How To End The Deficit Without Screwing the Poor

19 May 2014

The Abbott Government's first budget has forced the poorest Australians to do the heaviest lifting. As a low-taxing nation there are plenty of other places we should be looking for revenue, writes Ian McAuley

Mark Twain said that reports of his death were greatly exaggerated. So too, for New Matilda.

Ben Eltham and John Quiggin have exposed the hypocrisy, contradictions and plain bad economics of the budget. More will emerge in coming weeks as people trawl through the fine print.

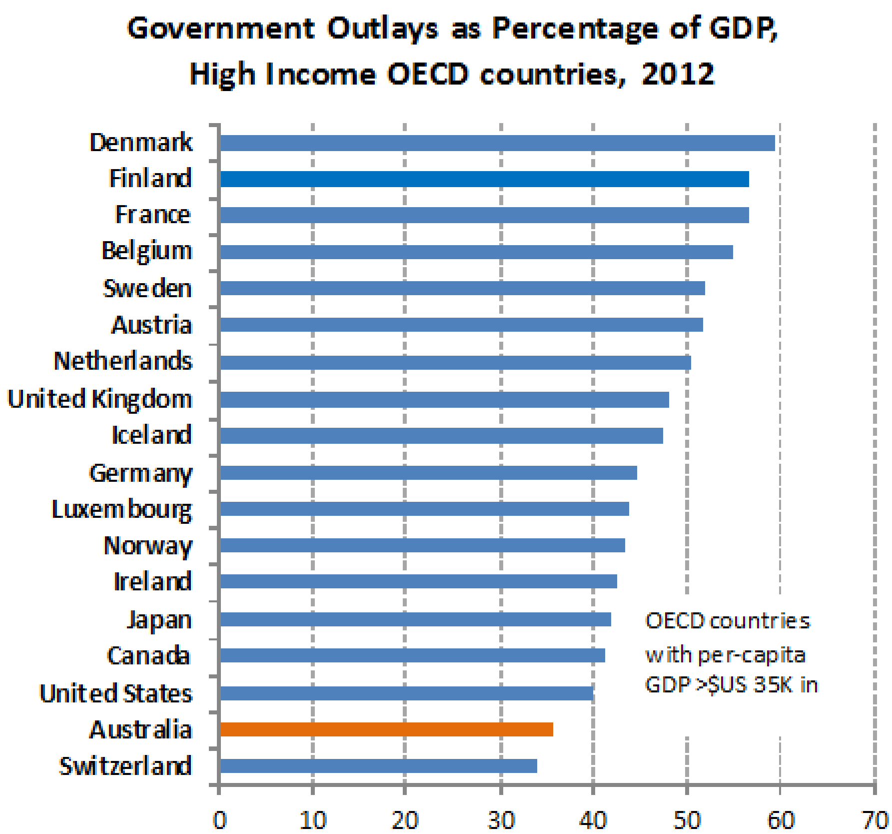
Anyone who is not addicted to 2GB and the Murdoch media knows there is no budget "emergency" or fiscal "mess", the Rudd-Gillard Government wasn't on a reckless spending binge, and Australia doesn't have a public debt problem. But they may not know the Government's real economic agenda, buried within the long-winded Budget Strategy and Output Paper, which states the Government's objective to:

> "...reduce the Government's share of the economy over time in order to free up resources for private investment".

That objective may be understandable if we were up there with the big spenders, like Greece and Italy, where public spending has topped 50 per cent of GDP on weak tax bases. But the reality is that out of the world's prosperous and developed countries, only Switzerland, a country with highly decentralised government and a unique public accounting system, has a smaller public sector than ours.

Even the Americans, with their mean social security system and crumbling roads have a bigger public sector than Australia.

At 35.6 per cent of GDP (all levels of government) Australia's public sector is a dwarf. The OECD average size of government is 40.4 per cent of GDP, and successful northern European countries, such as Germany, Netherlands and the Nordic countries all have public sectors above 43.0 per cent of GDP. See the graph below:



In short, Australia is already out of step, and our government wants us to get even further out of step.

Even if the public, conditioned by years of propaganda, believe Australia is a high-tax/big-spending country, state premiers, facing the Commonwealth's plan to slash $80 billion from health and education, are well aware that we have a revenue problem, not a spending problem.

There is an optimum public/private structure of an economy. We are constantly hectored about the cost of "big" government, but on the other side there is a cost of "small" government. And Australia is almost certainly on that side. We need to shift towards the optimum, not away from it.

What would it take then, to strengthen our public sector? Would a rise in GST be enough? Could we get there through cutting tax concessions for the wealthy?

Let's go through some arithmetic. Each one per cent of GDP equates to about $16 billion. So, if we were to have the modest objective of bringing our public sector up to the OECD average, we would need another $60 billion a year of public revenue. What could be the sources?

Superannuation tax concessions

These are an inequitable rort, but even if all were to be abolished at most they would bring in another $36 billion a year, and that's making the heroic assumptions that the rich wouldn't find other ways to avoid tax, and that there would be no long-term effect on the budget for pensions. It's an area needing reform, but it can go only part way.

GST coverage

Concessions, such as exemptions for fresh food, education, and health care, cost around $18 billion a year. There are some inequities in these arrangements. For example, the well-off eat more fresh food than the poor, and exempting school fees disproportionately favours those using private schools.

GST rate

At 10 per cent the GST raises around $54 billion a year. Lifting it to 15 per cent could raise another $25 billion. A rise in its rate would have to be accompanied by widening of its base, otherwise the distortions between taxable and non-taxable items would be too high.

Many people correctly point out that consumption taxes are regressive, but if all of the increase were to be spent on health and education (without any withdrawal of funding from other sources), the net effect would be quite progressive, as these services are the most important aspect of the social wage.

State governments, whatever their political colour, are more accountable for service delivery than the Commonwealth. They don't waste money on private health insurance or Joint Strike Fighters.

Also, the GST is hard to avoid or evade — even wealthy "self-funded" retirees have to pay it.

Out of those countries referred to in Figure 1, Australia has one of the lowest rates of consumption taxes. The Nordic countries, in spite of their high consumption taxes, achieve very progressive income distribution.

Transport fuels

The Government's move to restore indexation on fuel excise is half-hearted. Restoring full indexation (i.e. bringing excise up to its 2001 level) would bring in another $5 billion a year. That would be real "new" money for roads and public transport, and not just a re-shuffling of capital funding.

Even better would be comprehensive road-user charging, which could build in price signals for congestion and pollution, and could be structured so as to be fair on those who have no option but to use motor vehicles.

Income tax

The Government's "Budget Repair Levy", a two per cent extra tax on incomes above $180,000, will raise less than $1 billion a year. This is mere tokenism, and most of those on such incomes will find ways to avoid its impact through trusts and superannuation.

Closing trust and fringe benefits loopholes, and restoring full (and indexed) capital gains tax, would be far better than simply lifting rates.

Wealth taxes

These should be in the mix, including inheritance taxes. They are, however, hard to collect.

Carbon taxes and resource rent taxes

These are good taxes, in that they help account for long-run costs and bring some stability to public revenue. The Government's abandonment of these taxes is irresponsible. But they should not be relied on for long-term revenue.

As with tobacco taxes, the ideal world is one in which revenue from these taxes falls away.

There is no one source of revenue which can do the heavy lifting to repair our weakened public sector. The risk we face is that even if Australians come to realise that we have to collect more revenue, everyone will try to say that the job is someone else's.

The gauche way in which the Commonwealth has raised awareness, with a Commission of Audit suggestion that states engage in a race to the bottom to cut taxes, and a Budget which simply cuts funding, thereby goading premiers into making the first move, is hardly the right way to go about raising the issue.

But then, perhaps there is method in their approach.

If we take them at their word, as articulated above, perhaps they do want to take us way down the "small government" path, to a future of "private affluence" (for a few) contrasting with "public squalor", to use JK Galbraith's words.