[redacted]

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# Savings and efficiencies through changes to indexation

The practice of indexing Government outlays is now extensive and long-established. It produces a large, automatic jump in outlays each year and reduces the autonomy of Government with respect to expenditures.

The Committee may wish to consider changes in three areas:

## 1. Suspension of the indexation of outlays

As a means of deriving quick and sizeable expenditure savings, the current practice of automatically indexing outlays (using a price or cost measure, or a combination of both) could be suspended for a period.

Suspension would produce significant savings, as shown in the attached table.

- If the suspension were applied to 50 per cent of outlays savings would be $5.6 billion in the first year and, with continuation of the suspension, $11.5 billion in the second year (relative to the current forward estimates).
- Application to 75 per cent of outlays would produce savings of $8.4 billion and $17.2 billion.

The proportion of Commonwealth outlays that is currently indexed in one way or another is believed to be higher than 75 per cent, so the savings would be even greater if the suspension applied to all such outlays. Universal coverage is the ideal:

- The higher the coverage of the measure, the larger the savings.
- An across the board suspension may well be less unpalatable to those affected than one that is selective in its application – recognition by recipients of Commonwealth payments that all are equally affected, and then only temporarily, could help reduce opposition to the measure.

A suspension should not extend beyond two years – distortions and financial stress (such as for welfare recipients) would be aggravated by too lengthy a suspension.

A suspension could have wider macroeconomic benefits through increasing pressure on Government to implement policies that limited price and cost increases. It would enhance the need for Government to continue to contain inflation and to introduce a labour market regulatory environment that restored more flexibility in the market and through that help limit excessive wage increases.

An alternative to suspension is granting for a period just a proportion (say, half) of the indexation that would otherwise apply.

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## 2. Review of indexation

The opportunity might also be taken by the Commission to review:

1. The indexation factors applied to individual outlays, and
2. Whether particular outlays should be indexed at all.

Indexation was introduced largely in response to continuing high rates of inflation. The practice gradually was expanded to the current extensive coverage of outlays. Now that inflation has moderated considerably, and looks to be under control for the future (absent one-off events and given the continuing autonomy of the Reserve Bank), the need indexation is much lessened.

Removing indexation of certain payments and changing the indexation factors applying to others would probably produce net savings. And ensuring that the indexation factors applied were appropriate would ensure that outlays recipients received no more, or no less, than needed to compensate for the effects of price and cost increases.

Government could still make occasional, discretionary increases to the payments that were unindexed, in recognition of price and cost increases. (Compare, in this regard, the removal in 1982 of the automatic indexation of the personal income tax thresholds[1]. That change gave Government more control over the personal income tax settings and, with that, the quantum of collections. And it also restored the opportunity for Government to gain political kudos when it did introduce discretionary reductions in the thresholds – such kudos could be expected to accrue from discretionary increases in rates of payment.)

The suggested review would be a task of some magnitude, and may not be achievable within the timeframe for the Commission's deliberations and reporting. So the Commission might consider and recommend some guidelines for a review of these matters by Government.

## 3. Extension of the efficiency dividend

The dividend applies to the running costs of Government agencies, normally at the rate of 1.25 per cent (though 4 per cent in 2012-13). The dividend has its drawbacks, especially when applied over a number of years, but it is an effective means of putting some limit on expenditure increases.

The Commission might consider an extension of the coverage of the dividend. Areas for its wider application could include grants for the running costs of NGOs and other like payments. It would be important, however, to limit the time period of the dividend's imposition, lest the sorts of problems and inefficiencies Government agencies have experienced from its sustained application would arise.

[1] Indexation had been introduced in 1976 by the Fraser Government following sustained high inflation from the early 1970s. In 1976, CPI inflation was almost 14 per cent.

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Reviewing all spending for possible application of the dividend would be another large task, and may also not be achievable within the timeframe for the Commission's deliberations and reporting. So the Commission might consider and recommend some guidelines for a review by Government of an extension.