TARGET30

REDUCING THE BURDEN FOR FUTURE GENERATIONS

TARGET30—TOWARDS SMALLER GOVERNMENT AND FUTURE PROSPERITY

Simon Cowan

with contributions from
Robert Carling and Peter Saunders

and

Andrew Baker, Jennifer Buckingham, Stephen Kirchner,
Peter Kurti, and Jeremy Sammut

THE CENTRE FOR INDEPENDENT STUDIES

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Other Authors/Contributors:

Carling, Robert G., author.

Saunders, Peter., author.

Kirchner, Stephen, 1968- author.

Baker, Andrew, author.

Sammut, Jeremy, 1971- author.

Buckingham, Jennifer, author.

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Foreword by Greg Lindsay
Executive Director of the Centre for Independent Studies

It would be an understatement to say that we are living in challenging times. Whether they are economic, political, social or cultural, some profound changes and hard decisions are being forced on us. The continued growth of government has brought some countries to the brink of economic collapse with worrying implications for Australia. To date we've avoided the worst of the fiscal excesses seen elsewhere (particularly in southern Europe) but things can change very quickly. We cannot allow a similar crisis to happen here.

Australia, like much of the Western world, has an ageing population and is facing rising health care and social costs. Economic growth is likely to slow down further as many of the gains made from opening up our societies and economies to trade and new ideas have already been realised.

At the same time, these factors squeeze budgets. Fuelled by borrowed money, governments have been growing bigger and bigger and becoming more and more ill disciplined in their management of public resources. Governments have also been increasingly intruding into areas of our lives that were never, and should never have been, the state's responsibility. So much so now that voters expect government to inoculate them even from poor choices and bad luck. This is unsustainable.

Governments can be inefficient and ineffective because they use blunt political tools that rarely result in the best outcomes for citizens. Too often, the results of government action are not even considered before more taxpayer money is called for.

By defaulting to a big government solution to every problem, we disempower individuals and communities from dealing with their own problems. This ultimately leads to dysfunctional societies.

I believe the best way to meet the challenges of the twenty-first century is for governments to step back. I also believe they should do so sooner rather than later.

To deal with what we see as one of the most serious issues facing the country, The Centre for Independent Studies is inaugurating a program, TARGET30, aimed fairly and squarely at highlighting this unsustainable spending problem. We will also be questioning the expanding role and functions of government. This rebalancing of the relationship between state and society is long overdue.

TARGET30 will consist of a series of research reports and companion activities, including public events, commencing with this introductory report, proposing concrete plans and policy suggestions for reducing the size of government in Australia from approximately 35% of GDP today to 30% or less over the next 10 years.

The research in TARGET30 aims to continue to engage in this battle of ideas—and propose affordable and sustainable ways solutions to the challenges facing Australia and elsewhere. We will look at ways to improve the delivery of health care, education and welfare, among other areas. In each case, we will present realistic policy solutions designed to reduce the burden of government and generate real benefits for society as a whole. The CIS has always been an ideas leader, and as Hayek reminds us, belief in the power of ideas is the key to reform. We have the best ideas.

The forces arrayed in favour of big government should not be underestimated. Government's spending addiction and citizens' desire to get something for nothing will take a long time to mitigate. TARGET30 is a pragmatic, practical first step towards realising smaller government.

TARGET30 represents a positive vision for a future Australia that is socially dynamic, prosperous and free—the sort of society we would all be proud to live in and bequeath to our children and grandchildren.

Will you join us to build a better future for Australia?

Greg Lindsay

Executive Summary

- The size of government in Australia (federal, state and local) has been steadily expanding over the last 40 years, reaching into areas far beyond the core government responsibilities.

- Spending in the general government sector (across all levels of government) has been growing at an average of more than 4% per year (inflation adjusted) since 1972 and is now at nearly 35% of Gross Domestic Product (GDP).

- Australia will face budgetary pressures in the coming decades from an ageing population, falling economic growth, and rising costs (especially in health). These challenges and escalating government spending will impose heavy burdens on future generations.

- The Centre for Independent Studies' TARGET30 campaign will prepare Australia for these challenges by proposing realistic policy solutions to reduce the level of government expenditure to less than 30% of GDP over the next 10 years.

- Without TARGET30, government expenditures may exceed 50% of GDP by 2050, resulting in higher taxation, higher debt, lower economic growth, and a further reduction in social capital.

- TARGET30 on the other hand aims to boost economic growth and reduce taxes. Shrinking the size of government will also stimulate the charitable sector, foster personal responsibility, and reforge the community ties that once bound our society together.

- TARGET30 is not an 'austerity' campaign. It does not propose to abolish the welfare safety net, or punish the poor. TARGET30 merely asks Australians to consider what they really need government to provide, rather than simply demanding more of what they would like but don't want to pay for.

- The research reports prepared for TARGET30 will focus on ways to ensure the efficient and effective delivery of crucial services that Australians require while curbing the uncontrolled growth of wasteful government spending.

- Although Australia is in an enviable economic position compared to the rest of the world, we still need to learn lessons from the fiscal and debt crises in big-spending, big-government countries and act now to ensure prosperity for future generations.

- TARGET30—because a smaller government means a bigger future for us all.

Introduction

TARGET30 is a campaign promoting the benefits of smaller government, supported by a series of research reports proposing concrete policy solutions in key areas such as welfare, education and health. TARGET30 aims to reduce the share of Gross Domestic Product (GDP) absorbed by all levels of government from its current level of 35% to less than 30% within the next 10 years. Thirty per cent of GDP is a pragmatic and practical target for government spending and it would put Australia on the right track to meet its future challenges.

TARGET30 acknowledges that governments have a crucial role to play in modern societies. There are always some things that need doing which individual citizens, voluntary organisations, and private companies are unable or unwilling to do, therefore requiring state intervention.

However, over the last hundred or so years, government intervention has expanded far beyond this limited scope to include responsibilities that citizens could (and arguably should) be discharging themselves. Nowadays, anytime there is a problem, we invariably and immediately turn to the government rather than explore solutions on our own first. We have come to expect that governments will do anything we are unable or unwilling to do ourselves.

As the scope and scale of modern government has kept on expanding, we seem to have locked ourselves into a crazy spiral of increasing state intervention linked to declining policy payoffs. Instead of stepping back and exploring alternatives, every time some government initiative fails to deliver the promised benefits, the cry goes up for even more ambitious intervention. The result is that, despite an ever-increasing state and ever-escalating levels of public expenditure, the electorate is increasingly frustrated and dissatisfied by labyrinthine government policies that fail to discharge government's main duties.

TARGET30 aims to reduce government spending from its current level of 35% of GDP to less than 30% within the next 10 years.

Australia needs to check this continued government expansion to navigate the future fiscal challenges from an ageing population, spiralling health care costs, lower economic growth, and the risk of wider economic failures. The productivity gains from the economic reforms of the Hawke/Keating and Howard/Costello governments as well as the mining boom have given Australia the luxury of pursuing the benefits of smaller government while the economy remains strong, avoiding the downsides of enforced structural adjustment in a weak economy (mislabelled as austerity).

But we can do better than merely avoid a looming crisis. By scaling back the size of government, TARGET30 can inject new vigour into the economy. This would give us a competitive advantage in the global economy, enabling us to have some of the lowest tax rates in the developed world and boosting economic growth. This strong growth would generate the tax revenue necessary to sustain a social safety net for an ageing population.

TARGET30 can also unlock the social and community benefits of smaller government—allowing the charitable sector to once again play a significant role in society, strengthening the bonds of family and community, and recreating the social capital that once kept society functioning effectively.

This report will present the rationale for a realistic return to sustainable levels of government spending (30% of GDP) and form the foundation of a targeted campaign against wasteful, inefficient government spending (the TARGET30 campaign). It will explain what can be achieved with TARGET30. It will look at the current size of government in Australia and where it is headed given the challenges facing the country. Finally, this report will present the arguments for smaller government and build the case for a small government solution to our future problems.

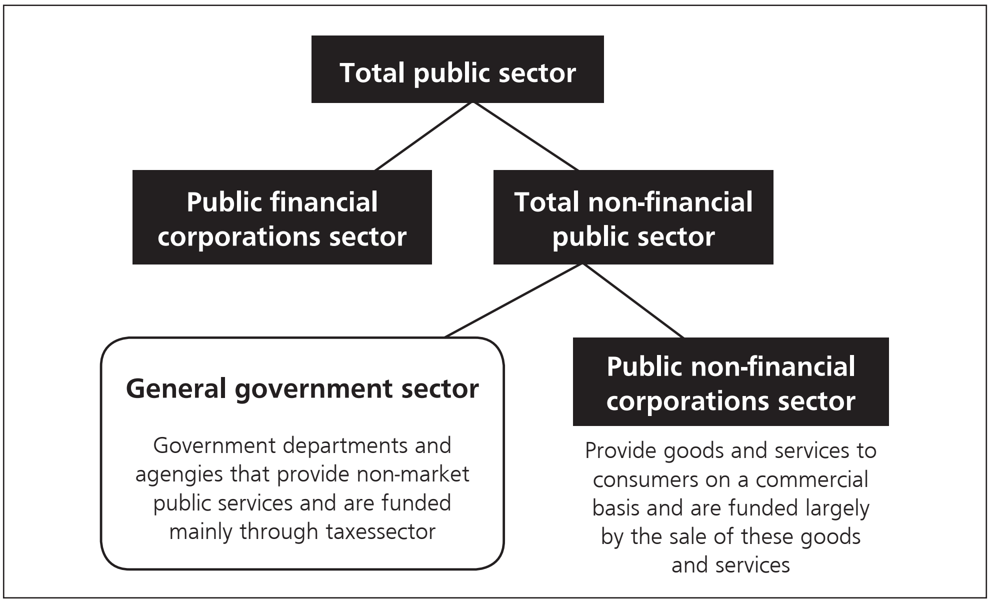
The size of government in Australia

The first step in the TARGET30 campaign is to look at the overall size of government in Australia and identify the priorities for further analysis.

Measuring the size of government

Any attempt to distil government intervention to a single figure has its limitations. However, since government spending drives taxation, and both raising and spending money have economic costs and benefits, aggregate general government sector spending (across all three levels of government) represents the best available option for measuring the size of government.

Figure 1: Components of the general government sector



Source: Commonwealth of Australia, *Budget 2011–12*, 'Budget Paper 1: Statement 9,' Appendix A.

TARGET30 can also unlock the social and community benefits of smaller government.

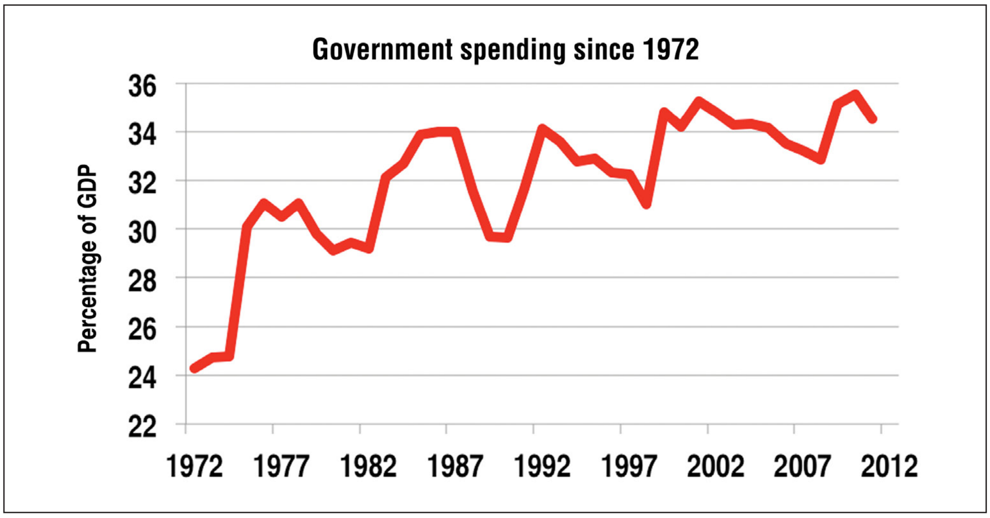
It should be noted that while aggregate government spending is a good measure of the size of government, it is an incomplete measure of government intervention (for example, it does not capture the impact of regulation). For further discussion of these issues see Appendix C.

Trends in government spending levels

The role of government has changed tremendously during the twentieth century and into the twenty-first century. The difficulties in constructing a meaningful data set across a century or more also show that any comparisons with the level of government spending from a hundred years ago are fraught with difficulty.

A more appropriate starting point for analysing the growth of government is the rapid expansion of Australia's welfare state commencing with the election of the Whitlam government in 1972. Among other policies, the Whitlam government introduced welfare for single mothers and relaxed means testing for pensions in 1973; scrapped university fees in 1974; and implemented a national health care scheme (now called Medicare but then called Medibank) in 1975.

Figure 2: Growth in Australian government expenditure, 1972–2012



Source: ABS (Australian Bureau of Statistics).[1]

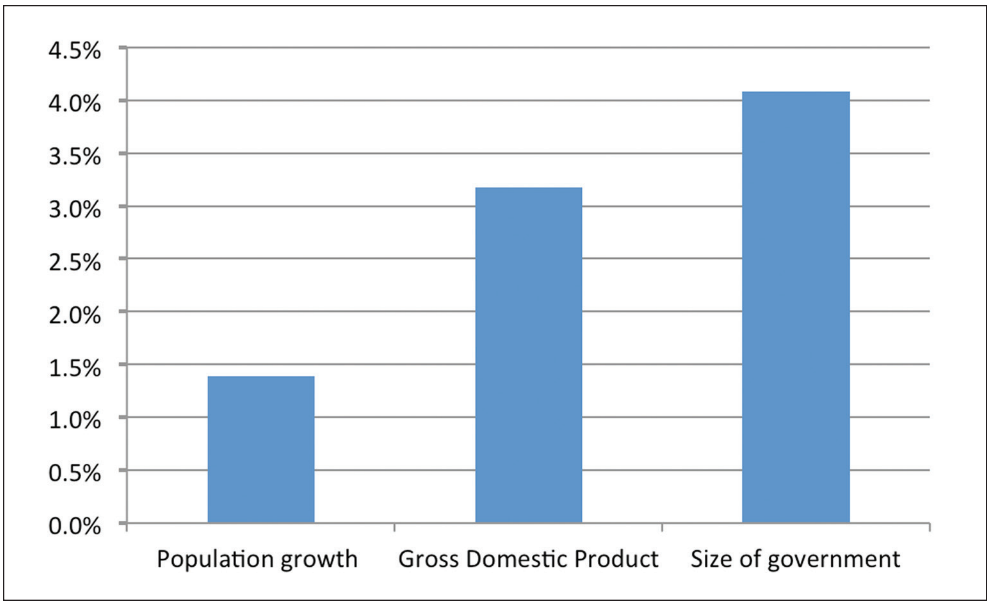
Note: The ABS figures are used because they constitute a reliable, complete data set.

Figure 2 clearly shows the continued increase in the size of government commencing with the implementation of Whitlam's social policies. Another noticeable feature is that, while changes in the size of government are cyclical (because during recessions, government expenditure expands while the economy contracts), the increases in government size during economic downturns are never fully unwound when the economy improves. The underlying trend remains firmly upwards.

The increases in government size during economic downturns are never fully unwound when the economy improves.

The trend towards larger government is even more self-evident in comparing the growth in the size of government with population and GDP growth rates.

Figure 5: Real average annual growth, 1972–2011



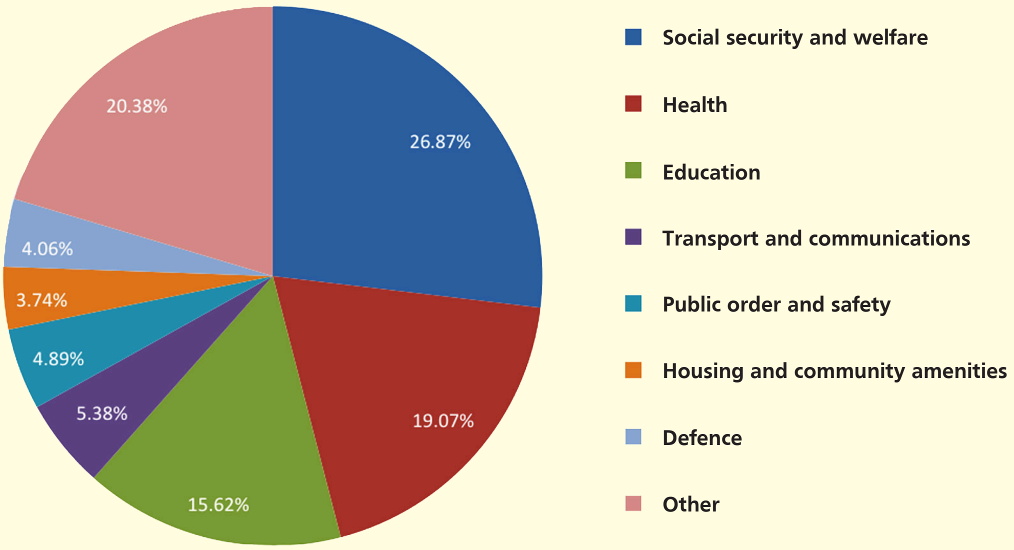
Source: Various.[3]

The history of government growth can also be viewed through the prism of Commonwealth/state relations. The Treasury's budget papers show that in the 40 years to 2010–11, Commonwealth payments grew at an average annual rate of 4.1% in real terms, which slightly exceeds the growth rate for all levels of government over this period. While total Commonwealth payments include grants

Box 1: Where is taxpayer's money spent?

The majority of government spending goes into three key policy areas: social security and welfare, health, and education—accounting for more than 60% of general government spending.[2] The large potential gains from savings in these areas make them the focus of the initial TARGET30 reports; however, future reports will also look at industry assistance and public sector workforce efficiencies.

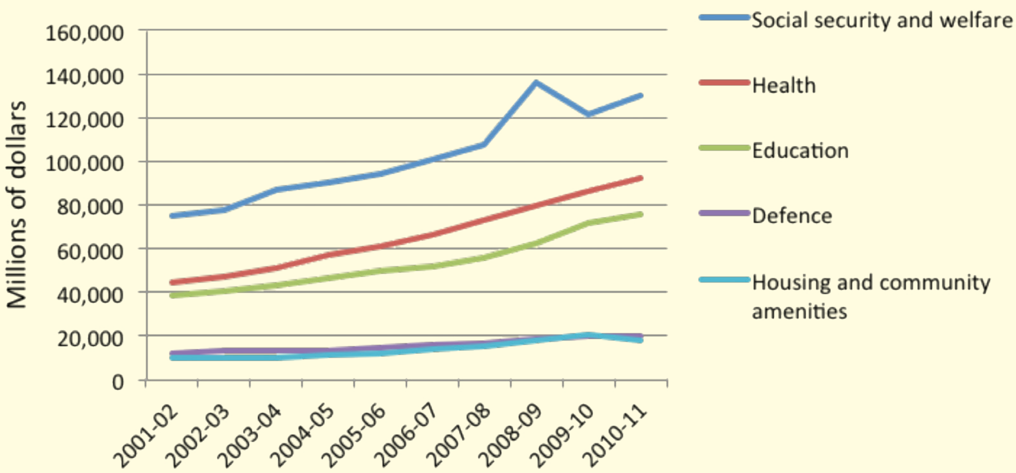
Figure 3: Government spending on key areas, 2010–11



Source: ABS (Australian Bureau of Statistics), *Government Finance Statistics 2010–11*, Cat. No. 5512 (Canberra: ABS, April 2012).

Health and education spending in particular have seen very strong growth in dollar terms over the last 10 years (health by 109% and education by 98%); other traditional areas of government spending (such as defence and transport) have grown much more slowly (68% and 66% respectively).

Figure 4: Spending trends across priority areas, 2001–02 to 2010–11



Source: ABS (Australian Bureau of Statistics), *Government Finance Statistics 2010–11*, Cat. No. 5512 (Canberra: ABS, April 2012).

to the states, these increased at a slightly slower pace on average, which means the Commonwealth's own-purpose payments grew more rapidly. The source of this rapid growth can be seen in the changing composition of Commonwealth 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.

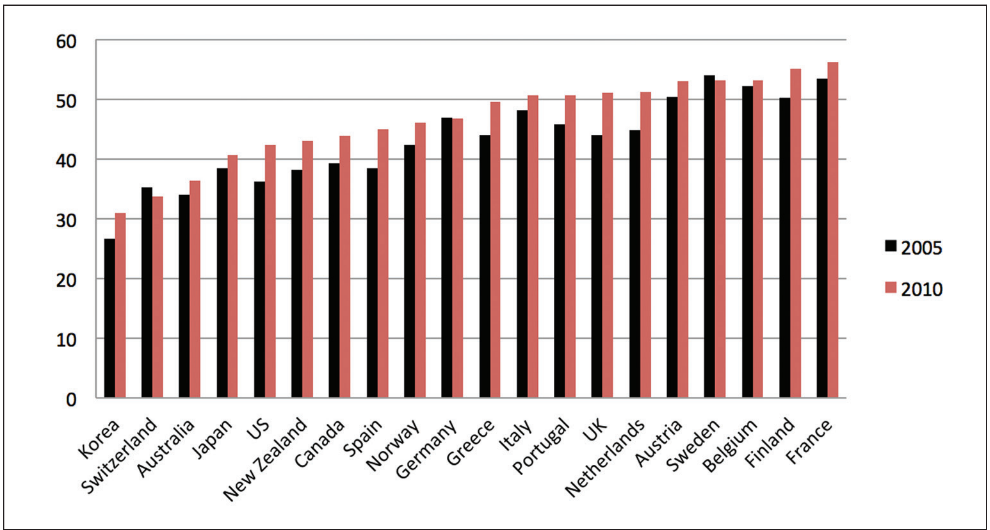
International comparisons of the size of government

Advocates of larger government in Australia like to cite international comparisons as evidence for the need for Australia to *increase* government spending. Australia belongs to a small group of OECD countries with government sectors in the range of 30% to 40% of GDP in 2010, the other two being South Korea and Switzerland. All other developed OECD countries have government sectors above 40%, with many above 50% of GDP.

The fact that government spending in many other developed countries is running at 40% or 50% or even more of their GDP does not mean big government is a worthy goal. Instead, it is the result of decades of misguided policies of advanced Western democracies.

Government spending at 50% or more of GDP is the result of decades of misguided policies.

Figure 6: Government spending as a percentage of GDP



Source: OECD (Organisation for Economic Co-operation and Development), www.oecd.org/statistics.

Note: Different data sets covering the same period of time show different figures depending on what is included in the underlying calculations.

As can be seen from some of the countries cited in Figure 6, many countries with larger public sectors than ours are under fiscal stress, if not in a state of crisis, at least in part because of their inflated levels of government spending. High levels of spending over many years have driven tax and/or public debt burdens to damaging levels. Their experiences should be a cautionary lesson to Australia rather than a clarion call for more government spending.

Instead, we can carve out competitive advantages by having smaller government with lower taxation and less regulation, as long as 'smaller' government is sufficient to meet the legitimate demands for taxpayer-funded education, infrastructure and other government services that can contribute to international competitiveness.

What Australia has got right and why government is growing anyway

While anecdotally government seems as intrusive in Australia as it is in other developed countries with government spending in excess of 50% of GDP, there are two reasons why our government spending ratio is still below 40% of GDP.

One is that the public age pension has been kept relatively lean and means tested, with more adequate retirement incomes channelled through the private superannuation system. In most other OECD countries, public pension schemes are contributory while the benefits—often linked to final earnings—are larger. These contributions and benefits inflate public sector size.

Another reason for Australia's relatively smaller public sector is that many social benefits are subject to means tests, and therefore, are more targeted than in many other countries. It is not that the range of available benefits is notably narrower, or that the benefits are less generous, but that the eligible population is contained by tighter criteria.

These policies have helped prevent some of the worst excesses of government spending evident in many other developed countries. The increasing challenge now is to prevent government growth stemming from new programs and the expansion of existing programs (especially in health and ageing).

If there had been no new programs or policy changes in existing programs in the 10 years to 2010–11, real Commonwealth spending growth would have averaged just 1% per year—a growth rate that would not even maintain the level of real spending per capita. It was the abundance of new programs and policy changes that boosted actual growth to over 4% a year.[4] That is a huge difference, cumulating to an ongoing annual cost of $85 billion after 10 years.[5]

Given the inefficiencies inherent in public spending, there is clearly scope to reduce the size of government without unduly reducing the social safety net.

Given the increasing reach of these new government programs and the general level of inefficiencies inherent in all public spending, there is clearly scope to reduce the size of government and strengthen economic growth without unduly reducing the social safety net.

What does the future have in store?

While the growth in government spending in Australia over the last 40 years is concerning, Australia is not facing a public spending crisis yet. However, this does not mean Australia is immune to the effects of a large (and increasing) public sector; nor can we ignore looming potential problems. TARGET30 is a forward-looking campaign, designed to put Australia in the right position to meet these challenges. So what pressures is Australia facing?

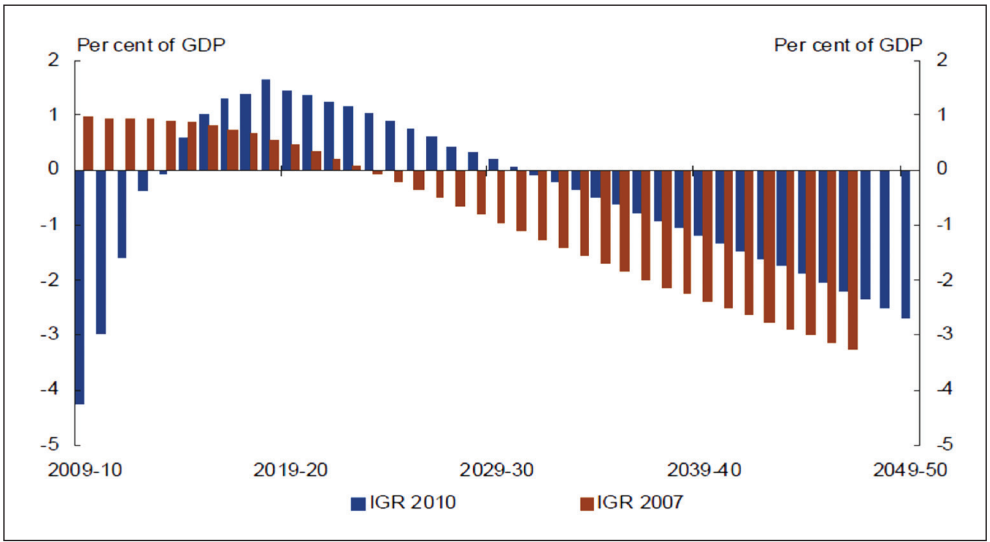
Driving future growth of government

The Treasury's third *Intergenerational Report* (IGR 2010) predicts federal government spending (excluding debt interest) will rise to 27.1% of GDP by 2049–50 on a 'no policy change' basis.[6] The report notes that a fiscal gap* of 2.75% of GDP by 2049–50 will need to be closed by increasing taxes (contrary to the government's stated policy), breaking promises on future programs, or cutting entitlements and spending.[†]

In his review of the Australian tax system, former Treasury Secretary Ken Henry flagged what he views as the more likely outcome:

> The tax system needs to be prepared for the probability that, in order to finance the government-provided goods and services demanded by the community … the tax system will, over time, have to generate revenues to meet substantially larger fiscal costs.[7]

Figure 7: Projected fiscal gap



Source: *Intergenerational Report 2010*.[8]

The factors driving demand and creating the fiscal gap are straightforward. First, despite being partially offset by an increase in the number of older Australians remaining in the workforce and the increasing retirement age, Australia's ageing population will result in slower rates of economic growth as the proportion of the overall population participating in the workforce falls.

Second, our expectations for government-provided goods and services are growing. Over the next 40 years, health and aged care costs are expected to grow faster than GDP, taking up a greater share of the economy as the population ages and the average cost of services increases. Compounding these pressures are community expectations that government will provide new services (National Broadband Network, National Disability Insurance Scheme, etc.) or substantially reform existing services with more spending (Gonski education reform).

Over the next 40 years, health and aged care costs are expected to grow faster than GDP.

Third, structural economic changes and global economic weaknesses are altering the relationship between the size of the economy and tax revenue. The boom in government revenue up to 2007–08 has not resumed following the abatement of the global financial crisis, with revenue growth averaging just 1% a year over the three years to 2010–11. Slow revenue growth is likely to continue for some years, particularly if the prices of Australia's commodity exports fall.

Treasury has suggested that the nation can grow the economy out of these fiscal challenges by increasing the size of the working-age population, workforce participation, and productivity growth.[9] However, this approach would be much more effective if it is coupled with fewer inefficiencies and lesser waste in government spending. TARGET30 reforms will reduce the size of the fiscal gap and boost growth—and have the added social and economic benefits associated with a reduced size of government. For further discussion of the economic and social rationales for smaller government please see Appendix A and Appendix B.

* The fiscal gap is total government receipts minus total government payments (excluding interest).

† Some countries have attempted an alternative approach of filling the gap with continual increases in government debt, an approach that is proving to be unsustainable in the long term.

Forecasting future government growth

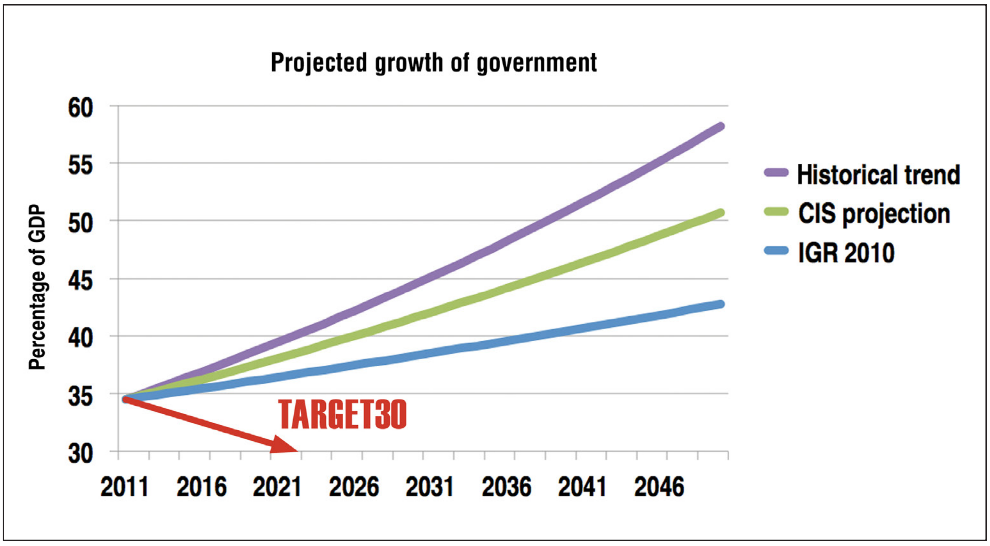
Despite noting the impact of the strong demand factors and forecasting a slowdown in economic growth to just 2.7% per year, IGR 2010 anticipates that growth in government spending to 2050 will be lower than the growth rate of the last 40 years.[10] When adjusted for estimated state government spending growth, IGR 2010 predicts that government spending will be approximately 43% of GDP by 2050.[11]

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 Commonwealth spending over the last 10 years). Finally, IGR 2010 assumes government will shrink substantially over the next few years because of strong economic growth and a cap on real spending growth at 2% a year.

Demand factors and growth trends may increase the size of government to more than 50% of GDP by 2050.

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.[12] This would increase the size of government to more than 50% of GDP by 2050.

Figure 8: Projections of government growth



Source: Various.[13]

Getting to 30% in 10 years

To be best placed to meet these challenges, Australia needs to be in good fiscal shape before their impacts are felt. This means limiting the growth in government expenditure and checking the expansion in the role of government, ideally leaving Australia free of public debt and with government spending under 30% of GDP in 10 years' time. While subsequent TARGET30 reports will deal with specific spending areas, it is worth identifying a basic approach to help us get to 30%.

So why 30%?

Before examining ways to get to 30%, let us study the reasons for targeting 30% of GDP or less as our goal for government spending.

The optimal or efficient size of government is that which maximises the rate of sustainable economic growth, as this is likely to provide the highest living standards and greatest utility for society. While the optimal size can never be known with certainty, there is considerable evidence to suggest that 30% is likely to be an upper limit to the efficient size of government.

The growth of government spending in the twentieth century was documented by Vito Tanzi and Ludger Schuknecht, who noted that countries with relatively smaller governments have economically outperformed their bigger government counterparts without underperforming on a broad range of social, environmental and other indicators.[14] Tanzi and Schuknecht find that for developed countries, the optimal size of government is likely to be less than 30% of GDP and closer to 20%.[15] This implies that many governments throughout the developed world likely surpassed their efficient or optimal size from 1960 onwards.

Even John Maynard Keynes, the economic godfather of big spending government, stated that '25% as the maximum tolerable proportion of taxation may be exceedingly near the truth.'[16]

The literature on the optimal tax rate for the United States and New Zealand suggests that the combined federal, state and local tax share of GDP should be between 19% and 23%.[17] Given that the Australian economy is structurally similar to the US and NZ economies, the optimal tax share of GDP in Australia is likely to be in this range.

30% is likely to be an upper limit to the efficient size of government.

There is a strong theoretical and empirical case for limiting growth in the size of government as a share of the economy. The empirical cross-country evidence on the relationship between government size and economic growth is mixed, and there is a fundamental problem of distinguishing correlation from causation. However, evidence points to a negative relationship between government size and economic growth.[18] It is also no coincidence that many countries with big, expanding governments face similar issues such as high debt, structural problems with taxation, and sluggish growth.

However, given the potent forces in favour of big government, cutting government spending is not easy. This is especially true if you attempted to cut 40% of all government expenditure (which would be needed to get government spending under 20%). In practical terms, this would mean government spending in 2021 would be $120 billion below the current level, an unrealistic goal.

In that sense, the TARGET30 campaign takes a pragmatic approach—a target of reducing government to 30% of GDP represents a compromise between the economically ideal size of government and what is achievable given the practical and political difficulties in cutting government spending at all.

How much does government need to save under TARGET30?

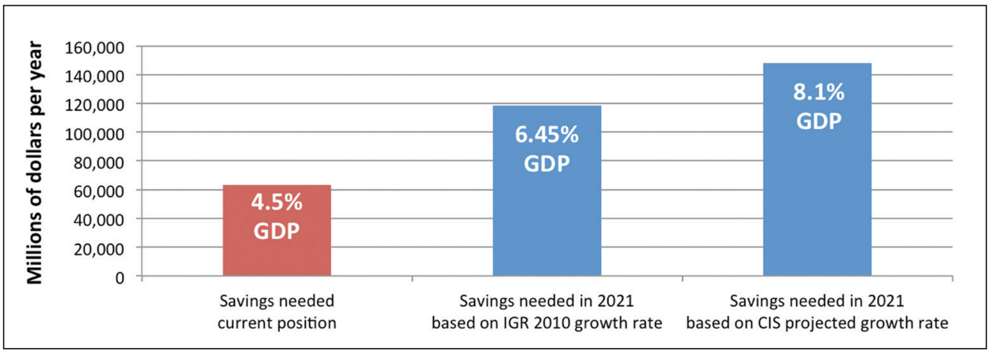
To reduce government expenditure to 30% of GDP, a reduction in government spending of about 4.5% of GDP would be needed (approximately $63 billion per year in savings based on 2011 data).

This may sound dramatic but, if spread over a number of years and if GDP keeps growing, it need not imply a reduction of that magnitude in the absolute level of government spending even in real (inflation-adjusted) terms. Even after achieving the TARGET30 cuts, government spending in 10 years would still be $65 billion dollars a year[‡] above 2011 levels (assuming 2.7% economic growth as predicted in IGR 2010). This is an increase of 1.35% per year, which means government expenditure per capita would remain will be broadly unchanged.

‡ Expressed in 2011 dollars.

However by 2021, if government continues to grow at an unchecked pace, the level of savings needed to reach 30% could be as high as 8.1% of GDP (nearly $150 billion).

Figure 9: Savings needed to achieve TARGET30—then and now



Source: ABS (Australian Bureau of Statistics), *Government Finance Statistics 2010–11*, Cat. No. 5512 (Canberra: ABS, April 2012); Commonwealth of Australia, *Australia to 2050: Future Challenges* (Canberra: January 2010); The Treasury, *Intergenerational Report 2010*.

While overall trends in government spending are important, these trends are driven by spending in welfare, health and education.

Box 2: Challenges in health, welfare and education sectors

While overall trends in government spending are important, these trends are driven by spending in the key areas of government. Growth in welfare, health and education spending has impacts on both the size of government and society. What are the pressure points in these key areas?

Health: Assuming there are no changes to current policy settings, Australian governments will become increasingly unable to fund the projected cost of existing programs, especially public health programs, out of existing sources of government revenue. According to IGR 2010, increased spending on Medicare, driven by the dual impacts of an ageing population and advances in health technology, will be the major factor contributing to unsustainable pressure on government budgets.

Ensuring our increasingly scarce health dollars buy better and more cost-effective health services is essential given that health is the area of public expenditure with the greatest potential for substantially increasing the size of government in coming decades.

Social security and welfare: In 2012–13, Commonwealth expenditure alone on social security services and welfare payments will be nearly $132 billion and will account for 35% of Commonwealth spending.[19] Forward estimates to 2015–16 show Commonwealth expenditure on social security and welfare is expected to grow to $150 billion.[20]

Australia's ageing population will place substantial pressure on government finances as more people begin to retire. From 2012–13 to 2015–16, the number of people receiving the Age Pension is expected to increase by around 220,000 to more than 2.5 million.[21] Ageing is expected to be the main source of budgetary pressure for future governments, and government spending on age pensions and aged care is expected to increase substantially as a proportion of GDP by 2049–50.[22]

Education: The key challenge to reducing, or even maintaining, public spending on school education is the pending implementation of a new federal funding model for schools—the Gonski reforms. In 2010–11, total government recurrent spending on primary and high schools was $44.3 billion[23] and capital spending over the same period was estimated at $8 billion[24]—together comprising 3.7% of GDP.[25] The additional recurrent spending associated with the new model was originally pegged at $5 billion per annum but has since been revised to $6.5 billion per annum. This figure has not yet been confirmed, but the Gillard government's pledge to fund school reforms through cuts in other areas indicates that the impact on the federal budget is likely to be substantial.

Is TARGET30 achievable for Australia?

In the past, many countries (including Australia) have recorded reductions in the relative size of government even larger than implied by TARGET30, albeit from a higher starting point. One notable case is Sweden, which gained international notoriety for its bloated public sector, and has cut back from above 60% of GDP in the 1980s and 1990s to around 50% in recent years through sustained policy reforms. As a result, the Swedish economy has gained new vigour. Another example is Canada, which went from a peak of more than 50% in the early 1990s to around 40% in the five years before the global financial crisis. Consequently TARGET30 is setting an achievable goal.

Historically, both in Australia and elsewhere, episodes of government spending restraint have been prompted by economic crises (such as the so-called austerity programs in Europe after the global financial crisis). The constituencies that develop around government programs have proven so strong that it has taken a crisis to overcome resistance to cuts in programs. TARGET30 asks Australians to take a long-term perspective on the national interest—to curtail government by choice or in anticipation of future problems resulting from oversized government, rather than in response to a crisis.

TARGET30 asks Australians to take a long-term perspective on the national interest—to curtail government by choice.

The challenge for TARGET30 is that governments are not good at clamping down on their own spending—even if it means no more than lowering their rate of growth—in the absence of an economic crisis or malaise to which lower government spending can be rationalised as a solution. To the contrary, governments have been satisfied to use some of the fruits of economic expansion to enlarge their spending. This is what happened in Australia, for example, during the decades of vigorous expansion up to 2008 and was the rationale for 'spreading the benefits of the boom.'

However, with the end of the boom in Australia's terms of trade and the increasing realisation that Australia's productivity needs to improve, conditions will be tougher in the future. Declining (or even just stagnating) terms of trade mean that government revenue will be lower than otherwise, necessitating an adjustment in expenditure. Together with the need to bolster productivity, these are the keys to the case governments should make for reducing the relative size of government.

Despite the current global challenges, the Australian economy is still growing and is expected to continue growing in trend terms (subject to the usual cyclical interruptions), which should make it easier to reduce the relative size of government. Rising living standards should result in less poverty and reduce the need for income support by government.

The faster the economy grows relative to government spending, the faster the share of government will fall. This is an arithmetic truism, but it is the key to shrinking the relative size of government over a number of years of economic growth. Moreover, as the government share shrinks and the relative tax burden becomes lighter, this will establish a positive feedback loop by helping further fuel economic growth. The following matrix illustrates this point for various growth rates of GDP and government spending, using the 2011 figure (34.5%) as the starting point for the government share.

Clearly, if government spending in the next 10 years were to grow at the same rate as the last 40 years (more than 4% per year), the share of government is likely to increase because the economy is unlikely to record average real growth above 3.5% a year.

Table 1: Government growth matrix for Australia in the next 10 years

Average level of government growth	Average level of economic growth: 2%	2.5%	3%	3.5%	4%
0%	28.3	27.0	25.7	24.5	23.3
0.5%	29.7	28.3	27.0	25.7	24.5
1%	31.3	29.8	28.4	27.0	25.7
1.5%	32.8	31.3	29.8	28.4	27.0
2%	34.5	32.9	31.3	29.8	28.4
2.5%	36.2	34.5	32.9	31.3	29.8
3%	38.0	36.2	34.5	32.9	31.3

Meets TARGET30 goals: 28.3, 27.0, 25.7, 24.5, 23.3 (0%); 29.7, 28.3, 27.0, 25.7, 24.5 (0.5%); 29.8, 28.4, 27.0, 25.7 (1%); 29.8, 28.4, 27.0 (1.5%); 29.8, 28.4 (2%); 29.8 (2.5%)

Fails to meet TARGET30 goals: all other cells

However, Table 1 also shows that TARGET30 is attainable in a 10-year timeframe if the economy grows in the most probable range of 2.5% to 3% per annum. As noted above, Australia can meet the TARGET30 goal by maintaining government spending in real per capita terms assuming the economy grows at the IGR 2010 growth rate (2.7% per annum).

Australia can meet the TARGET30 goal by maintaining government spending in real per capita terms.

As new or expanded spending programs have been the dominant driver of the real growth of government spending in the past, keeping spending constant in per capita terms will be much easier if governments focus on improving the efficient and effective delivery of existing services. Unfortunately, there may be little hope of a change in political behaviour. Costly new programs and policy ideas, such as the National Disability Insurance Scheme, are accumulating at a worrying rate.

Maintaining an *average* rate of government spending in per capita terms over 10 years (meaning spending growth of 1.2% based on population estimates from IGR 2010) does not imply a *constant* growth rate. It would be desirable to initiate restraint with a few years of lower or zero real growth. However, what would not be desirable is a short burst of severe restraint followed by reverting to the old ways, which would simply increase the size of government again. Rather, ongoing restraint needs to be institutionalised.

10 tips to TARGET30

How could the average real growth of government spending be kept down to 1.2% a year or less for 10 years, given that historically it has grown on average by more than 4% per annum? While subsequent reports in the TARGET30 campaign will make specific proposals, some broad strategies can be pursued to curb the growth of government and deliver services more efficiently.

1. Governments should limit new spending initiatives, and new spending programs should be subject to economic cost/benefit analysis and evaluation against alternative policy solutions by the Productivity Commission or an independent fiscal commission.

2. Governments should determine the priority of new spending programs and those programs should be matched by offsetting savings from existing, lower-priority programs.
3. All government programs should be periodically audited to see whether their functions need to be carried out by government at all, whether those programs that are needed are being delivered effectively, and whether spending is being carried out as efficiently as possible.
4. Where appropriate, savings and increased effectiveness can be found by contracting or devolving government services to the private sector.
5. Means testing should be extended to both cash and in-kind benefits. This should be combined with optimising effective marginal tax rates to avoid creating perverse incentives that distort the labour market.
6. Fiscal targets and policy rules (such as those above) could be made harder to ignore by enshrining them in legislation (potentially via a revamped Charter of Budget Honesty).
7. Automatic indexation of income tax thresholds would deprive governments of the revenue from bracket creep and act as an institutionalised control on the growth of government.
8. Government should provide greater transparency of the long-term impact of expenditure and tax policy decisions. Intergenerational reports should be prepared more frequently, updated annually, and include both Commonwealth and state projections.
9. Eliminating fiscal churn, whereby government taxes its citizens only to return the money in the form of various government benefits, could go a long way in realising the 30% target.
10. Governments can make significant savings by increasing public sector efficiency, both in productivity increases from the public sector workforce and reducing pointless bureaucracy and red tape.[††] [26]

While these tips are important, it is also important to look at ways of combating the underlying expectation that the level of government services will continually increase. It should not be assumed that because a government service is needed, it must be heavily subsidised or provided free of charge. Governments should provide much more transparency around the true costs of their services (such as pharmaceutical subsidies), while user charges send important price signals between consumers of services and government and their application should be more widespread (provided they reflect the efficient costs of service delivery and do not become disguised taxation).

It is also important to look at ways of combating the underlying expectation that government services will continually increase.

†† For example, the NSW Intergeneration Report 2011–12 noted that the state's projected fiscal gap could be closed entirely if productivity growth in the public sector were raised just 0.5% above the economy-wide level of 1.6% per year over the next 40 years (meaning public sector productivity would need to grow at 2.1% but starting from a lower base).

TARGET30 will focus on some key areas within health, welfare and education where significant savings can be made.

Box 3: Health, welfare and education: What will TARGET30 look at?

Given the enormous breadth of government programs in health, welfare and education, it will be impossible for TARGET30 to cover every facet of government spending. Instead, it will focus on some key areas within each portfolio where significant savings can be made.

Health: To address long-term affordability problems in health, a national health reform program needs to be implemented to increase the role of private sources of health funding, primarily by shifting to a health saving and insurance voucher health care financing system. A sustainable way to fund rising health costs is to save up and pay for health care over time, using a mix of 'superannuation style' health savings accounts (HSAs) to pay for minor medical services, and by paying for private health insurance premiums to cover the cost of treating major illnesses.

In addition, redirecting Medicare funding towards an insurance voucher system would allow health funds to choose to organise treatment for members in public or private hospitals based on the price and quality of services. Competition will spur improvements in the performance of public hospitals.

Social security and welfare: Any serious attempt at reducing government expenditure needs to tackle social security and welfare payments, and in particular, spending on the aged. Australia's approach to retirement incomes policy, which includes the age pension, compulsory superannuation, and voluntary saving, is not optimal at reducing government expenditure. Targeted superannuation reforms (including lifting the pension eligibility age and aligning it with the superannuation preservation age, as well as requiring pensioners to purchase annuities when they retire) would be a preferable approach. Reforms will not only reduce government expenditure but increase personal responsibility for retirement savings and help minimise lifetime tax-welfare churning. The Disability Support Pension should also be reformed to include job search requirements for those who have a partial capacity to work; for immediate savings of $4.5 billion per year, Family Tax Benefit Part B could be abolished.

Education: There are good reasons for overhauling federal funding arrangements for schools, but the need for a large associated increase in funding (as postulated by the Gonski review) has not been established. There is a tendency to see all money spent on education as an 'investment,' irrespective of the likelihood of any payoff, even though it has been well established that more spending does not equal a better quality of education.

The danger, as with all funding increases, is that it is a one-way street, placing an ever-growing burden on taxpayers. State and territory governments understand this well, facing great resistance to any attempts to rein in costs. TARGET30 will look at the Gonski reforms, as well as education spending in general, to identify areas where increased productivity and savings can be achieved by excising unnecessary programs and inefficiencies in allocation.

Conclusion

The size of government in Australia has expanded rapidly over the last 40 years, with spending increasing at an average rate of more than 4% per year. This increase has occurred during a time of strong economic growth, and has been driven largely by continual demands for new and expanded spending programs.

To date, Australia has avoided the high levels of debt and economic disorder seen in Europe and around the world because, unlike many other countries, some of the worst excesses of government spending in certain key areas have been kept in check here.

However, in the coming decades Australia will face serious budgetary pressures from an ageing population, falling economic growth, and rising costs (especially in health). These challenges and our trend of escalating government spending will impose heavy burdens on future generations.

TARGET30—because a smaller government means a bigger future for us all.

The TARGET30 campaign seeks to break those trends and prepare Australia to meet its future fiscal pressures. It aims to reduce government expenditures from their current level of 35% of GDP to less than 30% of GDP over the next 10 years.

Without TARGET30, government spending in Australia could exceed 50% of GDP by 2050—bringing with it higher debt, higher taxes, and a lower standard of living for our children and grandchildren.

By proposing realistic policy solutions to reducing the size of government, TARGET30 focuses on ensuring that the crucial services Australians require are delivered efficiently and effectively while curbing the uncontrolled growth of wasteful government spending.

Smaller government will also boost economic growth, foster personal responsibility, and help rebuild the social capital that our society once relied upon.

The TARGET30 campaign will be supported by a series of research reports, initially looking at government spending in health, welfare and education and presenting a realistic and achievable path towards smaller government in Australia.

Australia needs to fight the unbridled growth of government to ensure that the country we hand on to our children and grandchildren is still the envy of the world. TARGET30—because a smaller government means a bigger future for us all.

Appendix A—The economic case for smaller government

There are strong economic bases for preferring smaller government. Antonio Alfonzo, Ludger Schuknecht, and Vito Tanzi found that 'countries with "small" public sectors on average report the highest scores for overall performance, and especially for administrative and economic performance.'[27] Moreover, they noted that public sector efficiency was 'significantly higher' for countries with small public sectors.[28]

Table 2: Comparison of the performance of small, medium and big government

Country	Opportunity indicators				Stand "Musgravian" indicators			Total public sector performance
	Administration	Education	Health	Infrastructure	Distribution	Stability	Economic perform	
Average	0.99	1	1	1	1	1	1	1
Small govt (<40%)	1.11	1.01	0.98	1.08	1.08	1.17	1.17	1.07
Medium govt (40%-50%)	0.93	0.98	1	0.93	0.92	0.89	1.03	0.97
Big govt (>50%)	0.99	1.02	1.01	1.01	1.12	1.03	0.85	1.01

Source: Antonio Alfonzo, Ludger Schuknecht, and Vito Tanzi, *Public Sector Efficiency: An International Comparison,* European Central Bank Working Paper Series (July 2003).

David Smith from the Institute of Economic Affairs also looked at the impacts of larger government on economic growth.[29] He found that his own modelling, and that of R.J. Barro in 1997 and the OECD in 2003, all came to a similar conclusion: 'There is a statistically significant negative effect of government consumption on economic growth.'[30]

Smith applies Barro's estimated government consumption ratio co-efficient of –0.136 to the increases in government spending as a percentage of GDP between 1960 and 2005 to estimate the impact on economic growth. He concluded that Australia's GDP would have been 123% higher in 2005 had there not been such a significant increase in the size of government.[31]

Table 3: Estimated impact of increasing the size of government on GDP

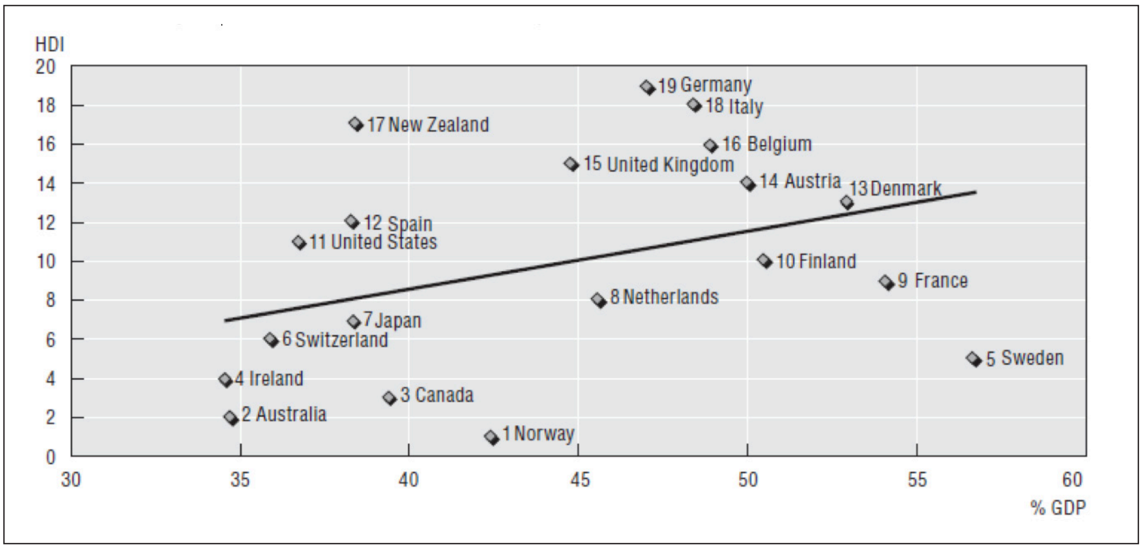
	Change in government spending 1960–2005 (%)	Estimated impact on GDP per year (%)	Cumulative effect on GDP (%)
Australia	13.2	–1.8	–123
Canada	8.1	–1.1	–64
France	19.8	–2.8	–246
Germany	15	–2.1	–155
Japan	19.4	–2.7	–232
New Zealand	–1.3	0.2	9
Sweden	23.4	–3.3	–331
United Kingdom	10.4	–1.5	–95
United States	5.3	–0.7	–37
Average**	13.8	–1.9	-160

Source: David Smith, *Living with Leviathan* (London: The Institute of Economic Affairs, 2006).

** Note the average is calculated from all countries included in the original study and is unweighted; only selected countries are shown here.

However, the impact of big government extends beyond GDP. Tanzi also examined the performance of major economies on the United Nations Development Program, the 2005 Human Development Index (HDI), and compared that with the level of government expenditure.[32] The HDI ranks countries by 'measuring development by combining indicators of life expectancy, educational attainment and income,' with the best performing country ranked 1.[33] He found that developed countries with smaller governments were more likely to be in the top 10 ranks on the HDI.

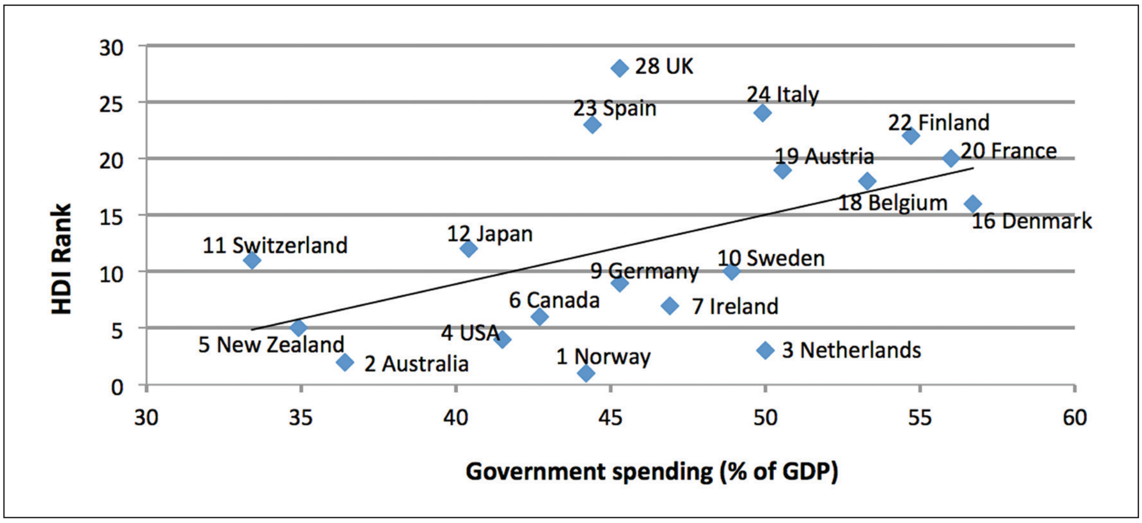
Figure 10: Size of government and the 2005 Human Development Index



Source: Vito Tanzi, *The Role of the State and Public Finance in the Next Generation,' OECD Journal on Budgeting Volume* 8:2 (2008).[34]

This result also held for calculations using the updated HDI data from 2011 and recent OECD / IMF government spending data.

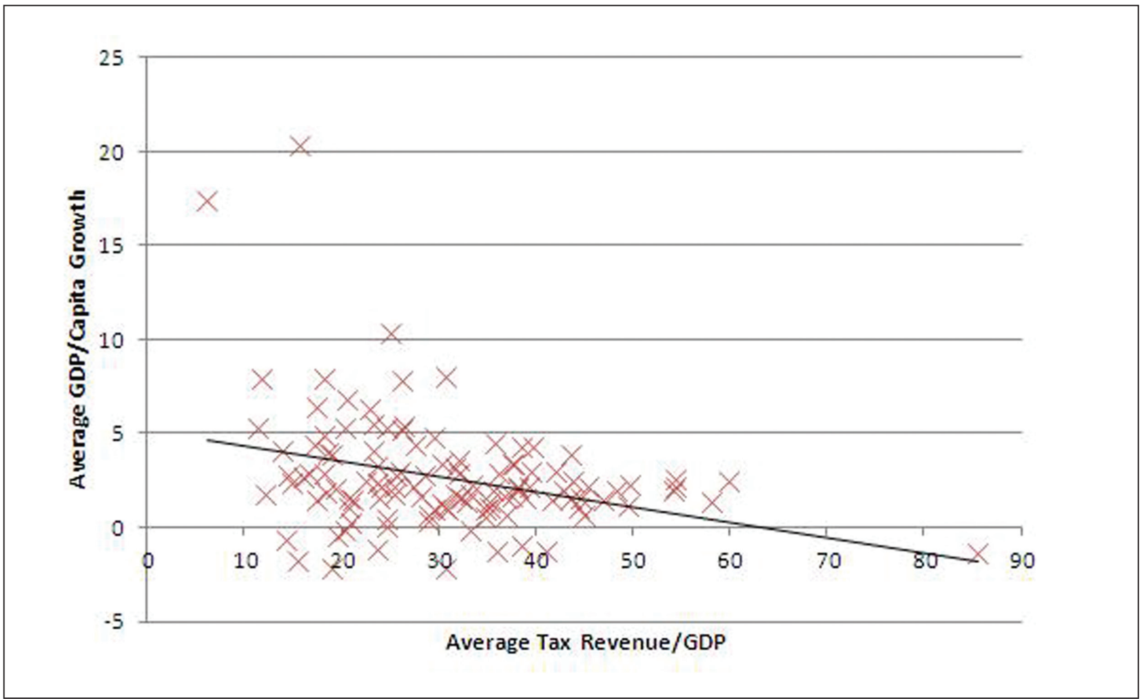
Figure 11: Size of government and the 2011 Human Development Index



Source: 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).[35]

Some commentators have also shown that there is a negative relationship between average GDP growth and the size of government.

Figure 12: Relationship between economic growth and size of government



Source: Sinclair Davidson, 'Everything Depends on Everything Else,' *Catallaxy Files* (3 June 2012).

In addition to the general impacts on the economy from having a large government sector, there are also several specific areas of concern for economies encumbered by large governments.

The burden of debt

While it is undoubtedly true that both small and large governments can run up debts and deficits, it is also a truism that almost everyone would like more 'free' services and to pay less tax. Consequently, the practical and political difficulties of imposing the large tax burden necessary to support a large government tend to lead those governments to fund their growth through debt.

Particularly for the last 50 years, governments of all sizes in developed countries have financed their growth to a significant extent through debt, giving in to their incentive to grow and effectively live beyond their means by borrowing against the future and consuming today.

This imposes an interest burden on current taxpayers and higher taxes on future taxpayers, while crowding out private sector investment. The cost of deficit spending is not just the rate at which the government borrows in capital markets, but it is also the cost of future taxes that will have to be raised to repay the debt.

In addition, high debt levels also negatively impact economic growth. Based on empirical research spanning many years and countries, Carmen Reinhart and Kenneth Rogoff have argued that 90% of GDP is the critical level beyond which the public debt burden significantly slows economic growth and exposes countries to the risk of a sovereign debt crisis.[36] While Australia is far from that level of debt at the moment (net debt is less than 10% of GDP), with IGR 2010 predicting a rapidly growing fiscal gap (expected to grow to more than 2% per annum), government debt will increase rapidly.[37]

Moreover, interest payments on government debt involve raising taxpayer dollars (taken from various income levels in society) and transferring them to the richer end of society (who can afford to lend the government money in the first place), potentially increases the level of inequality.

The burden of taxation

One of the burdens created by a large government is the imposition of substantial taxes needed to fund the government's activities. Taxes create inefficiencies in the allocation of resources, as participants in the economy restructure their activities from ones that are productive but highly taxed to those that are less productive but attract lower taxes. As the tax level increases, the benefits of engaging in extra economic activity shrink and some people choose not to act at all (for example, high marginal income taxes reduce the incentive for people to work extra hours).

These behavioural responses to taxation mean that it not only takes resources from the private sector equivalent to the amount of taxation but also generates an 'excess burden' or 'deadweight loss' (DWL). As a rule of thumb, DWL increases in proportion to the square of the tax rate. A rising tax share of GDP will reduce economic growth, and as tax rates increase, the excess burden rises faster than revenue raised. The economic burden of the tax system can be reduced through tax reform to restructure the burden by lowering rates, broadening tax bases, and shifting from less to more efficient taxes, but the payoff to these efforts will be constrained by the overall size of government.

Gerald Scully estimates that the United States has sacrificed $4 of income for every dollar of tax paid in excess of the optimal level of taxation ($2.64 for New Zealand).[38] It is likely that Australia is suffering similar losses in national income. As Scully also notes, the excess tax burden lowers overall revenue collections by reducing long-term economic growth. Smaller government as a share of GDP may actually allow for more government spending in absolute terms, not less, which will leave the federal government better placed to realise equity and other policy objectives.

Inefficient resource allocation

In his 1776 work, *The Wealth of Nations*, Adam Smith famously described the 'invisible hand' of the market—the self-interest of buyers and sellers in the market generating competitive forces that lead to benefits like productivity increases, innovation and the efficient allocation of resources.

Governments lack both the knowledge and the incentives of the market. They are motivated by different factors; as government spending increases, the productivity and ingenuity of the economy is likely to decrease.

Regardless of government's motives for intervening in this process (redressing inequality or fairness or benefiting a disadvantaged group), such measures reduce the efficiency of the market. The merits of these motivations, and their successes, must be weighed against the overall reduction in the potential size of the pie caused by governments intervening in the market.

Rent seeking

Related to the two points above, a significant problem of government intervention is that government must provide incentives to people to devote resources away from productive activities to the government's preferred (but less productive) activities.

By providing these rewards, more and more resources are devoted to lobbying and encouraging the government to provide greater benefits and more rents (which further reduces efficiency). This is a less visible, but still important, efficiency cost of government.

Appendix B—The impact of the size of government on society

The case for smaller government goes well beyond simply economic factors, however. There is evidence to suggest that big government also damages individuals and societies.

Entitlement mentality

One of the most striking features of the growth of government spending in the West over the last hundred years is that the demand for handouts has shown no sign of weakening. Quite the reverse: the more governments spend on goods and services, cash transfers and subsidies for their citizens, the more voters expect to receive. Spending on disability support payments has spiralled, for example, even as the health and fitness of the population has been improving. Families receive increased financial help, even as their real disposable household incomes have been rising. And as the richest generation in history approaches old age, increased demands are being made for government to provide a higher level of care for the elderly. Whatever gets spent is never enough.

The explanation for this ratchet effect is familiar. Some pressure group, political party, or academic research group identifies a 'need' or a 'problem' that it says government should ameliorate. The clamour for 'somebody to do something' intensifies, and politicians start making concessions. The people who benefit from these new provisions soon take them for granted, and may even begin complaining that the provisions are not enough. Meanwhile, others start pushing to be included in the victim group entitled to largesse. Over time, expenditure inevitably escalates, but the intensity of popular demand never reduces. No matter how much government does, it seems more is always needed. As Anthony de Jasay concludes in his classic study, *The State*, 'The beast must be fed continually.'[39]

The ratchet never goes into reverse, for while voters may not be particularly grateful for what they are given, they get furious if anyone tries taking it away. As the nineteenth-century philosopher Jeremy Bentham recognised, the pleasure we get from receiving something is much less than the pain we feel from losing it. The more the government gives, therefore, the bigger the rod it fashions for its own back, for people swiftly learn to regard handouts as 'rights,' and become self-righteously indignant if these 'entitlements' are ever challenged. For example, recent government reforms to Parenting Payment were attacked by the welfare lobby as an abuse of human rights because some parents of school-aged children would receive smaller welfare payments under the new system.

Crowding out of charities, weakening family connections

Another feature of the entitlement mentality bred by high public spending is it makes us disinclined to do much for ourselves. Reformers have long been aware of this. Right from the earliest days of the Poor Laws in Elizabethan England, reformers have worried that providing for people in need might erode the will and incentive to work hard and solve one's own problems without the assistance of well-meaning politicians or state functionaries.

Before the state created a right to unemployment benefits, for example, people saved or insured through friendly societies and trade unions to ensure an income if they lost their job. Nowadays, few bother. Before Medicare, families insured themselves so they could buy treatment if they fell ill, and charitable foundations raised money to build and run hospitals. But now that the state provides health care, individuals are less inclined to insure themselves. When government takes over such functions, therefore, the market shrivels, philanthropy dwindles, and self-reliance is replaced by state dependency.

Often, the way people coped before the state got involved in their lives was by mobilising extended family support, supplemented by friends and neighbours. People helped each other and this in turn created relationships that formed a safety net for people who needed help. If you needed someone to look after the children, you asked your parents or your neighbours; in return, you might help them with their groceries.

But once government started providing state nurseries, asking friends and family for help became an imposition. There was no need to befriend neighbours. Nowadays, politicians fret about the decline of what they call 'social capital,' little realising that their own interventions are often to blame for the erosion of the social ties that kept society functioning effectively.

The creation of a legion of out-of-touch, professional public servants

A significant proportion of the population is directly employed by the government in the public sector and so relies on the taxes levied on other wage earners for their income. Today in Australia, 1.9 million people (16.5% of the workforce) are employed in the public sector. Many of these people perform useful, sometimes vital, services for the rest of us—they staff the hospitals, teach our children, police the streets, and maintain urban infrastructure. Often they are motivated by high ideals of public service. But because the state has taken over responsibility for organising these services, the people who work in them now share a vested interest in defending big government and high taxation—their jobs depend on it—and they become more politicised.[40]

The more government spending rises, the greater voice this class has, and the harder politicians have found it to resist their claims. State sector workers are well organised to defend their interests, and they tend to support politicians who favour bigger rather than reduced government.

Only 18% of Australian workers belong to trade unions, but public sector employees like teachers and local government workers are heavily unionised, even in the higher administrative and managerial grades.[41] Public sector workers tend to enjoy more privileged conditions of work, such as lower hours, earlier retirement, cast-iron final salary pension schemes, and levels of job security that can make it almost impossible to dismiss them. In 2011, the percentage of Australian Public Service employees who had their employment terminated (including employees who were declared excess to requirements, not only those terminated for performance reasons) was just 0.1%.[42]

Recent data from the 2010 election shows that approximately 13.5% of all voters were employed in the public service (excluding a significant number of other workers employed by companies whose main source of income is government contracts). Of course, people employed by the state are not the only group in society with a strong interest in increasing taxes and government spending. Approximately 35% of all voters rely on government welfare payments for income; including 16.5% of voters on the age pension, 6% on the Disability Support Pension, and 3% on the Newstart Allowance (this also excludes other voters who receive substantial government support, for example, through the Higher Education Loan Program).

This means between 4 and 5 of every 10 voters rely on the government for virtually all of their income (there may be some overlap between these two groups). In some parts of Australia, there is an even bigger problem—for example, only a third to a quarter of the population in Tasmania derive their income independently of the government sector.[43] It is not surprising that unemployment in Tasmania is nearly 3% higher than the Australian average and Tasmania receives substantial subsidies from the rest of the country.[44]

Potentially, this dependence poses a formidable opposition for any politician trying to cut back on the growth in state spending.

Appendix C—Measures of the size of government

The following discussion explains the choice of general government expenditure as the appropriate measure of size of government for TARGET30. It is worth noting that, while a target for general government spending as a proportion of GDP is the best place to start in containing government, there are other important dimensions to the size, scope and influence of government that are not captured by general government spending.

Is spending or taxation the best gauge of the size of government?

The availability of different measures of the size of government creates much confusion. One figure as low as 21% could be used (referring to Commonwealth tax revenue as a proportion of GDP), though it is also possible to cite figures putting the size of government at twice that level for the same year.

TARGET30 includes government spending by the three tiers of government. While spending and revenue are obviously related and should be equal over the long term, the two are rarely equal in any given year, especially given the tendency of governments to run up deficits and finance them with debts. Tax revenue gives an even less complete picture than total revenue as governments raise significant amounts of revenue (around 6% of GDP) in non-tax forms such as investment income, dividends from public enterprises and user charges. Spending is therefore a more reliable measure of the size of government as it determines how much revenue governments will need to raise.

While government spending is the best and most widely used single measure of the size and scope of government, it is not perfect. One obvious limitation is that the costs and benefits of overall government of any size must depend on the composition, quality and effectiveness of the money raised and spent, not just the aggregates.

Which tiers of government are relevant?

In a multi-tier system of government such as Australia's federal system, all tiers should be included in the search for ways to slim down government. Commonwealth expenditures are around 25% of GDP, but when state and local government are included, the figure rises to 35%. Concerns about waste, government over-reach, inefficiency and ineffectiveness arise at all levels of government. In Australia, there is also much overlap and duplication of functions between Commonwealth and state levels. Therefore TARGET30 looks at spending at all levels of government, not just the Commonwealth.

Exclusions from general government sector and TARGET30

TARGET30 excludes several areas that would be included in the broader consideration of the size, scope and impact of government.

First, the activities of public enterprises such as Australia Post, the National Broadband Network, and state water utilities are excluded. Public enterprises may perform poorly, waste resources, and in some cases, perform functions that would be better carried out under private ownership but are excluded because they are supposed to operate commercially. Although the public enterprise sector has shrunk through privatisations over the past 20 years, it remains a significant player. Even before the NBN came into the picture, in 2010–11, the sector had annual operating expenses of $60 billion (one-fifth of the general government sector figure); gross fixed capital expenditure of $23 billion (half as much as general government); and $101 billion of debt (one-third as much as general government).

Second, general government spending figures also exclude new capital ('infrastructure') spending of government due to their treatment under modern public sector accounting rules, which mirror those applying to private enterprises. Under these rules, operating expenses of general government include depreciation of the existing stock of capital but not new capital investments. This means the cost of capital investment is smoothed across the life of the asset, which avoids spending figures being distorted by the lumpiness and volatility of new capital expenditure, but may understate the level of government spending in the short term.

Third, government spending figures do not include tax expenditures (broadly the loss of tax revenue from concessions and exemptions). The policy objectives of some tax expenditures—though not all—could instead be achieved through government spending, and in that sense, could be included in measures of the size of government.[45]

Regulation—Another dimension

One important dimension of government intervention that is hardly represented at all by government spending is regulation. The cost to government of administering regulation is included in government spending, but this is just the tip of the regulatory cost iceberg, which also includes paperwork and compliance costs.

The Business Regulation Review Unit estimated in the mid-1980s that the total cost of business regulation was 9% to 19% of GDP.[46] Even this does not include the deadweight economic cost that results from the allocation of resources being different from that which would otherwise prevail in the absence of regulation. Some regulation is justified, but much of it is not, and some of the policy objectives of regulation could be achieved at lower cost.

Deregulation provides significant benefits, such as improved economic efficiency, greater clarity for businesses, and reduced cost of 'red tape,' and will help contain government spending.

Endnotes

1 ABS (Australian Bureau of Statistics), *Government Finance Statistics 2010–11*, Cat. No. 5512 (Canberra: ABS, April 2012), additional figures from Reserve Bank of Australia, *Australian Economic Statistics 1949–50 to 1996–97*, Occasional Paper 8.

2 ABS (Australian Bureau of Statistics), *Government Finance Statistics 2010–11*, as above.

3 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.

4 Robert Carling, 'How to Double Government Spending in 10 Years,' *Policy* 27:3 (Spring 2011).

5 As above.

6 Commonwealth of Australia, *Australia to 2050: Future Challenges* (Canberra: January 2010).

7 Ken Henry, 'Changing Taxes for Changing Times,' speech to the Australasian Tax Teachers Association Conference (21 January 2010).

8 Commonwealth of Australia, *Australia to 2050: Future Challenges* (Canberra: January 2010).

9 The Treasury, *Intergenerational Report 2010*, vii.

10 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 Commonwealth government at a rate of approximately 0.6% of GDP a year.

11 *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.

12 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.

13 ABS (Australian Bureau of Statistics), *Government Finance Statistics 2010–11*, as above; The Treasury, *Intergenerational Report 2010*; NSW *Intergenerational Report 2011–12*.

14 Vito Tanzi and Ludger Schuknecht, *Public Spending in the 20th Century* (Cambridge: Cambridge University Press, 2000), 133–134.

15 As above.

16 As above, 54.

17 Gerald Scully, *Taxes and Economic Growth*, Policy Report No. 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.

18 Andreas Bergh and Magnus Henrekson, *Government Size and Implications for Economic Growth* (Washington, DC: The AEI Press, 2010).

19 Commonwealth of Australia, *Budget 2012–13*, 'Budget Paper 1: Statement 6.'

20 As above.

21 As above.

22 Commonwealth of Australia, *Australia to 2050: Future Challenges*, as above; The Treasury, *Intergenerational Report 2010*, Chapter 4.

23 Productivity Commission, *Report on Government Services 2013*, Table 4A.7.

24 Federal government capital spending was $5.7 billion in 2010–11, boosted by the Building the Education Revolution program (Productivity Commission, *Report on Government Services 2013*, Table 4A.8). State and territory capital funding was $2.3 billion in 2008–09, the most recent figures available (Australian Curriculum, Assessment and Reporting Authority, *National Report on Schooling 2009*, Table 8.9).

25 Calculated using year end June 2011 GDP data from ABS (Australian Bureau of Statistics), Cat. 5206.0 (September quarter 2012).

26 *NSW Long-Term Fiscal Pressures Report* (*Intergenerational Report*), as above.

27 Antonio Alfonzo, Ludger Schuknecht, and Vito Tanzi, *Public Sector Efficiency: An International Comparison,* European Central Bank Working Paper Series (July 2003).

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33 For more information on the HDI see United Nations Development Project, 'Human Development Index.'

34 Vito Tanzi, 'The Role of the State and Public Finance in the Next Generation,' as above.

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38 Gerald Scully, *Taxes and Economic Growth*, as above; Gerald Scully, 'Taxation and Economic Growth in New Zealand,' as above.

39 Anthony de Jasay, *The State* (Indianapolis: Liberty Fund, 1998), 206.

40 Given a choice between cutting public services or raising taxes, most public sector workers opt for the latter, while most private sector workers prefer the former. See Peter Saunders, 'The Rise of the Opinionators,' *Policy* 22:2 (2006).

41 ABS (Australian Bureau of Statistics), *Employee Earnings, Benefits and Trade Union Membership*, Cat. No. 6310 (Canberra: ABS, April 2012).

42 Australian Public Service Commission, *Australian Public Service Statistical Bulletin,* State of the Service Series 2010–11 (Canberra: 2011).

43 Jonathan West, 'Obstacles to Progress: what's wrong with Tasmania, really?' *The Conversation* (February 2013).

44 As above. See also 'Budget Paper 3, Part 3: General Revenue Assistance'; for example, Tasmania receives $1.60 from the Commonwealth government for every $1 in GST revenue generated in the state.

45 The Treasury, *Tax Expenditures Statement 2012* (Canberra: January 2013).

46 Commonwealth of Australia, *Review of Business Regulations* (Business Regulation Review Unit, 1986).

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REDUCING THE BURDEN FOR FUTURE GENERATIONS

Author

Simon Cowan is a Research Fellow in the Economics Program at The Centre for Independent Studies and specialises in government industry policy and regulation. Before joining the CIS, he practised corporate law for several years at a top tier law firm in Sydney and London, after which he joined the NSW government's industry division. He has degrees in commerce and law from the University of New South Wales.

Major Contributors

Robert Carling is a Senior Fellow in the Economics Program at The Centre for Independent Studies.
Peter Saunders is a Senior Fellow in the Social Foundations Program at The Centre for Independent Studies.

Contributors

Andrew Baker is a Policy Analyst in the Social Foundations program at The Centre for Independent Studies.
Jennifer Buckingham is a Research Fellow in the Social Foundations program at The Centre for Independent Studies.
Stephen Kirchner is a Research Fellow in the Economics Program at The Centre for Independent Studies.
Peter Kurti is a Research Fellow in the Religion and the Free Society Program at The Centre for Independent Studies.
Jeremy Sammut is a Research Fellow in the Social Foundations Program at The Centre for Independent Studies.

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PO Box 92, St Leonards, NSW 1590 Australia • **p:** +61 2 9438 4377 **f:** +61 2 9439 7310 **e:** cis@cis.org.au