- Restore economic growth through improved employment participation and productivity.
- Progressively shift the focus of public expenditures from 'cure' to 'prevention'
- Undertake a national dialogue on community expectations to reach a new consensus on the role of government and how it will be funded.

Appendices: Background information

Appendix 1: Gaps in the social safety net

Improving access to disability services

The lack of adequate, appropriate, affordable and universal services for people with disability that provide individuals with choice over what services best meet their needs as well as who is best suited to provide them has been a major gap in Australia's social infrastructure for some time. As such, the National Disability Insurance Scheme is a landmark social reform. Properly implemented, it is the fairest and most effective way to close long standing gaps in essential service infrastructure for people with a disability, through its provision of certainty of funding based on need, genuine choice over how needs are met (including choice of provider), and a long-term approach to care with incentives to fund cost-effective early intervention.[28]

Better schools for low-income communities

A well-educated population is the key to Australia's economic and social wellbeing now and into the future with Australia's overall productivity benefiting us all. Australia's educational performance has flat-lined over the last decade and declined in some areas. Significant numbers of children and young people, particularly from poor families, are not achieving key educational outcomes and funding is distributed inequitably.

Social security reforms to reduce the most severe poverty and strengthen workforce participation

Increasing the lowest social security payments for single adults is the single most effective way to reduce poverty in Australia. This should be part of a wider reform, to remove the out-dated distinction between 'pension' and 'allowance' payments for people of working age.

Family payments also have a crucial role to pay in protecting children from poverty. When the maximum rate of that is now called Family Tax Benefit Part A was raised substantially in the 1980s this reduced child poverty by around one third.[29] Another key plank in Australian policies to reduce child poverty is the Family Tax Benefit Part B payment for sole parents, which compensates them for the extra costs of raising a child alone. The removal of indexation of Family Tax Benefit Part A to wage movements inevitably means that child poverty will increase in future in the absence of ad hoc real increases in this payment.

More broadly, proper indexation of payments for those with no source of private income is critical to effective action to reduce poverty. If payments are only indexed to price movements (for example the CPI) then the real living standards of recipients will (at best) be frozen. They will not benefit from productivity improvements across the economy. Currently, Allowance and family payments are indexed to the CPI only. While valid concerns were raised in the 2008 Pension Review about the relevance of MTAWE for indexing payments, there is a strong case for indexing all payments to an appropriate measure of wage movements as well as an appropriate measure of price movements. As the UK Office of Budget Responsibility recently acknowledged:
'A similar issue arises on the spending side, where up-rating working-age benefits in line with prices rather than average incomes over the long term would see the value of those benefits shrinking steadily relative to the living standards of the bulk of the population. As in last year's report we therefore assume that working age benefits rise in line with earnings in the long term[30].

[28]Productivity Commission (2011) *Disability Care and Support,* Accessed at http://www.pc.gov.au/projects/inquiry/disability-support/report.
[29]ACOSS 2013, 'Back to Basics'.

[30]United Kingdom Office of Budget Responsibility 2012, Fiscal Sustainability Report, p55.

Employment opportunities for people excluded from the labour market

Australia has the 8th lowest unemployment rate among the OECD countries. Reliance on working-age income support payments fell by one fifth, from a peak of 18% of the working- age population in 1993 to 14% in 2011.[31] However as unemployment has fallen, the profile of those still on income support has become more disadvantaged.[32] People in regional and remote areas are more likely to be unemployed due to a lack of jobs and training opportunities and high travel costs.

Long-term reliance on Newstart and Youth Allowance (over one year) has increased by 75% since the GFC, from 290,000 in May 2008 to 505,000 people in May 2013. Employment services report a growing need for more intensive employment counselling, training, work experience, and sustained work with employers and other services to help get people disadvantaged in the jobs market 'over the line'. As a result of under-resourcing, and an administratively cumbersome contracting and reporting system, for most jobseekers JSA offers a standardised low-intensity service.

In addition to its investment on employment services and supports, Governments can also play a leadership role to bring employers and employment and training providers together, at national, regional and local levels. These forums can work together for mutual benefit – increasing the employment, retention and progression of formerly disadvantaged job seekers to fill skill and labour shortages. A system of *Local Workforce Development Networks* would improve cooperation between employers, employment services, and training organisations at the local level.[33]

Governments can also compensate for the forthcoming decline in mining investment through their own infrastructure investment. According to pre-election commitments, the Coalition will spend over $20 billion in new or upgraded infrastructure projects including $5 billion over the forward estimates.[34] Governments can bring employers to the table when they contract infrastructure spending by requiring a portion of workers are hired from local job seekers and include specific traineeships for disadvantaged job-seekers.

Housing and energy affordability

Housing has become unaffordable to a large number of Australian households but critically unaffordable for low-income households. Twenty one per cent of low-income private renters and 25% of lone parents currently experience housing stress.[35] There is a shortage of 539,000 rental properties that are affordable and available to low income renters.[36] Rental housing that would be affordable to low income households is increasingly occupied by people who could pay more as more people rent both by choice and because of the inaccessibly high price of home ownership. Current housing tax settings contribute to the problem, by encouraging investment in existing housing stock and contributing to house price inflation.

Closing the gaps in living standards between Aboriginal and Torres Strait Islander people and the rest of the community

Despite high levels of spending on services to address disadvantage in Aboriginal and Torres Strait Islander communities, progress towards equality in social and economic outcomes is slow. Top-down approaches to service delivery and contracting for services have resulted in reduced participation of and ownership by Aboriginal and Torres

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[31]Excludes student payments.
[32] Two thirds of the approximately 750,000 people receiving Newstart and Youth Allowances have been on income support for more than a year, one quarter are over 50 years old, two fifths have less than Year 12 qualifications, one in six respectively have a disability, one in eight is caring for a child alone, and one in ten has an Aboriginal or Torres Strait Islander background.
[33] Examples where this local cross-sector work is flourishing include G21, a formal alliance of 300 government, business and community organisations working together to improve the lives of people across five municipalities within the Geelong region.
[34] Hon Joe Hockey and Hon Andrew Robb, "Final Update on Federal Coalition Election Policy Commitments, 5.9.13.
[35]Melbourne Institute of Applied Economic and Social Research (2013) *Families, Incomes and Jobs, Volume 8: A Statistical Report on Waves 1 to 10 of the Household, Income and Labour Dynamics in Australia (HILDA) Survey.*
[36]National Housing Supply Council (2012) Housing Supply and Affordability – Key Indicators, 2012

Strait Islander people of program and service delivery to their communities. This is despite strong evidence supporting the effectiveness of Aboriginal community-led solutions.

Equitable access to mental and oral health services

Health expenditure by Australian governments is growing at an unsustainable rate. Despite this, people in the community still face inequities in their ability to access timely, affordable and high quality health services. Inequitable access to health services is most marked in the areas of mental health and oral health because people's oral health and mental health status effect and are affected by economic and social status. Too often, poor oral health and mental illness go unchecked in our community. Poor oral health is one of the clearest markers of disadvantage, making people uncomfortable to attend job interviews, apply for housing tenancies or engage in relationships.

Appendix 2: Targeting of benefits, services and tax breaks

A targeting framework for Government benefits and services

	Purpose	Target group	Examples
Universal* essential services	Essential services that have broad public benefits	All households	Primary and acute health care, child care and aged care, and public educational institutions
Life cycle income support	Sustain the incomes of low and middle income households at stages of life when they are vulnerable	Older people and families with children in low and middle income households (e.g. bottom 80%)	Age Pension, Family Tax Benefit Part A
Targeted** essential services	Help people participate effectively in the economy and society	People in disadvantaged circumstances	Disability services, social housing
Safety net income support	Poverty prevention	People with low private incomes (e.g. bottom 40%)	Newstart Allowance, Parenting Payment (and elements of Age Pension and family payments)

* Note: 'Universal' refers to essential services where the bulk of the overall cost is funded by Government and access for all is assured through direct service provision or public subsidies. This implies that the subsidies cover all, or almost all, of the cost for those on the lowest incomes and that all households receive some form of subsidy (in some cases such as child care this will be lower for high income earners).
**Note: Targeted refers to elgibility conditions (e.g. servere disability) rather than income, though some services would also be targeted to income.

Major service gaps and programs where savings could be made

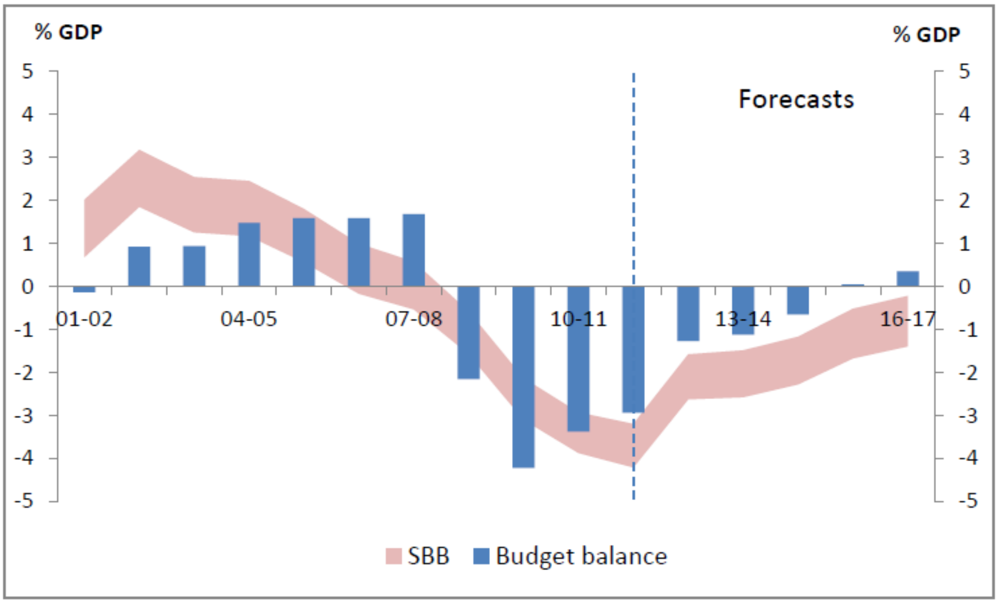
Service gaps	**Poorly targeted programs**	**Where savings should be redirected**
Individually tailored supports for people with severe disabilities	*Programs that disproportionately benefit high income earners*	
Equitable schools funding	Tax breaks for retirement (15% flat taxes for contributions, churning of income through super accounts, Seniors Tax Offset)	Higher contributions tax breaks for low income earners *, health and aged care
Inadequate allowances and family payments for those in poverty	*Programs that are poorly targeted and inflate the cost of services*	
Job opportunities and intensive employment assistance and training	Child Care Rebate	Absorb into a modified Child Care Benefit *
Housing and energy affordability	Extended Medicare Safety Net	Absorb into health care expenditures
Gaps in health, education, employment and living standards in Indigenous communities	*Programs that lack a clear rationale*	
Mental and dental health services	Schoolkids Bonus and Baby Bonus	Absorb into higher Family Tax Benefit payments for low income families
	Private Health Insurance Rebate for ancillary services	Absorb into health care expenditures
	Programs that are poorly targeted and inefficient in meeting their goals	
	Compulsory Income Management (especially NIM in the NT)	Invest savings in case management and community capacity building
	Structural flaws in the income tax system	
	Negative gearing and Capital Gains Tax discounts for passive investment in assets such as housing and shares *	
	The tax benefits associated with discretionary trusts	

*Similar options were proposed by the Henry Review

Appendix 3: Estimates of the structural budget balance, and why it is in deficit

While the Australian Government's underlying cash deficit in 2012-13 is estimated at 1.2% of GDP, estimates for the 'structural deficit' range between 2 and 3% of GDP ($30 to $45 billion).[37] These studies generally show that the structural Budget position started to deteriorate in the early 2000s and continued to do so through the GFC (see graph below).

Structural budget balance compared with underlying cash budget balance



Source: Parliamentary Budget Office 2013, 'Estimates of the structural budget balance of the Australian Government'.

The increase in the structural deficit after the GFC shown above was not due to the previous Government's economic stimulus packages, which ACOSS along with most economic commentators regarded as appropriate and timely. The effect of those measures was excluded from the PBO's analysis.

The above comparison of trends in revenues and expenditures in proportion to GDP suggests that most of the 'damage' to the budget position since 2000 occurred on the revenue side. In its analysis of the deterioration of the structural budget position in that period, the Parliamentary Budget Office identified the eight successive rounds of income tax cuts as a major factor. Personal income tax revenues fell from a peak of 12% of GDP in 1999 (just before the 'GST package') to around 10% in 2007-08, a period of robust economic growth. These revenues were replaced by a surge in company income tax courtesy of the mining boom, but that was only sustained as long as the terms of trade remained at historically high levels.

Tax expenditures, which attract much less scrutiny in the budget process than direct expenditures, have risen well in excess of economic growth over the last decade, from 4.1% of GDP in 2001-02 to 7.6% in 2011-12. The largest tax expenditures, those for superannuation, rose from 2.4% to 4.6% of GDP over this period and are now roughly equal to the annual cost of the age pension.[38]

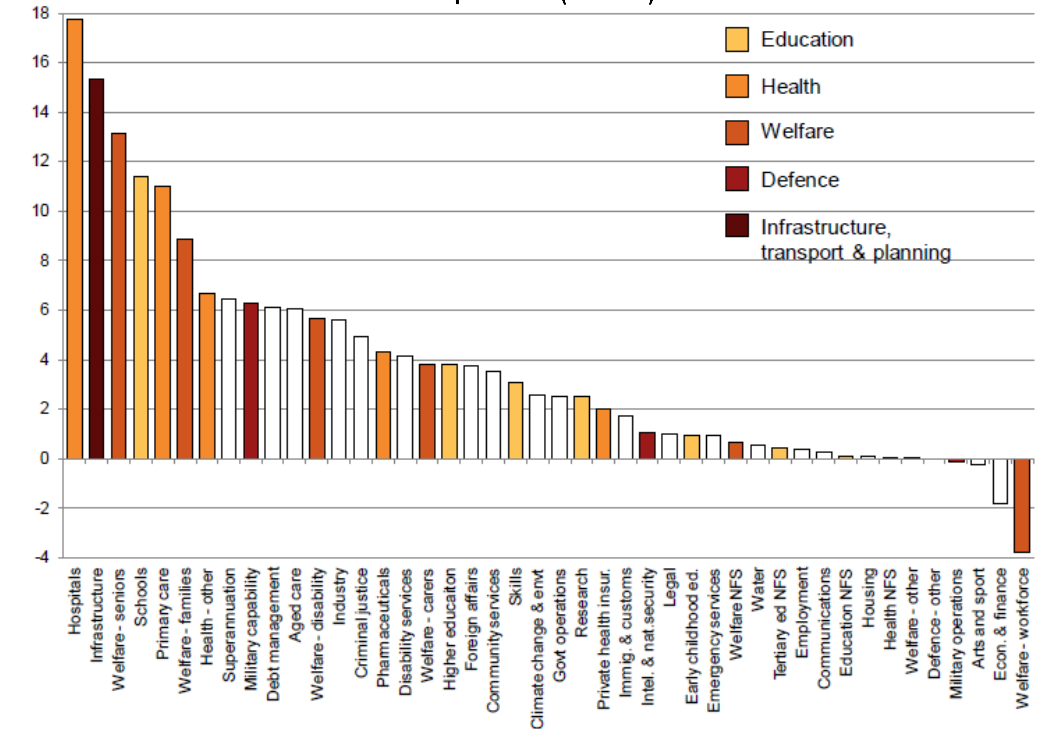
[37]These estimates were produced by the Treasury, Parliamentary Budget Office, IMF, OECD and Deloitte Access Economics.
[38]Treasury, 'Tax Expenditures Statements.'

What really happened to the cost of living over the 00s?

Concern about living cost pressures during this period was mainly based on above-average increases in a few key essentials such as housing and energy bills. Yet, when all expenses are taken into account and compared with average increases in household incomes over the last decade, the living standards of the vast majority of households rose strongly. This is in sharp contrast to the experience in many other wealthy nations, especially the United States, over this period. From 2000 to 2012, average living standards rose by 43% for the top quintile (20%) of households by disposable income, by 34% for the middle quintile, and 29% for the bottom quintile.[39] These average figures mask declines in living standards among some groups on the lowest incomes such as Newstart Allowance, the real value of which fell by 5% over the same period.[40] Nevertheless, the vast majority of people with secure jobs and housing experienced steady improving living standards over that period.

Other drivers of growth in Australian Government expenditures were already entrenched before the boom. Prominent among them was growth in health expenditures, the annual cost of which grew by $42 billion in real terms from 2002 to 2012. [41] This is desirable and to be expected as the country becomes more wealthy, and will rise further as the population ages. However, as discussed in more detail later, health expenditures in their present form are not sustainable. Over the last decade, the strongest growth in federal health expenditure has been in hospitals, where spending rose by $18 billion in real terms (see graph below). Too much of our investment in health care is at the acute care end, and too little is in primary care and preventive health programs. Further, poorly designed direct subsidies to households such as the private health insurance rebate and Extended Medicare Safety Net fuel inflation in health costs, especially the fees charged by specialist doctors.

Real increases in Australian Government expenditure (2002-12)



Source: Daly 2013, 'Budget pressures on Australian Governments,' Grattan Institute

Annual social security and welfare expenditure has also grown strongly, by $28 billion in real terms from 2002 to 2012. This was not due to growth in what are commonly called 'welfare' payments, such as Newstart Allowance for

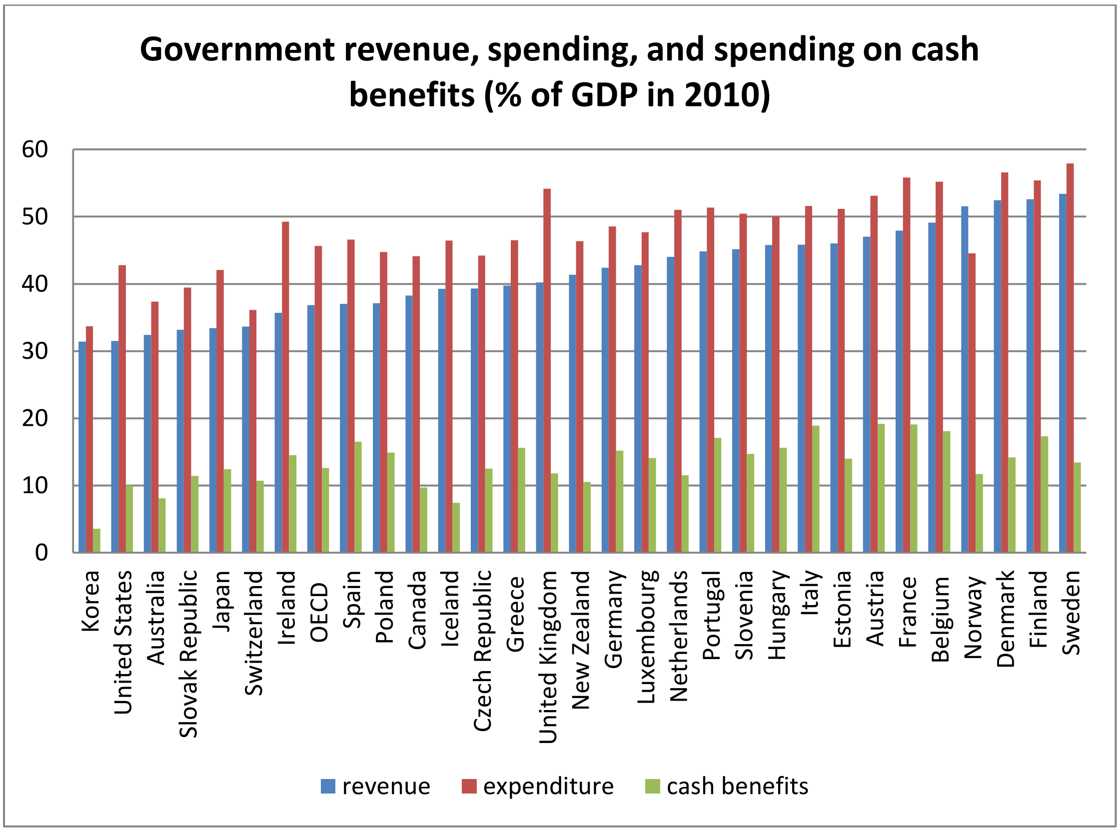
[39]Philips 2013, 'Cost of living and standard of living indexes for Australia,' NATSEM, University of Canberra.
[40]ACOSS 2012, 'Surviving not living,' ACOSS Paper 192; using the ABS 'Analytical Living Cost Index for other Government benefit recipients'.
[41]Daly 2013, 'Budget pressures on Australian Governments,' Grattan Institute.

unemployed people. In fact, expenditure on those payments declined by almost $4 billion in real terms. The largest rise here was a $13 billion real increase in spending on age pensions. This was partly due to an overdue increase in the maximum pension for single people in 2009, but also to an excessively generous liberalisation of the assets test in 2007 which extended access to the pension to couples with over a million dollars in assets aside from their homes.

Expenditure on family payments also rose, by almost $9 billion in real terms from 2002 to 2012. As with age pensions, much of this went to families in need of support. Nevertheless, recently introduced 'bonus' payments including the Schoolkids Bonus and Baby Bonus are poorly targeted and lack a clear rationale.

Appendix 4: Putting our fiscal position into international perspective

Australia has a low taxing, low-spending Governments by international standards. In 2010, the combined expenditures of all levels of Government in Australia were the third lowest in the OECD as a proportion of GDP (at 37%). Public revenues were also the third lowest in the OECD (32% of GDP). The principal reason for low public expenditures in Australia is our system of flat rate, targeted social security payments. (see graph below).[42]

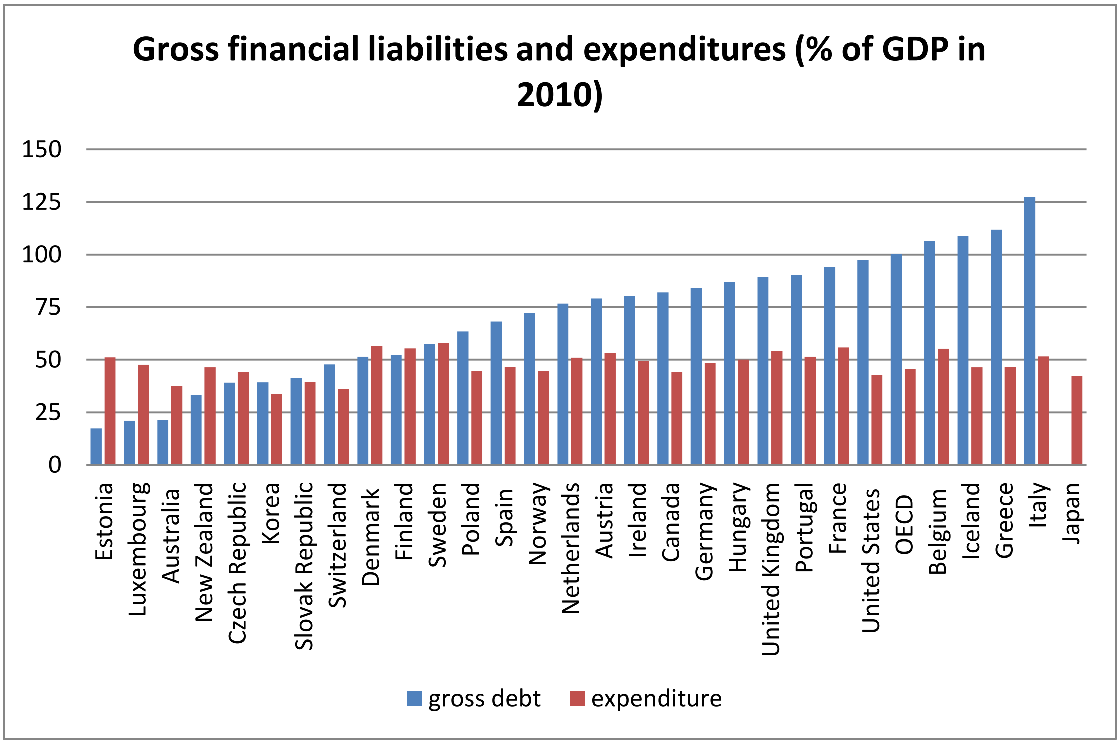


Source: OECD.
Note: All levels of Government; expenditure includes cash benefits; Australia has higher public expenditures than only Korea and Switzerland; and higher public revenues than only Korea and the United States.

To put the Government's budgetary position in context, public debt as a proportion of GDP is very low by OECD standards, at around 22% compared to 100% of GDP for the OECD as a whole (see graph below). It is noteworthy that

[42]There is some debate over whether compulsory superannuation contributions should be included in tax revenues, though they are conventionally excluded as they are privately administered and not shared with other fund members. Including them would not substantially alter our revenue 'ranking'.

there is no consistent relationship between public debt levels and annual expenditures. For example, some the countries with the highest debt levels (United States and Japan) have among the lowest annual expenditure levels.



Source: OECD.
Note: All levels of Government; Australia has a higher public debt to GDP ratio than only Estonia and Luxembourg. Japan (at 200% of GDP, not shown here) and the United States (at 98%) have among the highest debt to GDP ratios and among the lowest public expenditure levels.

Appendix 5: The 'size of Government' and economic growth.

The effect of the size of public revenues and expenditures on long term productivity and economic growth has been vigorously debated for many years. In studies exploring this relationship, 'size of Government' is usually proxied by public revenues (or tax revenues) or public expenditures as a proportion of GDP. Early studies suggested that there was an optimal size for Government, above which future economic growth would be constrained.[43] A number of subsequent empirical studies of the public revenues and expenditures and economic growth have found that higher revenues and expenditures are associated with slower long-term growth in wealthy countries.[44]

However, it does not follow from a simple association between Government size and economic growth that one 'causes' the other. There are three problems with this apparently 'simple' story.

1. The character of public spending and taxes may be as important as its 'size'. Studies have found that pubic investment in physical infrastructure and human capital development (education) are positively associated with economic growth. Much of what is usually classified as 'social expenditure' promotes employment participation and productivity. More broadly, the efficiency of the public sector matters.[45]
2. Whether or not the size of Government has an impact on economic growth, other policies may have a countervailing effect. While long term economic growth rates have been stronger in recent decades in the Anglo-Saxon countries (which have below average tax levels) than in continental Europe (with above average

[43]For example, Barro 1990, 'Government spending in simple model of endogenous growth', Journal of Political Economy Vol 98, No5.
[44]Bassanini and Scarpetta 2001, 'The driving forces of economic growth', OECD Economic Studies No 33.
[45]Angelopoulos et al 2008, Does public sector efficiency matter? Revisiting the relation between fiscal size and economic growth in the world sample, Public Choice, Springer, vol. 137(1), pages 245-278, October.

tax levels), the Nordic countries have both high tax levels and high long term economic growth rates (see table below). One suggested explanation is that the economic openness of the Nordic countries more than compensates for their relatively high tax and expenditure levels[46].

Tax levels and growth in three types of welfare system

Country group	Tax to GDP ratio (%)	Average annual GDP growth (95-04, %)
Nordic	45.7	2.5
Continental	38.8	1.5
Anglo-saxon	31.6	2.3

Bergh & Henriksen, 2011, 'Government Size and Growth: A Survey and Interpretation of the Evidence', Research Institute of Industrial Economics, IFN Working Paper No. 858, 2011 Stockholm.

3. Causation may be in the opposite direction. For example, slower long term growth rates in many continental European countries may be associated with higher unemployment rates (which increase the cost of unemployment benefits) or older populations (which increase the cost of pensions and health care services).
4. In any event, Australia, which is the third lowest spending country in the OECD, and has a relatively cost efficient social security system and human services, has considerable room to move before higher public revenues and expenditures put a brake on economic growth.

[46] Bergh & Henriksen, 2011, 'Government Size and Growth: A Survey and Interpretation of the Evidence', Research Institute of Industrial Economics, IFN Working Paper No. 858, 2011 Stockholm.