

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.¹

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.

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 play 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.² 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, pensions are

¹Productivity Commission (2011) *Disability Care and Support*, Accessed at <http://www.pc.gov.au/projects/inquiry/disability-support/report>.

²ACOSS 2013, 'Back to Basics'.

indexed to the greater of movements in Male Total Average Weekly Earnings (MTAWE), the CPI, and an index of living costs for pensioners and beneficiaries. 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. The Henry Report proposed that working-age benefits and pensions be indexed in a consistent way.

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 2011.³ However as unemployment has fallen, the profile of those still on income support has become more disadvantaged.⁴ 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.⁵

Governments can also directly support job creation through 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.⁶ 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.

³Excludes student payments.

⁴ 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.

⁵ 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.

⁶ Hon Joe Hockey and Hon Andrew Robb, "Final Update on Federal Coalition Election Policy Commitments, 5.9.13.

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.⁷ There is a shortage of 539,000 rental properties that are affordable and available to low income renters.⁸ 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 Strait Islander people of program and service delivery to their communities. This is despite strong evidence supporting the effectiveness of Aboriginal community-led solutions.⁹

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

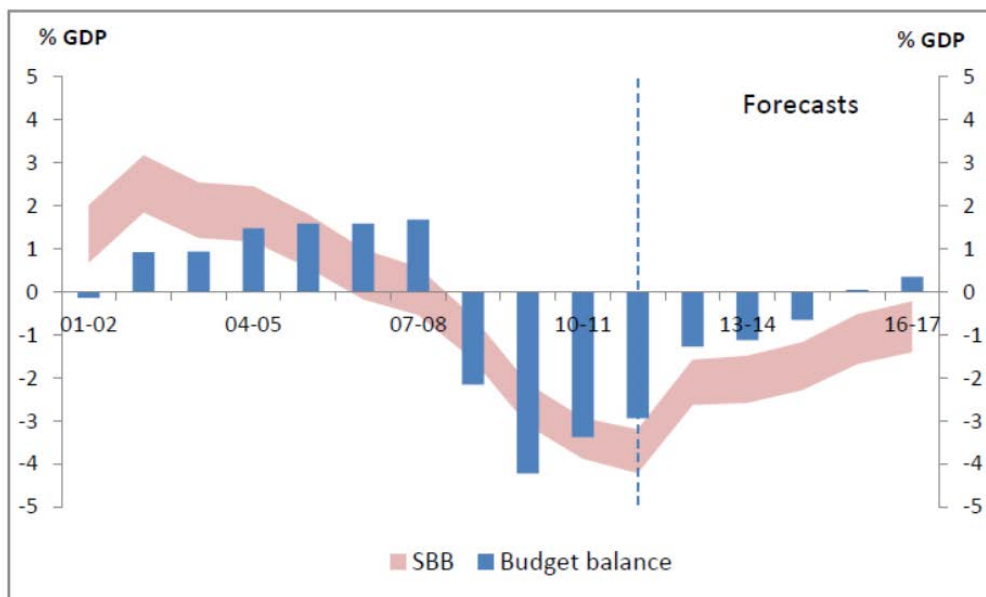
While the Australian Government's underlying cash deficit in 2012-13 is estimated at 1.2% of GDP, estimates for the 'structural deficit' range between 2 and 3% of GDP (\$30 to \$45 billion).¹⁰ These studies generally show that the structural Budget position started to deteriorate in the early 2000s and continued to do so through the GFC (see graph below).

Structural budget balance compared with underlying cash budget balance

⁷Melbourne 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*.

⁸National Housing Supply Council (2012) *Housing Supply and Affordability – Key Indicators, 2012*

¹⁰These estimates were produced by the Treasury, Parliamentary Budget Office, IMF, OECD and Deloitte Access Economics.



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.¹¹

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

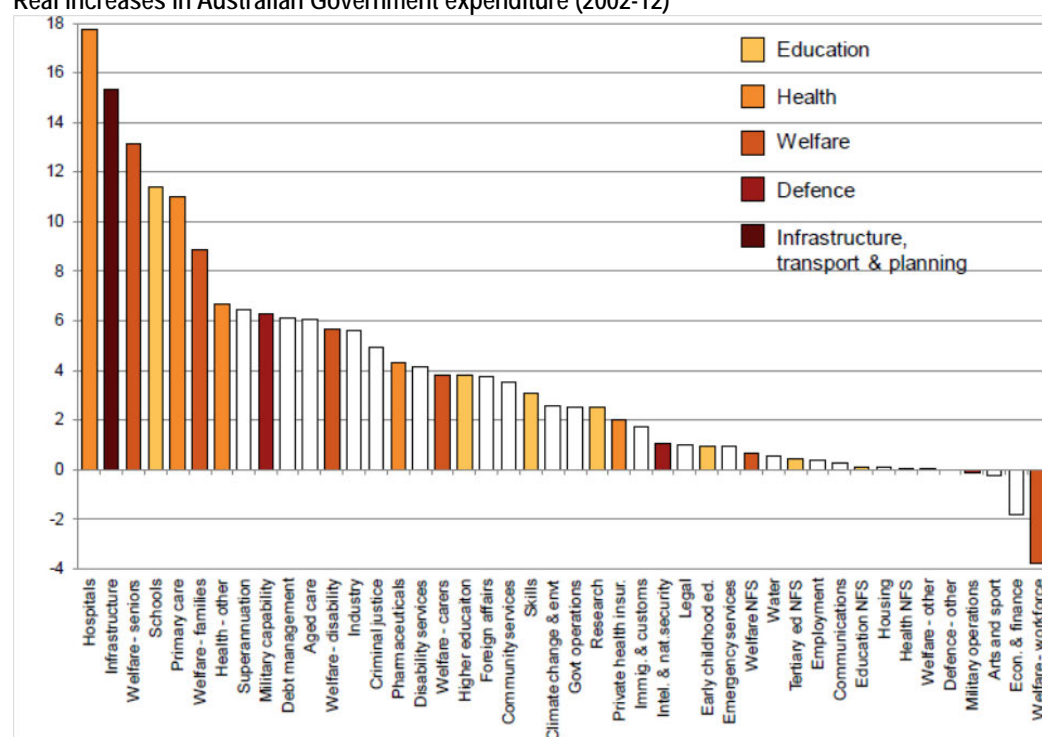
Concern about living cost pressures during this period was mainly based on above-average increases in a few key essentials such as housing and energy bills. Yet, when all expenses are taken into account and compared with average increases in household incomes over the last decade, the living standards of the vast majority of households rose strongly. This is in sharp contrast to the experience in many other

¹¹Treasury, 'Tax Expenditures Statements.'

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.¹² 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.¹³ 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 2012.¹⁴ 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

¹²Philips 2013, 'Cost of living and standard of living indexes for Australia,' NATSEM, University of Canberra.

¹³ACOSS 2012, 'Surviving not living,' ACOSS Paper 192; using the ABS 'Analytical Living Cost Index for other Government benefit recipients'.

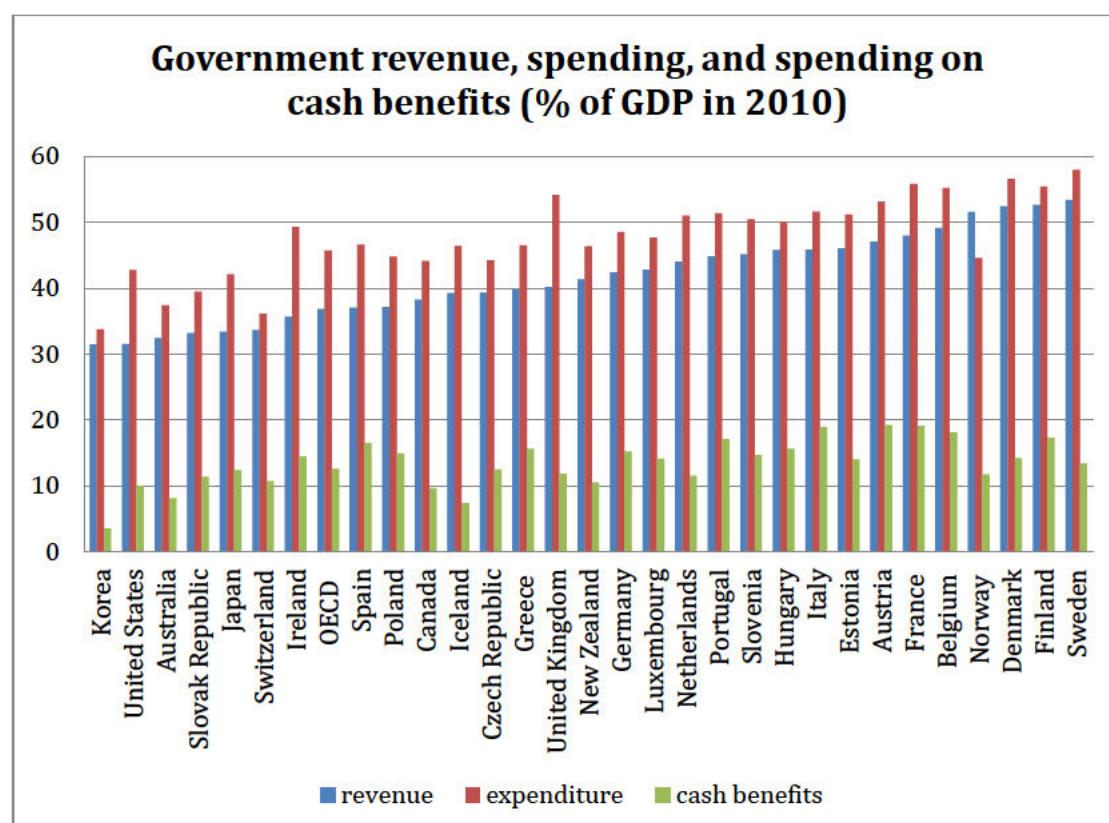
¹⁴Daly 2013, 'Budget pressures on Australian Governments,' Grattan Institute.

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 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 3: 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).¹⁵

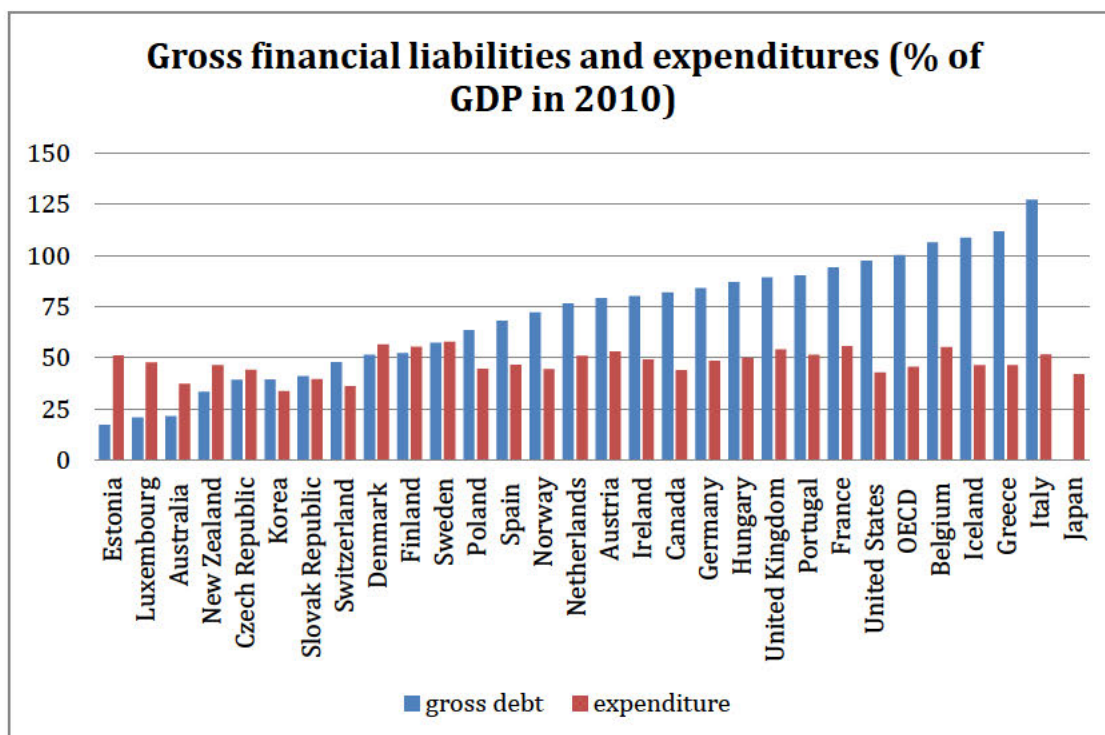


Source: OECD.

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 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.

¹⁵There 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'.



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 4: 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.¹⁶ 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.¹⁷

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 public investment in physical infrastructure and human capital development (education) are positively associated with economic growth. Much of

¹⁶For example, Barro 1990, 'Government spending in simple model of endogenous growth', Journal of Political Economy Vol 98, No5.

¹⁷Bassanini and Scarpetta 2001, 'The driving forces of economic growth', OECD Economic Studies No 33.

what is usually classified as 'social expenditure' promotes employment participation and productivity. More broadly, the efficiency of the public sector matters.¹⁸

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 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 levels¹⁹.

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.

¹⁸Angelopoulos 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.

¹⁹Bergh & 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.

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	<i>Programs that disproportionately benefit high income earners</i>	
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	<i>Programs that are poorly targeted and inflate the cost of services</i>	
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	<i>Programs that lack a clear rationale</i>	
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
	<i>Programs that are poorly targeted and inefficient in meeting their goals</i>	
	Compulsory Income Management (especially NIM in the NT)	Invest savings in case management and community capacity building
	<i>Structural flaws in the income tax system</i>	
	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