Submission to the National Commission of Audit

[redacted]—TARGET30 Program Director and others[1]

The Centre for Independent Studies

A full list of the recommendations in this submission can be found in Attachment A.

1. Introduction—The need to reduce the size of government

The Commission of Audit (Commission) is tasked with reviewing the scope, efficiency and functions of the federal government, according to the principles set out in the Commission's Terms of Reference (ToR). These ToR call for the Commission to consider ways to shrink the size and impact of government (for a further interpretation of the ToR, see Attachment B).

This submission contains recommendations both for spending cuts that will save the federal government billions of dollars every year in the short term, and reforms aimed at curbing the growth of government spending in the medium to the long term.

The recommendations focus on:

(a) remedying the institutional failures that lead to bad spending decisions

(b) suggesting alternative approaches in high cost areas such as health, welfare and education that will reduce future government liabilities.

1.1 Institutionalise ongoing restraint in government spending

Identifying and cutting specific programs that are unnecessary and reducing duplication across the state and federal governments is an important part of shrinking government. However, a short period of restraint followed by a return to elevated spending will not stabilise the budget in the medium term. Restraint needs to be institutionalised.

Therefore, in addition to identifying and reducing wasteful or poorly targeted spending, government should have an overreaching goal of lowering the real growth rate of spending over time. A reduction in the real growth of spending would itself be a major achievement, as a business-as-usual approach will see real growth continue at a rate of more than 3%, and a further increase in the size of government relative to GDP.[2]

Recommendation: The government should cap real growth in spending to less than 1.5% per year over the next 10 years—that is, government spending should remain constant in per capita terms—so Australia is once more on a sound fiscal footing.

Savings need to be permanent reductions in government spending. Deferrals simply change the timing of expenditure and do not help in the task of permanently lowering the rising trajectory of government spending.

2. Scope of government

There are broadly two important areas where savings in current programs can be found for the federal government. First, the relationship between taxpayers and government generally should be examined to determine whether some activities the government is undertaking should end. Second, savings can be found by improving the efficiency of the split of responsibilities between the federal government and the state governments.

2.1 Prioritise existing programs

Three factors must be kept in mind when examining the relationship between citizens and the government. First, there are economic and social costs caused by government debt and taxation. Second, there is a limit on the resources available to government (especially on the money that can be raised through taxation and borrowing). Third, all spending decisions attract opportunity costs.

Therefore, considering the case for 'continued direct involvement of government' in an activity (as the ToR requires) means determining whether a spending program provides sufficient benefit to offset the economic and social cost of funding it and whether there is a better use for those taxpayer funds. Answering both questions requires prioritising existing spending.

2.2 How spending programs should be prioritised

The first step is to consider the proper role of the federal government. While an entire submission could be written on this point alone, there are several principles that the government should keep in mind.

(a) Government support should be available for those who cannot help themselves.

(b) Government is responsible for arranging the provision of public goods (including law and order).

(c) Personal responsibility is a necessary element of a free society.

(d) Government should minimise its impact on individuals and business.

These principles are also influenced by the role of the federal government in the Constitution. Assessing spending against these principles, while keeping in mind the constitutional limitations on the federal government, should enable government to identify areas where government spending is a low priority.

Recommendation: The government should adopt a list of priority spending areas and then classify current spending programs either within or outside those areas.

However, it is not enough to simply identify areas where government spending is a priority. For example, health in particular is seen as a priority area, but there are wasteful programs in it too.

It is also necessary to assess the efficacy of each spending program by asking:

(a) What is the goal of the program?

(b) Is the program meeting its goal?

(c) Can that goal be better achieved through other means?

(d) How do the current results of the program compare with its cost?

This should be done every few years at a high level for all spending programs and in more detail for a selection of the most costly programs. The Australian National Audit Office carries out some analyses along these lines, so it may be well placed to do this.

By identifying efficient programs, in priority areas, the government can then either defund or retarget all other spending programs to take pressure off the budget.

Recommendation: The government should task an independent body with assessing the efficacy of government spending programs on an ongoing basis. This will build on the baseline work of the Commission.

2.3 Industry assistance fails this assessment process

One particular area that fails these assessment criteria, and so should be axed for significant savings, is industry assistance—most of which goes to a few areas: 30% to a handful of favoured industries; 28% to various R&D programs; and 22% to small business.[3]

Economically, industry assistance (worth approximately $10 billion a year[4]) distorts the efficient allocation of resources, encourages rent seeking, and wastes government money. Even within the protected industries, it doesn't ensure jobs or the long-term viability of that industry (as evidence by the billions given to the car industry over the past few decades). Assisted industries too generally come to depend on taxpayer support.

There is little evidence that tax credits substantially increase R&D activity when government funds research by corporations. That's because often the tax credit pays for research that would have occurred anyway without any incentives;[5] moreover, most innovation originates overseas.[6] The Productivity Commission has also questioned the evaluation and governance of business R&D programs.[7]

As for small business, while assistance is usually provided in the form of tax breaks, grant programs, mentoring and advice, and export development programs, evidence from small businesses suggests these programs don't address the main issues impeding growth in the sector.

Surveys from the Australian Chamber of Commerce and Industry have repeatedly found that the biggest impediment to small business growth is taxes and government charges.[8] State and federal regulation also feature highly on the list of impediments, suggesting that the best way for government to support small business is to get out of their way.

Recommendation: Government should end wasteful subsidies, tariffs and assistance to industry and instead support business by reducing the burden of taxation and regulation.

2.4 Federalism

The Commonwealth, states and territories are jointly involved in many functions of government such as education (schools and skills training); health (public hospitals); welfare (community services); public housing; transport (roads and rail); and the environment.

The Commonwealth's participation in the above functions mainly takes the form of specific purpose funding with conditions attached, which is expected to total $44 billion in 2013–14, or more than 10% of total budget expenses.[9] The Commonwealth is not directly involved in service delivery, but allocates administrative resources to negotiating, monitoring and enforcing conditions attached to funding. In addition to funding, there is a regulatory dimension to federal interventions in functions such as the environment.

There is potential for efficiencies in areas such as:

(a) eliminating unnecessary duplication of regulation between the Commonwealth and the states, particularly in environmental regulation

(b) ending federal oversight of state service delivery, particularly by the federal Departments of Education and Health

(c) stopping excessive growth in Commonwealth specific-purpose payments in the mistaken belief that throwing more money at a problem is always the answer to perceived deficiencies in state service delivery

(d) ending federal involvement in state functions where it has gone well beyond the limits of justifiable central government participation under the model of federalism.

Taken together, (c) and (d) distort the overall allocation of resources within the public sector and distort the incentives for state governments to optimise funding and service policy, deliver services efficiently, innovate, and tailor services to local conditions. Ultimately, these distortions can only be corrected by reviewing the Commonwealth's role in all areas of state responsibility and testing its validity under the subsidiarity principle.[10] This would result in the Commonwealth withdrawing wholly or partly from some state functions, which in turn would require reform of state funding because the states would lose substantial amounts of specific purpose funding.

Such a sweeping review of the roles, responsibilities and funding of the different tiers of government is clearly beyond the Commission's scope, but the Commission should highlight it as an important task for the separate review of federalism that the government has foreshadowed. In the meantime, the Commission should focus on (a), (b) and (c) above.

2.5 Overlap of departments

As noted above, substantial savings can be made by eliminating the overlap between the Commonwealth and the states, particularly in areas such as health, education and agriculture.

Health

The federal-state division of health responsibilities is frequently blamed for waste and inefficiency in the health system. The Commonwealth and states have a financial incentive to shift costs to the other jurisdiction where possible (e.g. by billing medication costs for discharged hospital in-patients to the PBS or by shifting after-hours GP care onto emergency departments). However, in the context of overall public health expenditure, the sums involved were found to be relatively small ($300 million to $500 million in 2008) by Ken Baxter, former head of the NSW and Victorian Departments of Premier and Cabinet.[11]

The federal-state split in health is also blamed for lack of continuity of care for patients transitioning in and out of hospitals, as the states are in charge of public hospital services and the Commonwealth controls community-based medical or primary care services through the MBS. Service gaps for non-hospital chronic disease care are also mainly attributable to the MBS operating primarily as a payment system for GP and other medical specialist consultations. Lack of access to a broader range of 'coordinated primary care' (nurse-led and encompassing allied health care) is blamed for causing unnecessary hospital admissions by chronic patients. Yet the evidence that admissions are 'avoidable' is weak,[12] as is the evidence that coordinated care prevents admissions.[13]

An area of increasing overlap is in public hospital performance. Revised accountabilities for federal health funding have led to the creation of new federal hospital pricing and reporting agencies, and to additional data reporting requirements for the states and territories. While there has been an attempt to address rising health costs (principally via a national system of activity-based funding), this has entailed additional bureaucracy, complexity and compliance costs. Consolidating the new agencies within the federal Department of Health and Ageing

(DOHA) may yield savings on overheads. However, there is a strong case for closing down DOHA and giving its remaining functions to Treasury, given that it no longer administers MBS and PBS payments and has no hands-on role in health service delivery.

Recommendation: The government should close the Department of Health and Ageing.

Education

The federal Department of Education has a staff of approximately 1,000 people, yet it does not manage any schools, employ any teachers, or provide any essential educational support services.

School education is the constitutional responsibility of the states. Yet the number and cost of programs developed, funded and administered by the federal government has proliferated since the 1990s, peaking in 2009–10 with the Labor government's multibillion-dollar Building the Education Revolution, Digital Education Revolution, and National Partnerships programs.[14] These programs did not extend or diversify educational provision, but simply provided supplementary funding to state systems and non-government schools to enhance existing educational facilities and activities. Their impact on educational quality is unproven, but unlikely to reflect the size of the investment.

With the planned commencement of the Better Schools funding system in 2014, the number of programs in the federal schools education budget will be halved.[15] This major change in schools funding is occurring at an opportune time for the Commission to examine the functions of the Department of Education and purge any non-essential programs. The few programs that are currently within the specific purview of the federal government can be transferred to other portfolios (for example, school funding administration to Treasury, and Abstudy to the Department of Human Services). After these steps have been taken, the Department of Education can be abolished, returning full provision and regulation of school education to the states.

Recommendation: The Department of Education should be closed.

Agriculture

The federal Department of Agriculture contains six research and development agencies—cotton, fisheries, grains, grape and wine, rural industries, and sugar. It also has a wine marketing body and two regulatory agencies.

Each state, and the Northern Territory, has its own department and agencies to regulate agricultural land and administer grants for R&D.

There is no need to have both federal and state governments each regulating agricultural land and doling out industry assistance for R&D. Furthermore, there is no justification for a federal marketing body to promote Australia's wine interests. That is a function the government should not be involved in at all.

The two agencies within the department that ought to be preserved are the Australian Pesticides and Veterinary Medicines Authority (APVMA) and the Australian Fisheries Management Authority (AFMA). The rest of the portfolio, however, should be abolished, along with the associated taxes levied on the industry.

Recommendation: The federal Department of Agriculture should be wound up and the AFMA and APVMA transferred to the Industry portfolio.

The abolition of the federal Department of Agriculture would mean the states need to take upon a larger share of biosecurity matters than they do currently. But it should be noted that these regulations are often manipulated for protectionist purposes, rather than real concerns over disease.[16] Hence, the resources needed to police bona fide biosecurity threats may be lower than what is currently being spent. The states already have some responsibility for biosecurity matters and licensing. This role would need to expand, but a review of existing biosecurity regulations could shed light on which regulations are absolutely necessary, and which are simply veiled protectionism. This would also reduce the resources required to fulfil our biosecurity needs.

3. Efficiency and effectiveness of government expenditure

In addition to the spending cuts that can be found by reassessing the role of government, it is necessary to address the efficiency and effectiveness of future government spending. This will be a key process for limiting growth in light of future fiscal pressures.

3.1 Limit and independently review new spending

The Regulatory Impact Statement process has not been successful in limiting increases in the size of government or increases in regulation, often because it has been bypassed.[17]

In addition, lobby groups and vested interests have presented their own assessment of the benefits of particular policies that have questionable assumptions and are not as robust as they should be.

Governments have not thoroughly examined the costs of government spending (especially opportunity costs, which are typically ignored by government), nor are the benefits appropriately quantified. In some cases involving major expenditure of taxpayer funds, no cost-benefit analysis was carried out at all.

For government actions that are likely to have a significant impact, an independent cost-benefit analysis would provide valuable information to the public and act as a restraint on excess. A good baseline for whether an action is likely to have a significant impact is if it does any of the following: costs $1 billion or more across the forward estimates or more than $5 billion in total; creates a new department; or imposes regulations with substantial compliance costs.

Recommendation: The Productivity Commission (or any other appropriate body) should be tasked with providing independent cost-benefit analysis of government actions with a significant impact. This analysis should specifically include reference to the opportunity costs of government action.

As noted above, it is important to prioritise new and existing spending. Having a consistent and comparable framework for reviewing cost-benefit analyses across multiple projects would enable greater understanding by taxpayers of the merits of new spending initiatives.

Recommendation: The Productivity Commission (or any other body tasked with implementing the recommendation above) should develop and publish a standardised format for government cost-benefit analysis.

A final point to note is that if direct benefits of government spending exceed the costs, there is likely to be an opportunity for the private sector to participate in the project which should be explored.

3.2 Ongoing review and analysis

Another way to improve efficiency and increase the accuracy of cost forecasts is to regularly compare government's promises against the results of a program after it has been in operation for a period of time.

Too often, governments believe they have delivered or achieved an outcome simply by passing legislation or introducing a program. Politicians are also not held to account for their rhetoric in selling the merits of new initiatives.

Analysis by an independent body of the results of new initiatives will help limit the continual growth in new programs and act as a trigger for reforming poorly performing initiatives.

Recommendation: An independent reassessment of regulatory impact statements (and independent cost-benefit analysis recommended under 3.1 above) should be undertaken and published 12 months after a new spending initiative has been implemented.

3.3 Contract out government services to the private sector

The private sector provides services more efficiently than the public sector because of the competitive forces of the market. Bringing these competitive forces to bear on the provision of government services will increase the efficiency of their provision.

Monopoly services providers such as the NBN are particularly prone to inefficiencies. While arguments are raised that the NBN needs to remain a government monopoly to ensure access to services for regional Australia, there is a much better approach.

By opening the NBN to competition, in addition to the productivity improvements generated by market forces, private sector competitors may take on some of the risk of building infrastructure. If the provision of fast Internet services to remote and regional areas is a priority for the government, they should provide a transparent subsidy for regional access (preferably the government would run a tender for the provision of internet services so private operators will compete to provide it).

Recommendation: Any subsidies for government services should be transparent. Governments should not cross-subsidise regional services via a government-owned monopoly.

Another advantage of contracting out government services is the ability to outline clear expectations and outcomes in contracts. However, contracting involves transaction costs, and ongoing work may end up becoming more expensive if the objectives are ill-defined or if multiple departments with conflicting goals and priorities are involved. There is also the risk that, once knowledge and capabilities are lost within government they cannot easily be reacquired.

Recommendation: Government should seek to contract out services where possible but contracts should be strictly defined with time limits and identified outcomes.

3.4 Reducing tax welfare churn

Reducing churn, where taxes are paid to the government and then returned either as cash or in-kind benefits to those same taxpayers, should be a priority for the Commission. Churn affects health, social security and welfare, and has both economic (high administration and compliance costs, higher tax burden, and higher effective marginal tax rates) and non-economic costs (increased welfare dependency, government paternalism and patronage, and a complex tax-transfer system).[18]

ABS data show that the third and fourth income quintiles experience the most substantial levels of churn with in-kind services: the third quintile pay $348 a week on average in taxes and receive $359 in in-kind services; the fourth quintile pay $533 a week and receive $292 in service benefits.[19] Churn is especially prevalent with in-kind services like education and health.

It makes much more sense for users to pay for the services they want directly rather than through the inefficient tax-transfer system. Not only are people more careful with their own money (which limits overuse) but it allows people to make meaningful choices about what services they need.

Recommendation: Wherever possible government should fund services provided directly to individuals via user charges rather than taxation, provided those charges represent the efficient cost of providing the service. Any assistance for those less well-off to access that service should be transparent.

3.5 Managing future expenditure growth

No area of government spending should be quarantined from the search for savings, but the Commission will need to recognise that some areas (such as Defence) have already been squeezed while others (such as public debt interest and payment of GST to the states) are contractual arrangements.

As health, education, and welfare account for more than 60% of payments across all three tiers of government and have been the fastest growing historically; to quarantine them would severely compromise the project.[20]

Health

Rapidly rising health outlays over the last decade have made the single largest contribution to growth in federal government expenditure, with the Commonwealth now spending more than double the nominal amount (nearly $60 Billion) on Medicare than it did in 2001–02.[21]

In real terms (adjusted for inflation), federal health expenditure has increased by 63%.[22] Since 2001–02, growth in federal health outlays has averaged 4.9% compared to average GDP growth of 3.1% per year.[23]

Expenditure growth proved relatively manageable due to high rates of pre-GFC economic growth. Paying for continued growth will be more difficult in the new era of lower growth underway, particularly as health-related budgetary pressures are expected to increase as the population ages.

To prepare to meet future budgetary challenges, action needs to be taken now to rein in spending across the entire government. There is no case for ring-fencing health. Wasteful and ineffective health programs should be scrapped or modified to achieve savings as in any other policy area. The simple reforms below can save $3 billion a year.

MBS GP Management Plans have been rorted by both providers and consumers, as non-chronically ill consumers pressure doctors to provide management plans in order to receive ‘free’ allied health care and shift the cost on to Medicare.

Recommendation: MBS GP Management Plans should be scrapped.

The Better Access to Mental Health Services scheme funds counselling for people who could afford to pay for their own treatment. There are better ways to assist the disadvantaged and build capacity in underserviced country and low socioeconomic status regions.

Recommendation: The Better Access to Mental Health Services scheme should be ended.

The Hawke government's short-lived, 1991 copayment for Medicare-funded GP visits should be reintroduced and extended to pathology, diagnostic imaging, and optometry services. It should be accompanied by a $5 reduction in Medicare rebates.

Recommendation: A $5 Medicare copayment should be introduced with a $5 reduction in the Medicare rebate.

Additional savings include reductions in DOHA overheads (see above) and defunding federally funded public health initiatives targeting 'lifestyle diseases,' given the lack of an evidence base demonstrating their effectiveness.[24] Means-testing Medicare entitlements, consistent with the means test for the Private Health Insurance Rebate, is also likely to yield considerable savings.

Recommendation: The government should examine the benefit of means testing Medicare.

Education

Until 1964, there was no federal funding for schools; it now represents 35% of total government expenditure on school education. The Better Schools funding system, which is due to commence in 2014, provides increasing levels of federal funding to schools. The individual bilateral agreements between the federal government and the NSW, Victoria, SA, Tasmania and the ACT governments specify funding amounts and minimum increases in funding for the next six years, with the largest increases in the last two years of the agreement (2018–19).

Although only the first four years of funding (2014–17) are included in the federal budget forward estimates, and the federal minister has explicitly refused to commit to retaining the Better Schools model beyond 2017, it is not clear how or whether these agreements can be broken. What is clear is that if the funding agreements are honoured, federal expenditure on school education will reach unprecedented, and arguably unsustainable, levels. Governments that seek to reduce spending on school education take a large political risk. The best way to rein in spending on education is to prevent unnecessary increases in the first instance. The federal government should review the Better Schools model and the associated funding agreements and legislation as a high priority.

Recommendation: The government should review the Better Schools funding model to ensure that the funding is provided as efficiently as possible.

Welfare

Most areas of government spending grow inexorably, but there are a few programs in particular that currently do and/or will in the future put public finances under great strain.

The Age Pension is a major source of government spending growth, and this will only worsen as the population ages. Treasury predicts the number of people meeting the pension's age eligibility criteria will increase by approximately 150% by 2049–50.[25]

Continuing to increase the Age Pension eligibility age—which will keep more people in the workforce for longer, increase tax revenue, reduce government expenditure, and allow people to save more for retirement (further reducing pension liabilities)—is the first step in reducing lifetime churn and expenditure.

Recommendation: The government should continue to increase the Age Pension eligibility age in line with increases in life expectancy.

However, increases in the pension age will not solve all the problems caused by our future pension liabilities, further reforms to superannuation are needed to reduce dependence on the Age Pension. A start would be to align the preservation age, the age at which someone can withdraw their superannuation (60 years), with the pension eligibility age (65 years). Because these two ages are not aligned, superannuation isn't having as large an effect on reducing pension liabilities as it could. Instead, it becomes a vehicle to fund early retirement, allowing people to reduce their means-tested assets to the point that they become eligible for the pension when they are 65.[26]

Recommendation: The superannuation preservation age should be aligned with the Age Pension eligibility age.

Another source of expanding future liability is the exemption of the principal home of an age pensioner from the pension assets test. This means retirees can spend their lifetime savings buying a more expensive home, renovating their current home, or going on holidays with the aim of reducing their assets to the point where they are eligible for the Age Pension and its associated perks.

Recommendation: The assets test for the Age Pension should be revised to take into account the value of the primary home.

The Disability Support Pension is another area of marked future expenditure growth. It has grown in relative budgetary importance to the rest of working age income support.[27] It will come under strain as the population ages and the recognition of, and treatment options for, mental ill health increases. Stricter eligibility rules and a broader conception of capacity to work ought to be applied for budgetary and workforce participation reasons—only about 1% of DSP recipients return the workforce.[28]

The development and implementation of the National Disability Insurance Scheme (the NDIS) is good policy, but there is huge potential for cost blowouts. Several factors have been overlooked in estimating the additional cost to the budget of implementing the NDIS, such as inflation, ageing and staff wage increases. Consistent upwards revisions of cost estimates suggest this will continue well into the future.[29] Moreover, the estimates are based on assumptions that only roughly half of current DSP recipients will qualify for support under the NDIS. As the number of people on the DSP (827,512 in May 2012[30]) continues to rise, commensurate pressure on the NDIS to widen its scope could drive further expenses.[31]

Recommendation: The DSP should be reformed to align it with the National Disability Insurance Scheme, including introducing a requirement for those with a partial capacity to work to actively look for employment.

4. Commonwealth finances and medium-term risks

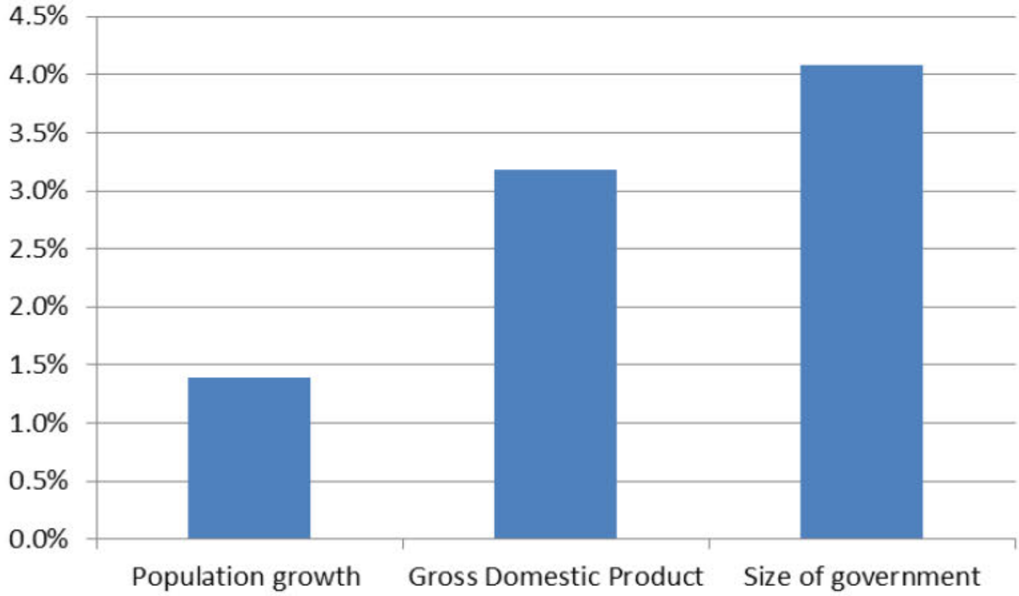
The risks to fiscal stability in the medium to long term are well known, though precious little has been done about them to date.

The Intergenerational Report (IGR) details the risks from an ageing population, rising health care costs, and the expected slowdown in economic growth. These risks are likely lead to an increase in the size of government, unless action is taken now to address wasteful spending.

4.1 Growth in spending (historical and projected)

Over the last 40 years, Australia has seen a strong growth trend in the size of government. The trend is self-evident when comparing the growth in the size of government with population and GDP growth rates.

Figure 1: Real average annual spending growth, 1972–2011



Source: Various.[32]

This rapid growth can be seen in the changing composition of federal payments, with the share going to social security and welfare, health and education entitlements ballooning from 25% in 1970–71 to almost 58% in 2010–11.[33]

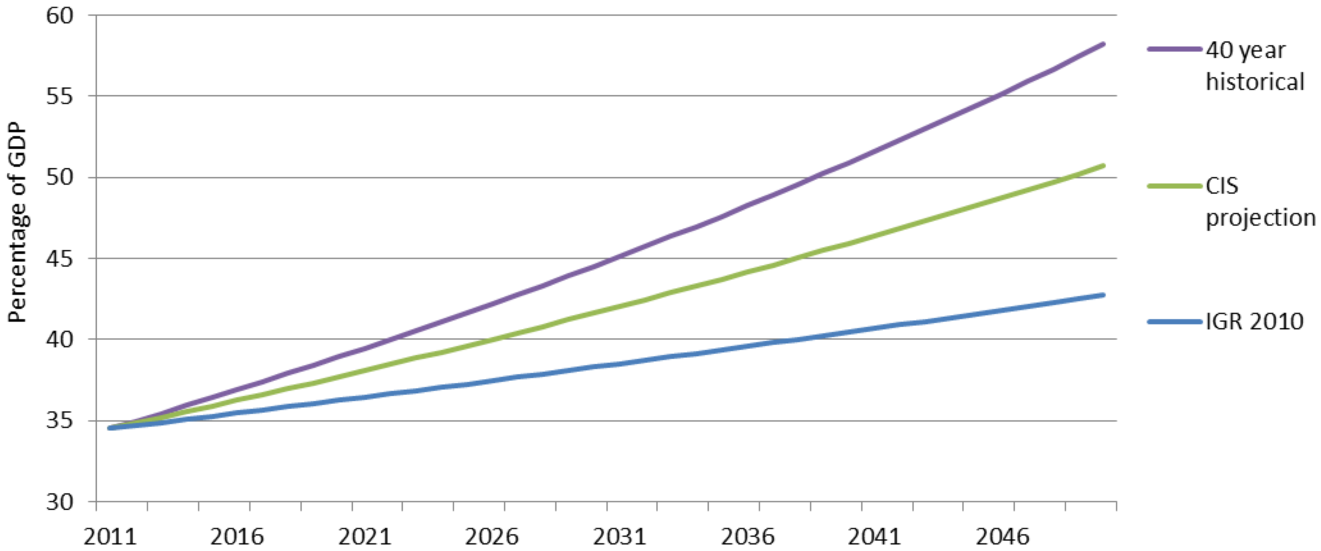
This is a concern, as it means the increase in government spending has largely gone on recurrent spending rather than productive investment. Given the inefficiencies inherent in government spending, some of this spending increase has been wasted.

Despite this historical growth trend, and despite noting the impact of the strong demand factors and forecasting a slowdown in economic growth to just 2.7% per year, IGR 2010 predicts that growth in government spending to 2050 will be lower than the growth rate of the last 40 years.[34] When adjusted for estimated state government spending growth, IGR 2010 predicts that government spending will be approximately 43% of GDP by 2050.[35]

However, exclusions and ambitious assumptions in IGR 2010 mean that its growth rate is almost certainly an underestimation. First, IGR 2010 doesn't cover many recently announced programs that will have a significant impact on the budget in years to come (for example, the NDIS). Second, IGR 2010 excludes the likelihood that governments will introduce new programs or expand existing ones over the next 30 years (as noted above, these programs have been the main drivers of growth in federal spending over the last 10 years). Finally, IGR 2010 assumes that government will shrink over the next few years because of strong economic growth and a cap on real spending growth at 2% a year.

While government spending is unlikely to grow as rapidly as it has over the last 40 years, a more accurate representation of the size of government in 2050 comes from combining the growth from the demand factors in IGR 2010 with the existing growth trends in spending.[36] This would increase the size of government to more than 50% of GDP by 2050.

Figure 2: Projections of government growth



Source: Various.[37]

Government spending growing to this extent would be a disastrous outcome for Australia. We need to act now to avoid this looming fiscal crisis.

4.2 Health care and HSAs

As noted above, while the IGRs outline the health-driven financial pressures ahead, they have failed to detail specific policies to contain costs by better targeting of public health spending and improving health care efficiency and productivity. They have also comprehensively failed to canvass potential alternatives to address the problem of long-term unaffordability: No policies that will directly reduce the government share of health spending and increase private financing have been proposed.

Given the magnitude of the fiscal challenges in health, we need to establish large non-government sources of health funding and limit government exposure to rising health expenditure.

Health care financing in this country could be reformed by reconfiguring the way existing Medicare spending is used to pay for health care.

The TARGET30 'New Medicare' plan[38] calls for younger Australians to be allowed to save up and pay for health care over time. This could be achieved by splitting Medicare funding into two new funding streams.

Stream 1 would fund 'superannuation-style' Health Savings Accounts (HSAs), which individuals would use to pay for lower-cost health services such a GP visits. Stream 2 would fund risk-rated, high-deductible health insurance vouchers (along the lines of the Medicare Select proposal outlined in the final report of the National Health and Hospitals Reform Commission), which would cover individuals and families against the cost of expensive chronic and catastrophic health care.

Creating a New Medicare for generations X and Y would permit the existing Medicare scheme to be transformed into an age-limited and targeted program for the current generation of retirees or near-retirees. Shifting away from the existing Pay-As-You-Go health finance system would see the taxpayer-funded share of health costs progressively decline as the Save-As-You-Go system matures, with an increasing share of health costs funded by personal health savings and private insurance.

This is not as radical as it sounds. Mandating self-provision through superannuation has, despite its flaws, reduced government responsibility for the cost of caring for the elderly and somewhat lowered the financial burden that population ageing would otherwise impose on future generations.

Recommendation: The proposed increase in the Superannuation Guarantee to 12% of income by 2019 should be used to fund a national HSA system to enhance the sustainability of the Australian health system.

5. Adequacy of existing budget controls and disciplines

Public financial management would benefit from greater transparency concerning the prospects for the public finances and the impact of expenditure and tax policy decisions in the long term in addition to the current four-year forward estimates and the periodic IGRs.

5.1 Reform of forward estimates

The four-year forward estimates are a necessary but not sufficient condition for transparency. They have the benefit of showing the medium-term budget outlook based on spending and tax policies adopted by the government at the time the forward estimates are prepared, and they are updated in the Mid-year Economic and Fiscal Outlooks (MYEFOs). However, the risks of current policies to fiscal sustainability may well lie beyond a four-year horizon. Moreover, governments have sometimes 'gamed' the forward estimates by making policy decisions whose full impact they know will be beyond the four-year horizon.

Recommendation: The government should supplement the detailed four-year forward estimates with less detailed 10-year estimates of the main fiscal aggregates under different scenarios.

In addition, information about specific policy decisions would be made more meaningful by including the ongoing yearly costs of spending and the costs of implementation.

Recommendation: In addition to the impact of a new spending program on the four-year forward estimates, cost predictions should show the cost of a new spending program in the first year of implementation and the yearly cost once the policy is fully implemented.

5.2 Reform of the IGR process

IGR projections have been an extremely useful addition to the range of information about the fiscal outlook but need to be improved if they are to make their full potential contribution to transparency. One problem with the IGRs is they are prepared infrequently—at least every five years as required under the Charter of Budget Honesty. Parameters usually do not change enough from year to year to justify more frequent, full-blown revisions of IGRs, but governments are constantly making policy decisions that widen or shrink long-term fiscal gaps.

Recommendation: Government should provide a report each year of the long-term fiscal impact of all expenditure and tax policy decisions made in the preceding year.

Another problem with IGR arrangements is that there is no coordination between the Commonwealth and the states and no picture of the national public sector. Not all states produce IGRs, and those that do have done so at different times from the Commonwealth.

The Commonwealth makes its own assumptions and uses its own methodologies, which may well be different from those of a state IGR. There is therefore no information on the long-term outlook for the general government sector as a whole.

Recommendation: The IGRs should be extended to the whole general government sector with collaboration between federal, state and territory agencies on common assumptions and methodologies.[39]

Given the IGRs will require input from different tiers of government, and the benefits of a depoliticised IGR process, the IGR should be produced by an independent body.

Recommendation: The expanded IGR should be prepared by either the Productivity Commission or a newly created independent fiscal authority.[40]

5.3 Enforce fiscal targets and policy rules

Reform of Australia's fiscal institutions should go beyond transparency. They need to be redesigned to ensure that fiscal policy remains focused on long-term fiscal sustainability and supply-side efficiency, and not be distracted by demands for short-term fiscal stimulus and politically popular spending. The first step is to reform or replace the Parliamentary Budget Office with a body responsible to the people rather than subordinate to the Parliament and to give greater effect to existing fiscal rules.

Recommendation: A new independent statutory fiscal commission should be created to administer legislated fiscal rules and to replace the Parliamentary Budget Office.

The role of the fiscal commission would include setting parameters for the annual budget and other policy statements. The government would formulate its budget within those parameters, subject to legislated fiscal rules the fiscal commission would monitor and enforce. These rules should include requirements to:

(a) maintain the federal fiscal balance within +2% to -2% of GDP on both an actual and forecast basis;

(b) limit net debt to GDP ratio to 10%;

(c) cap the federal revenue and expenditure shares of GDP to gradually reduce the relative size of government over the next decade; and

(d) cap real growth in federal spending at 2%.

Recommendation: Fiscal rules should be made binding via a Fiscal Responsibility Act.

The fiscal policy rules would be subject to caveats allowing for temporary breaches of the rules in the event of war, natural disaster and other severe supply shocks. Aggregate demand shocks should be accommodated through monetary policy and automatic fiscal stabilisers. This approach provides an explicit framework for departure from the rules and limits the scope for fiscal opportunism or ineffective attempts at demand management and macroeconomic stabilisation through fiscal stimulus.

6. Public sector performance and accountability

The above recommendations contain reforms that will transform the nature of the public service. However, specific reforms of the public service would also provide benefits.

6.1 Increase workforce efficiency in the Australian Public Service (APS)

Though the number of ongoing employees in the public service has not increased far above its 1993 level, it is costing much more. This is because there are far fewer APS1 employees working on lower wages, and many more employees at APS5, APS6 and EL level workers.

From 1991 to 2012, the number of employees classified as APS1 and APS2 has dropped 97% and 81%, respectively.[41] Over the same period, the number of employees classified as APS5 has grown at 40%, those classified as APS6 has grown 80%, and EL1 classifications have grown by a factor of three. There has also been substantial growth in the Senior Executive Service.[42]

The public service has become top-heavy. A larger proportion of the workforce is on higher classifications and this has significantly increased the wage bill.

This shift in the classification composition may in part be a response to the changing nature of public service work. Another explanation is that classifying jobs at a higher level has been done as a way to increase pay and conditions without breaching wage and hiring caps.

Recommendation: The government should review the classifications in the APS to determine whether the inflation of APS levels over the last 20 years is justified.

ATTACHMENT A—Summary of recommendations

Section 1 Introduction

Section 1.1 Institutionalise ongoing restraint in government spending

Recommendation: The government should cap real growth in spending to less than 1.5% per year over the next 10 years—that is, government spending should remain constant in per capita terms—so Australia is once more on a sound fiscal footing.

Section 2 Scope of Government

Section 2.2 How spending programs should be prioritised

Recommendation: The government should adopt a list of priority spending areas and then classify current spending programs either within or outside those areas.

Recommendation: The government should task an independent body with assessing the efficacy of government spending programs on an ongoing basis. This will build on the baseline work of the Commission.

Section 2.3 Industry assistance fails this assessment process

Recommendation: Government should end wasteful subsidies, tariffs and assistance to industry and instead support business by reducing the burden of taxation and regulation.

Section 2.5 Overlap of departments - Health

Recommendation: The government should close the Department of Health and Ageing.

Section 2.5 Overlap of departments - Education

Recommendation: The Department of Education should be closed.

Section 2.5 Overlap of departments - Agriculture

Recommendation: The federal Department of Agriculture should be wound up and the AFMA and APVMA transferred to the Industry portfolio.

Section 3 Efficiency and effectiveness of government expenditure

Section 3.1 Limit and independently review new spending

Recommendation: The Productivity Commission (or any other appropriate body) should be tasked with providing independent cost-benefit analysis of government actions with a significant impact. This analysis should specifically include reference to the opportunity costs of government action.

Recommendation: The Productivity Commission (or any other body tasked with implementing the recommendation above) should develop and publish a standardised format for government cost-benefit analysis.

Section 3.2 Ongoing review and analysis

Recommendation: An independent reassessment of regulatory impact statements (and independent cost-benefit analysis recommended under 3.1 above) should be undertaken and published 12 months after a new spending initiative has been implemented.

Section 3.3 Contract out government services to the private sector

Recommendation: Any subsidies for government services should be transparent. Governments should not cross-subsidise regional services via a government-owned monopoly.

Recommendation: Government should seek to contract out services where possible but contracts should be strictly defined with time limits and identified outcomes.

Section 3.4 Reducing tax welfare churn

Recommendation: Wherever possible government should fund services provided directly to individuals via user charges rather than taxation, provided those charges represent the efficient cost of providing the service. Any assistance for those less well-off to access that service should be transparent.

Section 3.5 Managing future expenditure growth - Health

Recommendation: MBS GP Management Plans should be scrapped.

Recommendation: The Better Access to Mental Health Services scheme should be ended.

Recommendation: A $5 Medicare copayment should be introduced with a $5 reduction in the Medicare rebate.

Recommendation: The government should examine the benefit of means testing Medicare.

Section 3.5 Managing future expenditure growth - Education

Recommendation: The government should review the Better Schools funding model to ensure that the funding is provided as efficiently as possible.

Section 3.5 Managing future expenditure growth - Welfare

Recommendation: The government should continue to increase the Age Pension eligibility age in line with increases in life expectancy.

Recommendation: The superannuation preservation age should be aligned with the Age Pension eligibility age.

Recommendation: The assets test for the Age Pension should be revised to take into account the value of the primary home.

Recommendation: The DSP should be reformed to align it with the National Disability Insurance Scheme, including introducing a requirement for those with a partial capacity to work to actively look for employment.

Section 4 Commonwealth finances and medium-term risks

Section 4.2 Health care and HSAs

Recommendation: The proposed increase in the Superannuation Guarantee to 12% of income by 2019 should be used to fund a national HSA system to enhance the sustainability of the Australian health system.

Section 5 Adequacy of existing budget controls and disciplines

Section 5.1 Reform of forward estimates

Recommendation: The government should supplement the detailed four-year forward estimates with less detailed 10-year estimates of the main fiscal aggregates under different scenarios.

Recommendation: In addition to the impact of a new spending program on the four-year forward estimates, cost predictions should show the cost of a new spending program in the first year of implementation and the ongoing yearly cost once the policy is fully implemented.

Section 5. 2 Reform of the IGR process

Recommendation: Government should provide a report each year of the long-term fiscal impact of all expenditure and tax policy decisions made in the preceding year.

Recommendation: The IGRs should be extended to the whole general government sector with collaboration between federal, state and territory agencies on common assumptions and methodologies.

Recommendation: The expanded IGR should be prepared by either the Productivity Commission or a newly created independent fiscal authority.

Section 5.3 Enforce fiscal targets and policy rules

Recommendation: A new independent statutory fiscal commission should be created to administer legislated fiscal rules and to replace the Parliamentary Budget Office.

Recommendation: Fiscal rules should be made binding via a Fiscal Responsibility Act.

Section 6 Public sector performance and accountability

Section 6.1 Increase workforce efficiency in the Australian Public Service (APS)

Recommendation: The government should review the classifications in the Australian Public Service (APS) to determine whether the inflation of APS levels over the last 20 years is justified.

ATTACHMENT B—Interpreting the ToR

While the principles in the Commission ToR can be interpreted in a number of ways, the most logical interpretation, especially of the principles that 'government should do for people what they cannot do, or cannot do efficiently, for themselves, but no more' and 'government should live within its means,' is that the Commission should aim to reduce the size of government.

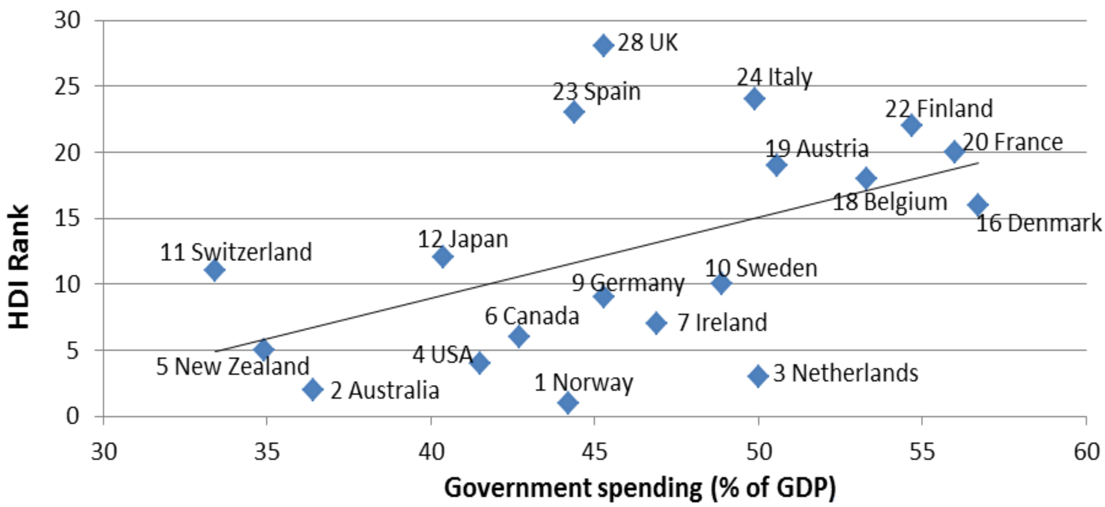
The government is not living within its means, having accumulated hundreds of billions of dollars of debt over the last six years, nor does it only do for people what they cannot do themselves.

Instead, government attempts to do much more, which has a negative impact on the economic prosperity of the country. David Smith from the Institute of Economic Affairs has found 'a statistically significant negative effect of government consumption on economic growth.'[43]

In addition, Vito Tanzi and Ludger Schuknecht note that countries with relatively smaller governments have economically outperformed countries with larger government sectors without underperforming on a broad range of social, environmental and other indicators. [44]

A comparison of country performance on the Human Development Index (HDI) (which ranks countries by 'measuring development by combining indicators of life expectancy, educational attainment and income') carried out by Tanzi based on 2005 HDI data and repeated by The Centre for Independent Studies based on 2011 data backs this up. It shows that countries with smaller governments also perform better on non-economic indicators.

Table 5: Size of government and the Human Development Index, 2011



Source: Authors' calculations based on data from the United Nations Development Project, Human Development Report 2011, Sustainability and Equity: A Better Future for All (New York: 2011); Paolo Mauro, Rafael Romeu, Ariel Binder, and Asad Zaman, A Modern History of Fiscal Prudence and Profligacy, IMF Working Paper (2013).[45]

The positive benefits of smaller government can be contrasted with the negative impacts of making government live within its means by increasing taxation. Aside from the strong public opposition to increasing taxes, higher taxes create disincentives for economic activity, cause deadweight loss, and create inefficiencies in allocating resources. The tax burden should be as low as possible. Higher taxes make us all poorer.

Gerald Scully estimated that the United States has sacrificed $4 of income for every dollar of tax paid more than the optimal level of taxation ($2.64 for New Zealand).[46] It is likely that Australia is suffering similar losses in national income.

High debt also has a negative correlation with economic growth.[47] It is an intergenerational transfer of wealth, where future generations pay for consumption today. In addition, increased taxation to fund future interest payments creates deadweight loss. There may also be negative implications for income equality from transferring taxes raised across society to those wealthy enough to lend to the government.

For these reasons the Commission should focus on lowering expenditure rather than increasing revenue.

ATTACHMENT C—About the CIS and TARGET30

The Centre for Independent Studies is the leading independent public policy think tank in Australasia. Founded in 1976, our work is informed by a commitment to the principles underpinning a free and open society:

- individual liberty and choice, including freedom of association, religion, speech and the right to property
- an economy based on free markets
- democratic government under the rule of law
- an autonomous and free civil society

The CIS works on aspects of social and economic policy affecting Australia. The Centre prides itself on being independent and non-partisan in its funding and research. It is funded by donations from individuals, companies, and charitable trusts, as well as by subscriptions and book sales.

'Independent' in our name means:

- we are politically non-partisan
- our research is not directed by our supporters
- we are financially independent of government

TARGET30 is a research initiative with the aim of reducing government spending from its current level of 35% of Gross Domestic Product (GDP) to 30% within the next 10 years.

TARGET30 promotes the benefits of small government, and is supported by a series of research papers and companion activities, including public events. TARGET30 provides concrete plans and policy suggestions for reducing the size of government in key areas, including welfare, education and health care.

Having a smaller government will increase economic growth in Australia and strengthen social and family bonds, leading to better communities and better outcomes for all Australians. Without TARGET30, by 2050 government could be clawing more than 50% of the value of all goods and services produced in the economy.

The initiative focuses on ensuring that the crucial services Australians need are delivered efficiently and effectively by all levels of government while curbing the uncontrolled growth of inefficient spending.

For more information on the CIS and TARGET30 please visit www.cis.org.au

ATTACHMENT D—References and reading list

CIS TARGET30 publications

T30.05 Simon Cowan, Emergency Budget Repair Kit (2013)

T30.04 Robert Carling, Shrink Taxation by Shrinking Government! (2013)

T30.03 Jeremy Sammut, Saving Medicare But NOT As We Know It (2013)

T30.02 Andrew Baker, Tax-Welfare Churn and the Australian Welfare State (2013)

T30.01 Simon Cowan, Towards Smaller Government and Future Prosperity (2013)

References

---

[1] Authors: Jennifer Buckingham, Research Fellow, Social Foundations Program; Robert Carling, Senior Fellow, Economics Program; Simon Cowan, Research Fellow, Economics Program; Trisha Jha, Policy Analyst, Social Foundations Program; Stephen Kirchner, Research Fellow, Economics Program; Alexander Philipatos, Policy Analyst, Economics Program; and Jeremy Sammut, Research Fellow, Social Foundations Program.
[2] Simon Cowan (ed.), *TARGET30: Towards Smaller Government and Future Prosperity*, T30.01 (Sydney: The Centre for Independent Studies, 2013).
[3] Productivity Commission, *Trade and Assistance Review 2011–12* (Canberra: June 2013).
[4] As above.
[5] John Daley, Julian Reichl, and Leah Ginnivan, *Australian Government Spending on Innovation* (Melbourne: Grattan Institute, March 2013); Productivity Commission, *Public Support for Science and Innovation* (Canberra: March 2007).
[6] John Daley, et al. *Australian Government Spending on Innovation*, as above.
[7] Productivity Commission, *Public Support for Science and Innovation* (Canberra: March 2007).
[8] Australian Chamber of Commerce and Industry, *Small Business Survey* (May 2013).
[9] Commonwealth of Australia, *Budget Paper No. 3*, 2013–14 Budget, Part 2.
[10] The subsidiarity principle is a cornerstone of the theory of federalism. It states that each function should be allocated to the lowest tier of government at which it is feasible and efficient for the function to be carried out.
[11] TFG International, *Report in the operation and future of the Australian Health Care Agreements and the funding of Public Hospitals,* (Melbourne: Australian Centre for Health Research, 2008), 62–63.
[12] Paul Cunningham and Jeremy Sammut, 'Inadequate acute hospital beds and the limits of primary care and prevention' (Emergency Medicine Australia, October 2012).
[13] Jeremy Sammut, *The False Promise of GP Super Clinics Part 2: Coordinated Care*, Papers in Health and Ageing 4, Policy Monograph No. 85 (Sydney: The Centre for Independent Studies, 2008)
[14] ABS (Australian Bureau of Statistics), *Government Finance Statistics*, Cat. No. 5512.0 (Canberra: ABS, various years).
[15] DEEWR (Department of Employment, Education and Workplace Relations), *Portfolio Budget Statements 2013–14* (Canberra: DEEWR).
[16] Saul Eslake, 'They've gone bananas,' *The Sydney Morning Herald* (14 February 2011).
[17] Flavio Menezes, 'Abbott's "open for business" honeymoon is over,' *The Conversation* (12 November 2013).
[18] For a more detailed discussion of the costs of tax-welfare churn, see John Humphreys, *Ending the Churn: A Tax/Welfare Swap*, Perspectives on Tax Reform 18, Policy Monograph 100 (Sydney: The Centre for Independent Studies, 2009), 2–3.
[19] ABS (Australian Bureau of Statistics), *Government Benefits, Taxes, and Household Income, Australia 2009–10*, Cat. No. 6537 (Canberra: ABS).
[20] Simon Cowan (ed.), TARGET30: *Towards Smaller Government and Future Prosperity*, as above.
[21] Australian Institute of Health and Welfare (AIHW), *Health Expenditure Australia 2011-12*, (Canberra: AIHW, 2013), Table 3.1.
[22] AIHW, *Health Expenditure Australia 2011-12,* as above.
[23] AIHW, *Health Expenditure Australia 2011-12,* p.33

[24] Jeremy Sammut, *The False Promise of GP Super Clinics Part 1: Preventive Care*, Papers in Health and Ageing 3, Policy Monograph 84 (Sydney: The Centre for Independent Studies, 2008).
[25] The Treasury, *Australia to 2050: Future Challenges* (January 2010).
[26] Simon Kelly, *Household Savings and Retirement: Where Has All My Super Gone?* A report on retirement for CPA Australia by KellyResearch (Southbank: CPA Australia, October 2012).
[27] PC (Productivity Commission), Appendix K—Disability Support Pension, *Disability Care and Support* (Canberra: Productivity Commission, 2011), K.2.
[28] Lixin Cai, Ha Vu, and Roger Wilkins, 'Disability Support Pension Recipients: Who Gets Off (And Stays Off) Payments?' *Australian Economic Review* 40:1 (2007), 37–61.
[29] For a more detailed discussion on the risk factors that have been omitted, see Andrew Baker, *The New Leviathan: A National Disability Insurance Scheme*, Policy Monograph 131 (Sydney: The Centre for Independent Studies, 2012).
[30] FaHCSIA (Department of Families, Housing, Community Services and Indigenous Affairs), *Answers to Questions on Notice*, 2012–13 Budget Estimates Hearings, Question No. 255.
[31] Andrew Baker, *The New Leviathan: A National Disability Insurance Scheme*, as above, 18–19.
[32] World Bank, *Health Nutrition and Population Statistics*; ABS (Australian Bureau of Statistics), *Australian System of National Accounts*, Cat. No. 5204 (Canberra: ABS, November 2012); ABS, *Government Finance Statistics 2010–11*, as above.
[33] ABS (Australian Bureau of Statistics), *Government Finance Statistics 2010–11*, Cat. No. 5512 (Canberra: ABS, April 2012).
[34] Commonwealth of Australia, *Australia to 2050: Future Challenges*, as above. IGR 2010 assumes that taxation will remain constant as a percentage of GDP, and over the 34 years from 2015–16, government expenditure will increase by 21% to 27.1% of GDP. This represents an expansion of federal government at a rate of approximately 0.6% of GDP a year.
[35] *NSW Long-Term Fiscal Pressures Report* (Sydney: Government of NSW, September 2011). The NSW *Intergenerational Report* suggests that state expenditures will increase by 0.4% of Gross State Product a year to 2050. Combining this rate and the IGR 2010 figures (weighted for the relative sizes of the levels of government) gives an approximate rate of increase in the size of government as 0.55% of GDP per year.
[36] The 'CIS projection' rate assumes that (a) the growth factors in IGR 2010 (primarily affecting existing programs) and the historical growth factors (primarily new spending initiatives) will contribute to growth in the size of government to 2050; (b) approximately half of the historical growth rate should be discounted for any potential overlap with the IGR 2010 factors; and (c) the historical rate of spending will adjust downwards to reflect expected lower economic growth such that the increase in spending relative to GDP will be constant.
[37] ABS (Australian Bureau of Statistics), *Government Finance Statistics 2010–11*, as above; The Treasury, *Intergenerational Report 2010*; NSW *Intergenerational Report 2011–12*.
[38] Jeremy Sammut, *Saving Medicare But NOT As We Know It*, T30.03 (Sydney: The Centre for Independent Studies, 2013).
[39] This IGR could show the results for the Commonwealth and the states separately, as well as for both levels of government combined. Local government probably does not need to be included because its expenditure is not subject to the same demographic influences as the other levels of government.
[40] Robert Carling and Stephen Kirchner, *Fiscal Rules for Limited Government: Reforming Australia's Fiscal Responsibility Legislation,* Policy Monograph 98 (Sydney: The Centre for Independent Studies, 2009).
[41] Australian Public Service Statistical Bulletin: State of the Service Series, 2004–05 to 2011–12.
[42] As above.
[43] David Smith, *Living with Leviathan: Public Spending, Taxes and Economic Performance* (London: Institute of Economic Affairs, 2007), 78. Smith cites R. J. Barro, *Determinants of Economic Growth: A Cross Country Empirical Study* (1997) and OECD, *The Sources of Economic Growth in OECD Countries* (2003).
[44] Vito Tanzi and Ludger Schuknecht, *Public Spending in the 20th Century* (Cambridge: Cambridge University Press, 2000), 133–134.
[45] UNDP (United Nations Development Project), *Human Development Report 2011*, *Sustainability and Equity: A Better Future for All* (New York: 2011); Paolo Mauro, Rafael Romeu, Ariel Binder, and Asad Zaman, *A Modern History of Fiscal Prudence and Profligacy,* IMF Working Paper (2013).
[46] Gerald Scully, *Taxes and Economic Growth*, Policy Report 292 (Dallas, Texas: National Centre for Policy Analysis, November 2006); Gerald Scully, 'Taxation and Economic Growth in New Zealand,' *Pacific Economic Review* 1:2 (1996), 169–177.
[47] Carmen Reinhart and Kenneth Rogoff, 'Growth in a Time of Debt,' *American Economic Review* 100:2 (May 2010).