Australian government revenue slides, but our spending rages on

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The Australian Government faces a crisis of their (and past governments') own making. Ian McAuley explains.

"Throw this mob out", or something similarly strident, would have been the headline from the Murdoch media had a Labor Government presided over the fiscal blow-out revealed in yesterday's Mid-Year Economic and Fiscal Outlook (MYEFO).

Just since the May budget, the estimated deficit for this year and the next three years has blown out by $26 billion. The cash deficit this year will be $37 billion, or 2.3 per cent of GDP.

It would be unreasonable, however, to blame the newly-minted Turnbull Government for this outcome. They have been in the job for only three months, and have made less than $1 billion worth of spending decisions affecting this year's budget.

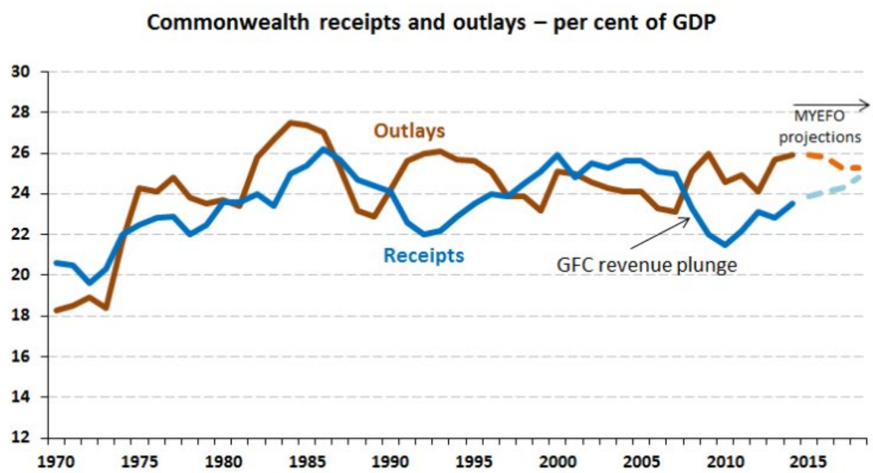
Our ongoing fiscal problems have their roots in decisions made by earlier governments, Labor and Coalition.

Of course the collapse in commodity prices, particularly iron ore, is the main excuse the government uses for this year's poor revenue outcome. But that begs the further question: how did we allow our economy to become so dependent on mining and the fortunes of one country, China, going through an unsustainable growth spurt?

In simple terms, we have squandered the proceeds of our recent boom, spending public revenue windfalls on tax cuts and family welfare payments, rather than on investments that would strengthen and diversify our economy – investments in education, surface transport, communications infrastructure and industry re-structuring in preparation for a decarbonised future.

To its credit the Rudd-Gillard Government made some steps in the right direction, including a carbon tax, but they too continued with the Howard tradition of tax cuts, and their program was seriously thrown off-course by the global financial crisis when Commonwealth revenue, as a percentage of GDP, plunged to its lowest level for 35 years.

Ever since then, the main stress on the Commonwealth budget has been on the revenue side. The graph below shows the Commonwealth's revenue and spending going back to 1970. The plunge that accompanied the GFC, and the stimulus measures taken by the Rudd-Gillard Government, are clearly shown.



The future convergence of the revenue and spending dotted lines should be seen more as statements of pious hope rather than a reflection of any firm fiscal policy (one reason receipts are forecast to rise as a percentage of GDP is that the MYEFO estimates that GDP growth in 2016-17 and subsequent years will be a half of one percent lower than was forecast in the May Budget.)

Treasurer Scott Morrison and Finance Minister Mathias Cormann stand almost alone in their refusal to acknowledge our revenue problem, so committed are they to the idea that we have a spending problem. Rather, they blame the Senate for not passing the measures proposed in Hockey's 2014 Budget – cuts in higher education, freezing of age pensions, and tightening eligibility for Newstart to name a few.

The point Morrison and Cormann miss is that at 26 per cent of GDP, which they consider as high, Commonwealth spending is actually low by the standards of other developed countries – and as for talk about "record" spending, people making such claims should look at the figures in the MYEFO from which the above graph is constructed.

To the Commonwealth's 26 per cent must be added around another 9 per cent of GDP accounted for by state and local government spending, bringing our total public sector spending up to about 35 per cent of GDP.

But this is still low in comparison with other prosperous, developed countries. As Miriam Lyons and I point out in our work [Governomics: can we afford small government?](#) the OECD average for public sector spending is 41 per cent of GDP, and in prosperous northern European countries, with successful economies and living standards comparable to Australia's, public spending is between 45 and 55 per cent of GDP.

We can muddle through with "small government", using tricky and costly private mechanisms such as road tolls and private health insurance to do what is done so much better with public funding, and we can cut public spending on health, education and research, deferring the costs to future generations: the false economy of "small government" takes some time to reveal itself.

Eventually, however, a country with "small government" becomes a country with an emaciated state, where kids are left uneducated and idle or in dead-end jobs, where the streets belong to criminals and beggars, where the parks are infested with weeds, where the roads are congested and potholed, and where diseases of the third world take hold. That is not a pleasant place to live, even for the well-off who retreat in fear to their gated communities.

Or we can face up to the fact that we need to collect more revenue, and that means fewer perks and more taxes.

A place to start on perks is on superannuation tax concessions, forecast to cost the budget $170 billion over the next four years. (Note to readers, that is not an error or an omitted decimal point.) Then there are the $11 billion annual subsidies for private health insurance, revenue forgone through a 50 per cent concession for short-term capital gains (while relatively penalising long-term investment), and a permissive attitude to tax avoidance through family trusts.

If Turnbull is serious about putting everything on the tax table, then a carbon tax is an obvious candidate: had the carbon tax been retained it would now be raising at least another $6 billion a year.

A higher GST and a higher Medicare levy should not be ruled out, provided these taxes go to funding the states for health and education services, rather than funding corporate or individual tax cuts. We have plenty of scope to raise fuel taxes, or better, to develop road user charging. And of course, with wealth disparities continuing to widen, inheritance taxes should be under consideration.

And if Labor is serious about aspiring to government, it should show political leadership and share the message conveyed in the MYEFO: we must restore our public revenue.