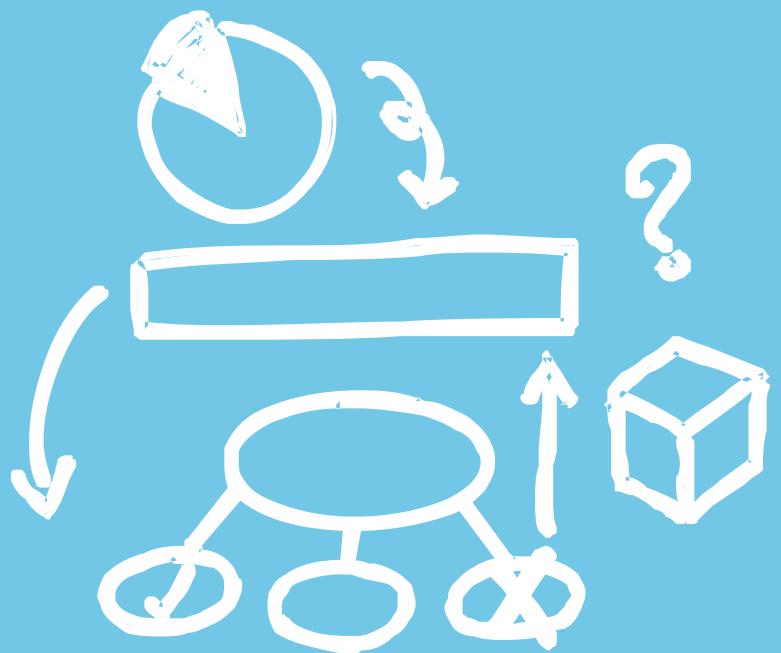


# Rebuilding Foundations for Reform: *Why is the Budget so hard to fix?*

Chris Richardson  
5 November 2015



# Which conversation are you having?

Australians are having three Budget conversations all at once

There are three Budget conversations underway:

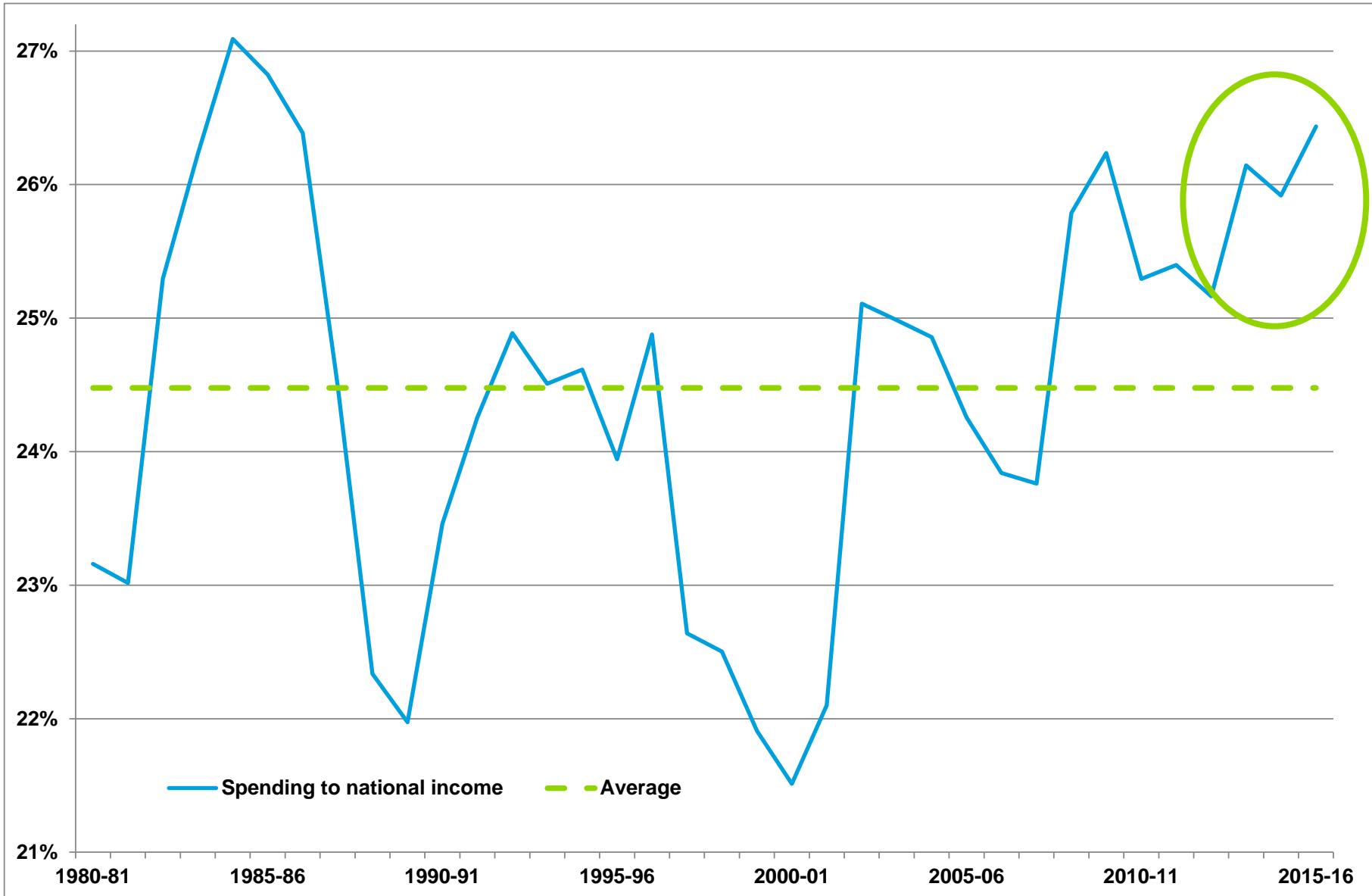
1. What to do about Budget repair,
2. What to do about tax reform and (related to these first two)
3. Whether Australia's social compact is swinging in favour of bigger government.

The first topic is about sustainability, the second is mostly about prosperity, and the third is about society's choices.

But people get these three debates confused together, making difficult decisions even harder. Yet debate and decisions are exactly what Australia needs, because the de facto alternative is one in which the Senate accepts the proposals before it that lift spending while rejecting most cuts – so we're drifting towards bigger government without consciously making that decision.

# With the full cost of the NDIS to come

Federal spending now 26% of national income (vs average of 24.5%)



# Is our social compact changing?

## Is the upward drift in spending a deliberate decision?

There is a respectable case that our social compact is changing:

1. A rich nation such as Australia should have disability insurance.
2. And the electorate demands more of government as incomes rise over time – that is, the demand for ‘government’ is income elastic, and so it grows faster than incomes themselves grow.
3. If that is true, then you can expect national social compacts to gradually increase in size relative to their economies.

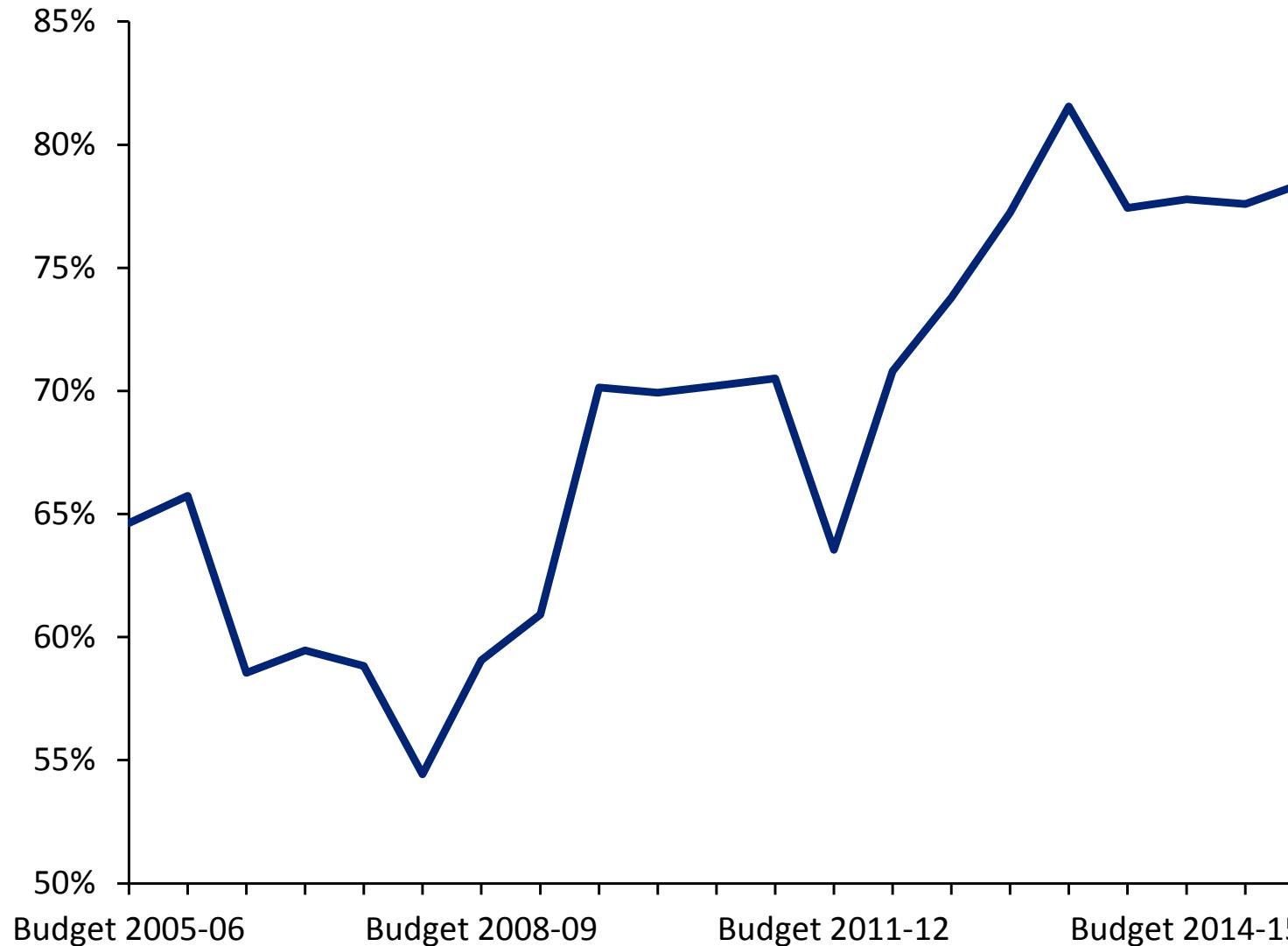
If our social compact really is changing towards demanding that governments do more than they used to, then we need to be thinking more about raising taxes, and less about cutting spending.

That's not a view that Deloitte Access Economics holds. But some people do. Just don't let that view get mixed up with two other discussions: tax reform and Budget repair.

Either way, there's a risk the current trajectory of the Budget means a de facto change in the national social compact is already underway: as Glenn Stevens of the RBA notes, Australians have voted for extra spending, but they haven't yet voted for the extra taxes to pay for that.

# Policy has favoured spending

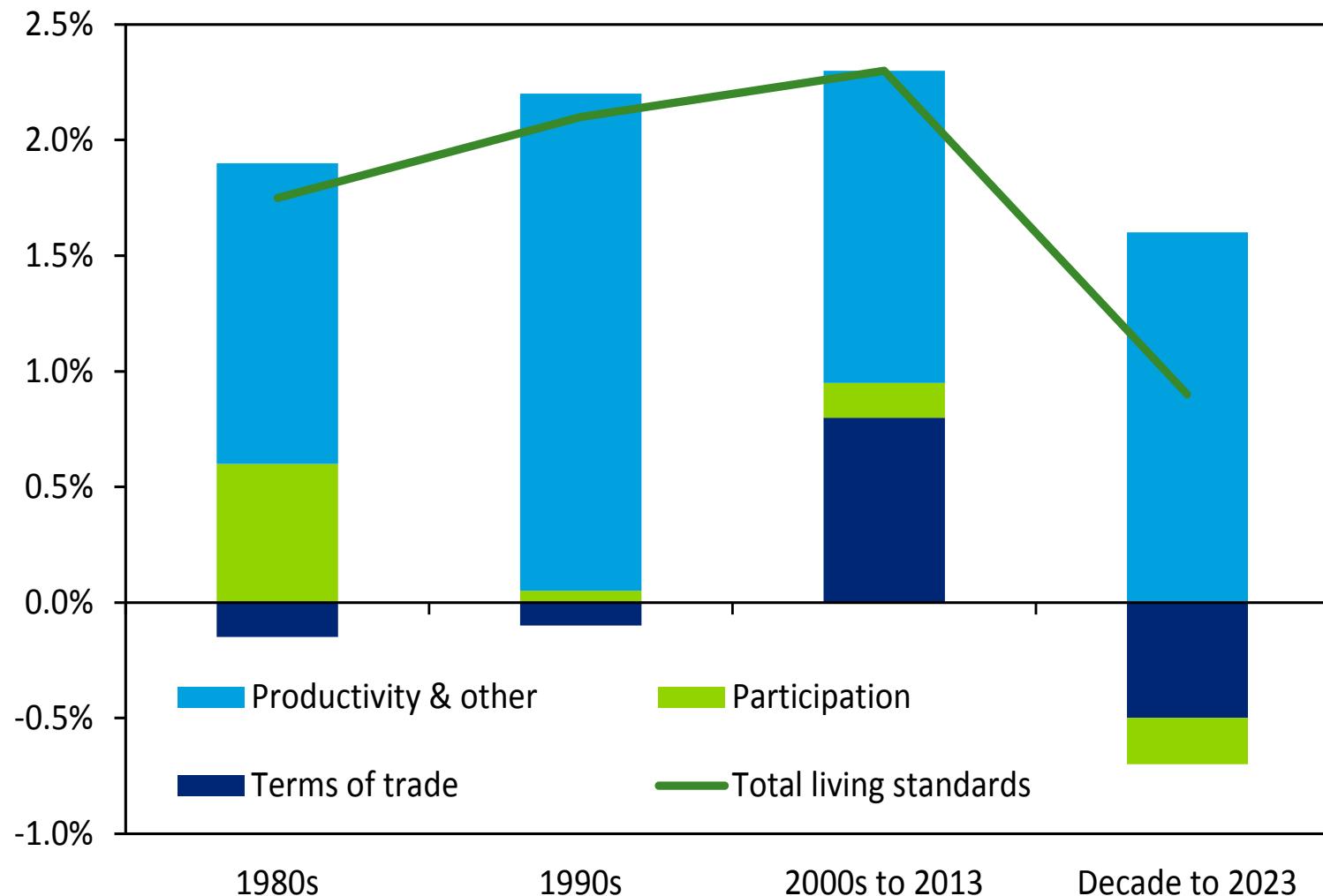
Share of policy costs: Spending increases as % total policy costs



# The WHY of tax reform

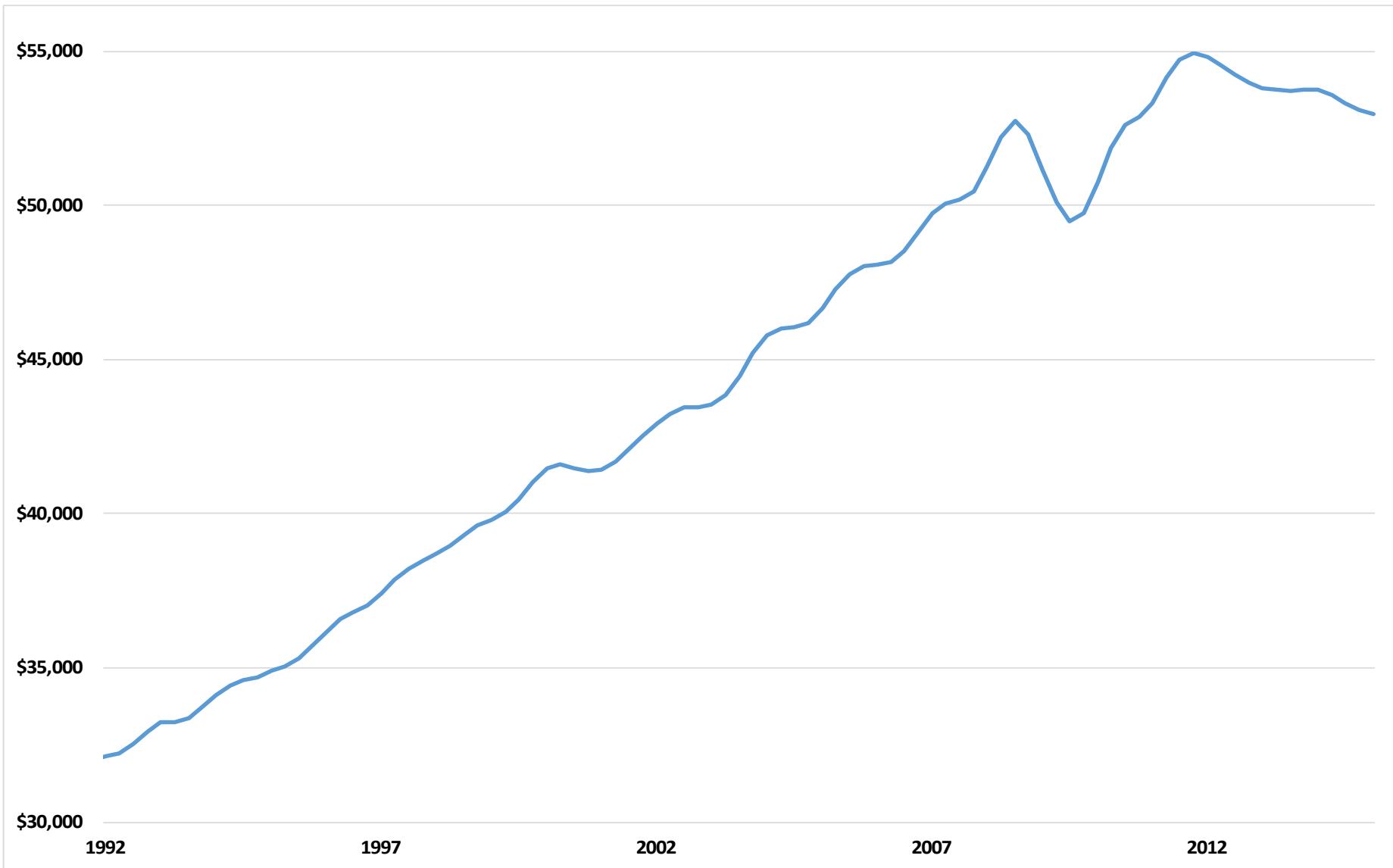
Living standards depend on productivity growth

Contribution to annual income growth



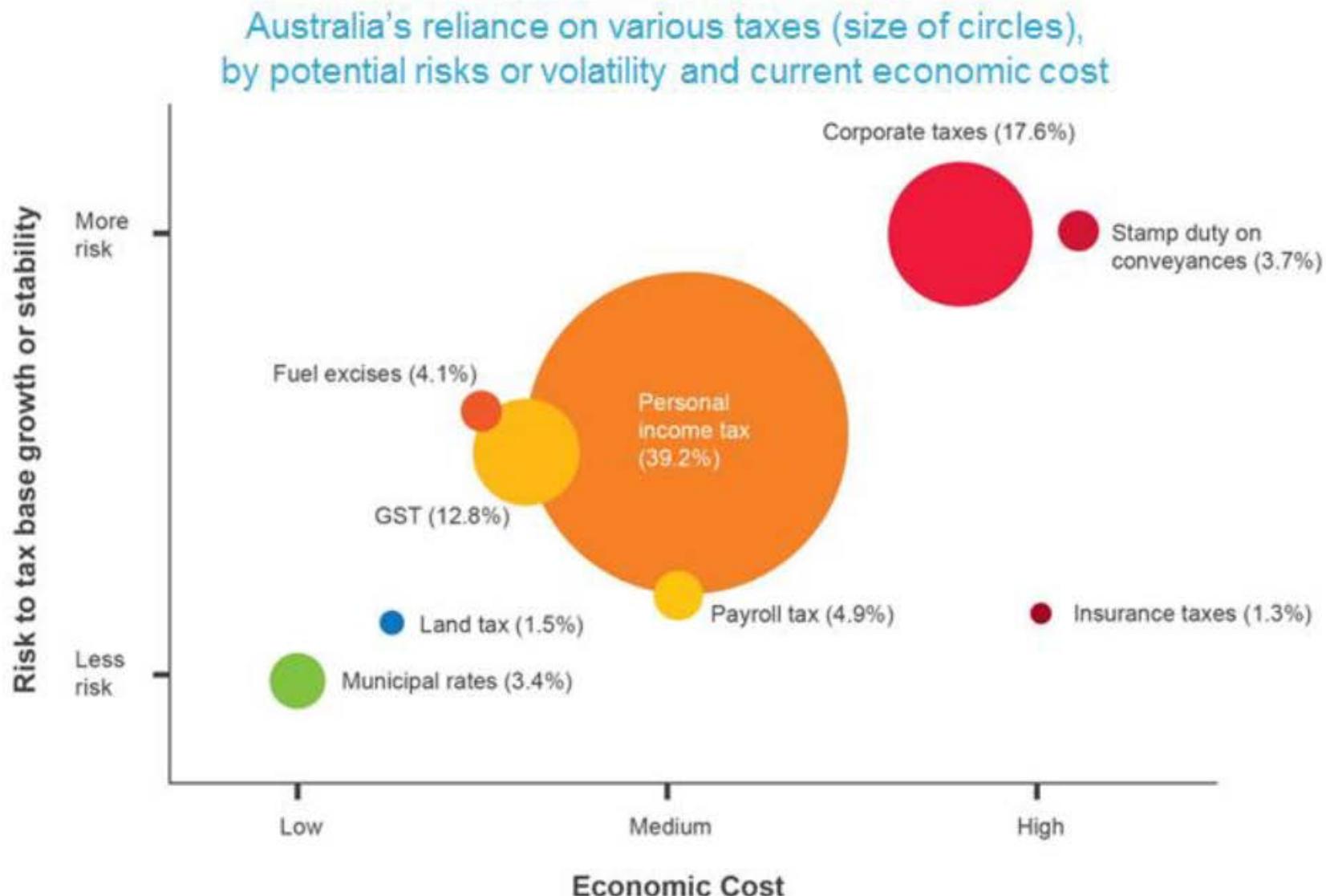
# The WHY of tax reform – 2

Recent real net national disposable income per head trend is down



# The HOW of tax reform

Shift from ‘bad’ to ‘good’ taxes (raise on the left, cut on the right)



# Tax reform is mostly about prosperity

But fairness needs a look in too

Tax reform can boost living standards if we rely less on taxes that hurt the economy the most.

How much prosperity is at stake? The maths is pretty simple. The extent to which tax reform makes Australians better off comes down to:

The dollars shifted from ‘bad taxes’ to ‘good taxes’,  
*multiplied by*

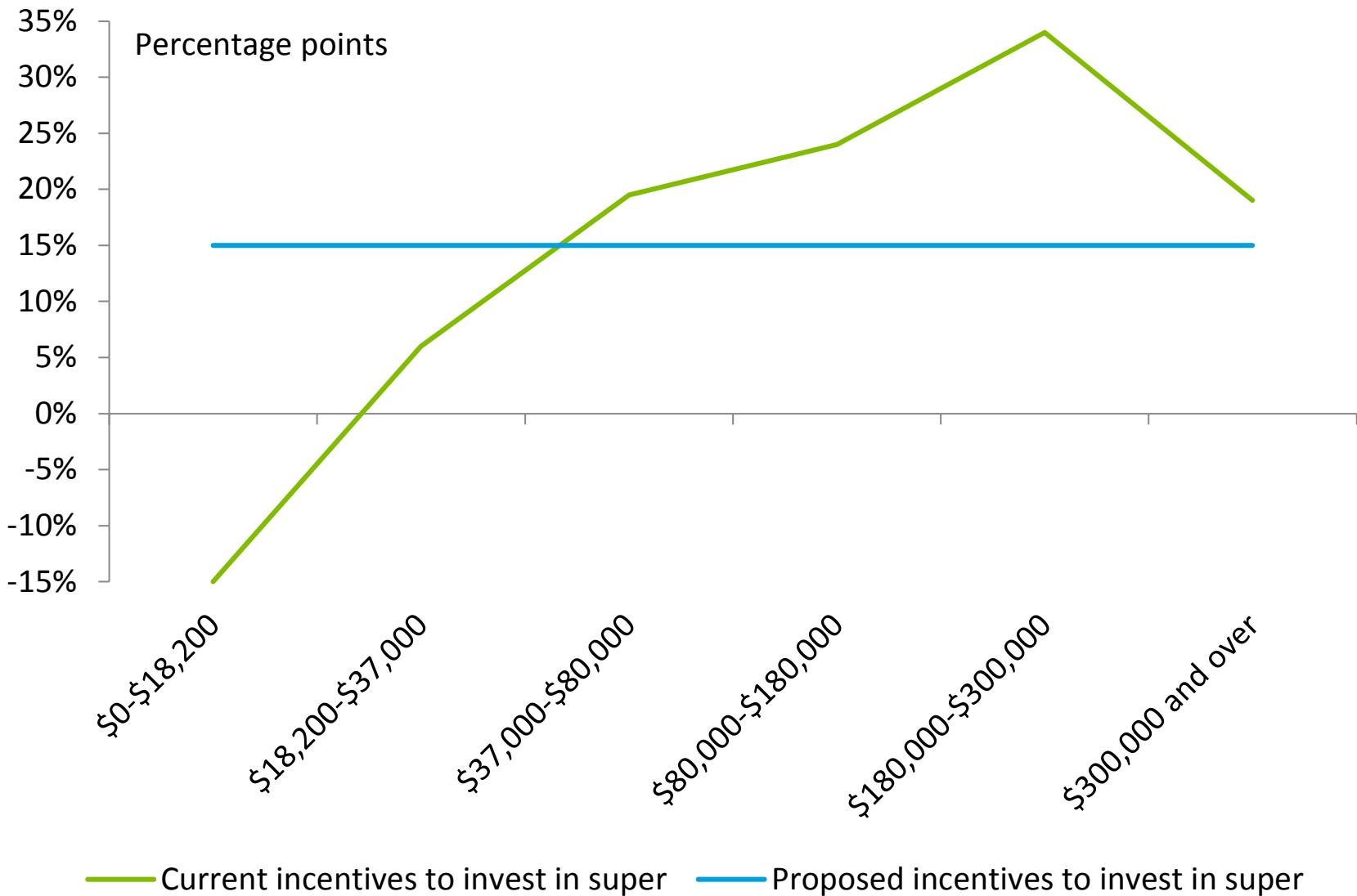
The gap in economic costs between ‘good’ and ‘bad’ taxes.

Bad taxes include State stamp duties on business and residential conveyancing, insurance taxes and royalties, as well as Federal company tax.

Good taxes include taxes such as the GST or broadly-based land taxes.

# For fairness, super is the standout

Give everyone the same tax benefit from putting a dollar into super



# Which brings us back to Budget repair

## It is hard for several reasons

Some think that Australia's social compact has shifted in favour of more spending – so they see Budget repair solely in terms of raising extra revenue (with more to come, given NDIS / health spending pressures).

Some favour smaller government – so they want not merely to undo years of rising spending, but to have additional cuts to spending that finance tax cuts as well.

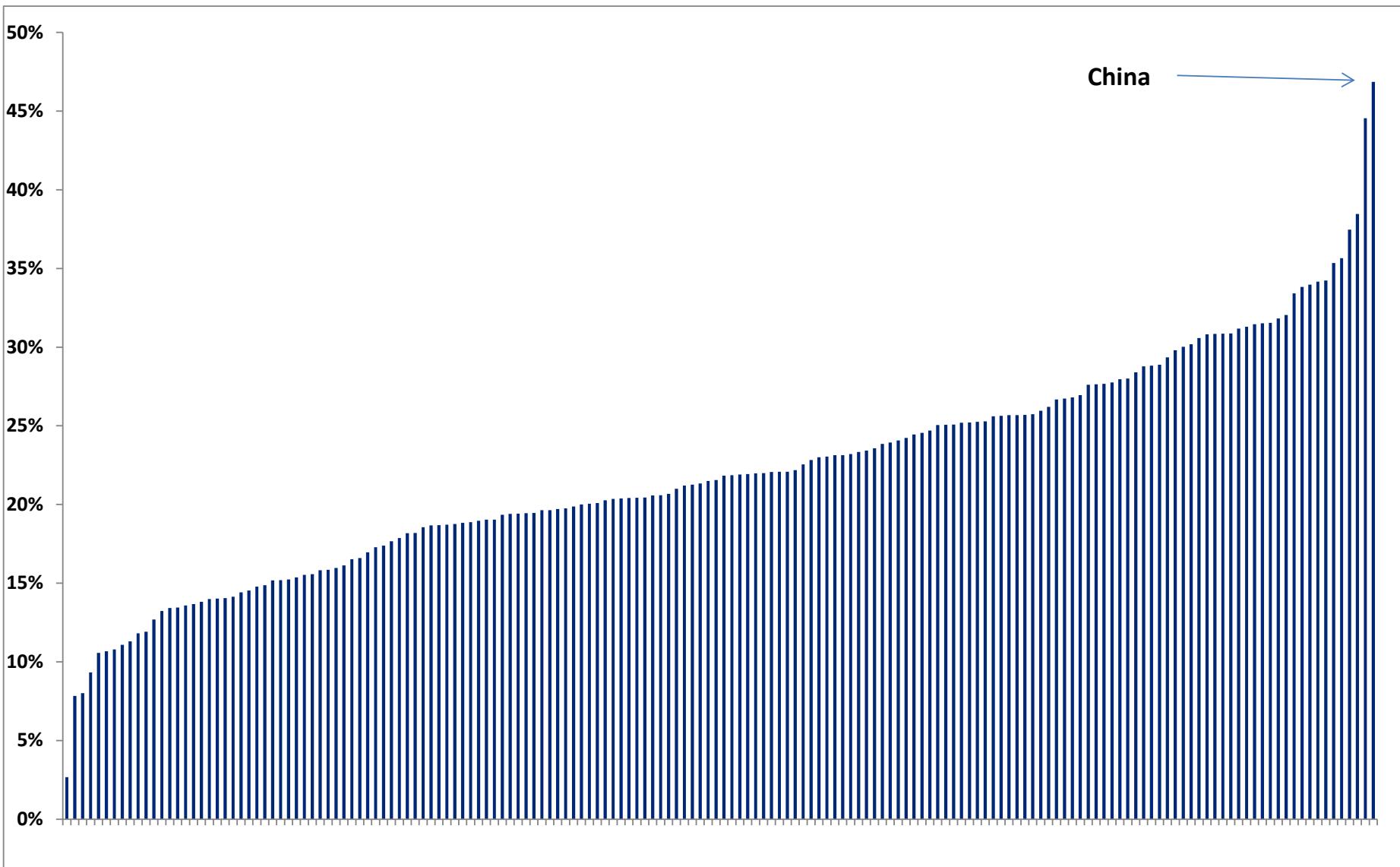
Some say living standards need priority over Budget repair – so their focus is a grand bargain that shifts away from State property and insurance taxes and company tax moves towards land taxes and the GST.

Some say speed of Budget repair is of the essence, as they fear a lack of Budget repair would leave Australia exposed in a future recession – so they sound old and grumpy.



# Deficits as far as the eye can see

Investment spending as a share of 166 different economies



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