

Why Labor Really Worries About Coalition Cuts

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The Federal Government's dire financial situation is the truth that can't be named this election. Why? Because neither party is prepared to do what must be done, writes Ian McAuley.

In the Kivila language of Papua New Guinea the word "Mokita" is best translated as "the truth everyone knows but is unwilling to tell". In the election campaign our Mokita is the structural deficit – the budget deficit that would occur if the economy were growing at its long-term average rate – which results from the inadequacy of our taxation base.

Earlier this year the Grattan Institute, while finding that so far Australia has not had a significant debt or deficit problem (contrary to the propaganda of the Coalition and the Murdoch press), also found that on present trends we face an ongoing deficit – a structural deficit – of 4 per cent of GDP.

That's \$60 billion a year – a figure that dwarfs Treasury's projected short-term deficit of \$30 billion over four years and Penny Wong's \$70 billion black hole in the Coalition's costings, also over four years (around \$18 billion a year). Our obsession with four year forward estimates has pushed aside longer-term fiscal considerations. To close that structural gap we need either to raise taxes or to cut spending.

Even though taxes have fallen sharply and show no sign of recovery to pre-GFC levels, neither Tony Abbott nor Kevin Rudd is talking about increasing taxes. For a little while Abbott held open the possibility of an increase in the GST, but when Rudd made it a campaign issue that door was closed. Rudd has also promised stability in superannuation tax arrangements, shutting off the possibility of reversing the huge revenue leakages through granting "self-funded" retirees tax exemption on their first \$100,000 of income.

Abbott has gone further, promising to cut company tax (except for large corporations), and to abolish the mining and carbon taxes. At the same time he is promising subsidies to the finance sector (the private health insurers and the salary packaging industry) an absurdly generous (and easily portable) parental leave scheme and \$17 billion for roads. That \$17 billion, because of our accounting standards, would show up as net Commonwealth debt, so would have to be met with savings if an Abbott government were to keep to its balanced budget target.

That means, if politicians are to keep their promises, there will be sharp reductions in government spending whoever wins office, and that those reductions would be significantly higher under a Coalition government because it is proposing big reductions in taxes.

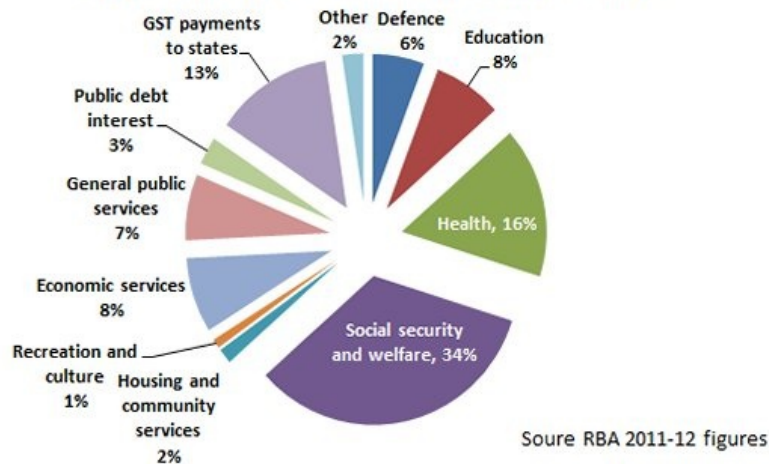
Those reductions in spending would be from a low base: at 36 per cent of GDP (all levels of government) our public spending is already the third lowest of the 31 OECD countries. For example, our public spending is lower even than America's, which is around the OECD average of 40 per cent, and is much lower than the economically successful countries of Northern Europe, where public spending is between 45 and 55 percent of GDP.

So what would be the consequences of lowering public expenditure even further? Let's start by looking at how the Commonwealth presently spends money – shown in the chart over the page.

The biggest item is "social security and welfare". Abbott has clearly indicated that he would increase welfare spending. Contrary to some "left" views, conservative governments do not cut welfare transfers: in fact they generally have to increase them because their policies result in more inequality, which has to be rectified with increased welfare. In Australia both Howard and Abbott, against the traditions of their party, had no qualms about nurturing a culture of entitlement. No government is going to reduce GST payments to the states, and as many independent analysts point out, defence spending, which has been cut in recent years, is likely to be restored in the near future.

Those commitments, comprising more than half the budget, mean spending reductions would have to be borne by other programs, and of these health and education, comprising 24 per cent of expenditure, are the big candidates, lending credibility to Labor's claim that under an Abbott government there would be savage cuts to spending in these areas. Under an Abbott Government we would also expect deep cuts in a host of smaller programs on the left side of the pie chart, such as the CSIRO, the Bureau of Meteorology and the ABC.

Composition of Commonwealth Outlays



Calling on our general dislike of seeing our taxes being spent on bureaucracy, Abbott makes much of cutting the public service, but even if he were to eliminate 10 per cent of Australia's 170,000 workers on the Commonwealth payroll, the savings would go little way to eliminating an annual \$60 billion annual structural deficit. Such staff reductions may save up to \$1.4 billion a year, and that's a high estimate because inevitably some of the work presently done by public servants would be done by more highly paid private sector workers on contract to government.

Could we get by with such reductions in public expenditure? Obviously yes, but at great cost. The Commonwealth could reduce spending on public education, but the costs in long term productivity and equity would be severe – I trust New Matilda readers need no convincing of the need to sustain and increase the resources we are putting into education.

There could be cuts in public spending on health care, allowing private insurance to take a greater role, but this would be expensive and inequitable. For every \$1.00 we were to save in taxation, we would be paying at least \$1.10 to private insurers, and that's just to cover the extra administrative overheads of private insurance. The longer-term costs would be even greater, as private insurers become easy conduits for hospitals, specialists and pharmaceutical companies to pass inflated charges through to consumers. Some may consider those taxes we pay through the Australian Taxation Office to be burdensome, but it's much more equitable and efficient to have governments collect our taxes than to hand the taxation task to private agencies. To the extent we choose to share our health care costs with one another, it's best that we use the system we have used for such sharing – our official tax system. The argument that we cannot afford Medicare is bunkum: shifting costs off-budget to more expensive methods is a net cost to the community, not a saving.

The Government could call on the private sector to fund more of our infrastructure; in fact that is happening already. But that is generally an expensive and inefficient way of funding such projects. For example, a toll road in the middle of a "free" road system results in a valuable asset being under-utilised (what economists call "deadweight loss") and, in any event, the use of private funding for such projects, while saving on public debt, replaces that public debt with more expensive private debt. We still have to pay for the road.

The Commonwealth could continue to starve the states of funds, but one consequence is that they turn to expensive and inequitable ways to support their revenue base. Stamp duties on house sales discourage labour mobility and fall heavily on those who have unstable employment. Car registration and driver's licence fees are akin to poll taxes, and, as fixed charges, do nothing to help the environment through discouraging vehicle use. Gambling taxes are paid disproportionately by the poor. And so on.

Chris Richardson, of Deloitte Access Economics has said that "our standard of living is at risk if Tony Abbott and Kevin Rudd continue to ignore 'root-and-branch' tax reform". Ross Gittins warns that "both sides' belief that government debt is evil condemns us to a life of inadequate public infrastructure". Richardson and Gittins have broken the code of silence, but our politicians haven't.

It is easy to heap blame on both mainstream parties, but the reality is that the "right" has been mounting a sustained attack on the public sector for at least the last thirty years. As Noam Chomsky points out, we have been encouraged to hate government, and to see taxation not as payments we make to bring some decency to society and to fund public goods, but as a form of theft to be resisted.

The Coalition, in holding back its costings, is using an established tactic to deceive pre-poll voters. But its greater deceit is about its longer-term fiscal plans. Labor in its warning about the Coalition's \$70 billion "black hole" is on the right track, but that's only a small part of the story – a gap of \$18 billion a year is a long way short of \$60 billion a year.

Presumably the only reason Labor is not talking about the full extent of the cuts that would occur under an Abbott-led Coalition is that to raise the issue, they would have to show how we need tax increases to sustain an economically responsible level of public services – the truth we know but dare not utter.