COMMENTS ON 'BETTER BUDGETING DISCUSSION PAPER'

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The following comments are offered in response to the call for submissions on the 'Better Budgeting Discussion Paper' issued by Jim Chalmers MP in February 2017. The comments represent the views of the authors and not necessarily those of The Centre for Independent Studies.

1. Greater focus on medium-term pressures

A 10-year view of the budget would be desirable. The four-year forward estimates are 'gamed' by governments and oppositions and it would be more difficult to 'game' 10-year estimates. However it needs to be recognised that 10-year estimates would be subject to a wider margin of error and could not be made in the same detail as the four-year forward estimates. A higher level of aggregation would be needed.

Subject to that qualification, 10-year estimates could serve two purposes: to illustrate the long-term budgetary costs of individual budget measures; and, at a higher level of aggregation than the forward estimates, to show how the budget is expected to evolve in the longer term under unchanged policies. This would be like an annual version of the Intergenerational Report (IGR), but greatly scaled down by comparison with it. The 'higher level of aggregation' should mean more than just total expenses, total revenue and the budget balance; it should include the major heads of revenue (personal income tax, company income tax, GST, etc) and the major heads of expenditure by type and by function.

One problem that has emerged in the use of multi-year estimates is the practice — now very common — of aggregating amounts of expenditure and revenue over four or 10 years. Any period chosen for such aggregation is arbitrary (why stop at four or 10 years?). The main purpose of aggregation often seems to be that of making the financial impact of budget measures appear as large as possible for political purposes. A good example of this in recent times is the opposition's 10-year aggregation of the estimated revenue cost of the government's proposed company tax cuts to produce the figure of $48 billion. It is largely meaningless to aggregate recurrent flows of revenue or expenditure over an arbitrary number of years. There is no way of stopping politicians from doing this kind of thing, but the budget papers themselves should not encourage it by using multi-year sums. The best way for the budget papers to present the financial impact of policy measures affecting recurrent expenditure or revenue is to emphasise the impact in the year the measure first takes effect and the impact in the first full year of implementation. Capital expenditures are different in that they have a finite life, so the total expenditure over the multi-year life of a project is meaningful in addition to the year-by-year expenditures.

2. Greater independence

There would be value in the PBO obtaining greater independence, for example to prepare the IGR. However, there are several arguments against having the PBO take over economic forecasting:

- Forecasting is interlinked with many other functions of government, so Departments would probably continue forecasting even if the PBO took this over. This duplication would be unnecessary.
- While there are legitimate reasons to consider the IGR has some political bias, economic forecasts do not suffer similarly from the same issue.

The proposal for the PBO to publish an annual structural budget statement is worthwhile, although the budget now includes such as statement and it is not clear why the PBO should duplicate this work.

3. Reporting transparency

The discussion paper poses the question as to whether the budget papers should "provide information on the distributional impact of key policies". The impact of budget policy measures is multi-dimensional and there is no reason to single out the distributional impact as suggested. To do so would be to elevate distributional considerations to a higher status than they deserve. It would be at least as relevant for the budget papers to provide information on the economic efficiency impact of key measures. So if the distributional impact is included, then estimates of the impact on economic welfare, GDP, national income or similar should also be presented.

Moreover, the distributional impact that matters most is the impact of the tax/transfer system as a whole, not that of individual policies. It is widely recognised, for example, that a 'regressive' tax can have a legitimate place in a broader tax/transfer system that achieves distributional objectives. This broader perspective would be lost were the budget papers to highlight the distributional impact of individual policies.

Another relevant issue in this context is budget paper 'overload'. While all significant budget policy measures should be scrutinised for their implications for economic efficiency, regulatory impact, distributional impact and so on, the budget papers are not necessarily the place for this. Cabinet submissions certainly are the place for it, while in the public arena there is scope for a greater role for green papers, white papers, and policy discussion papers for major policy initiatives. That is, public policy proposals should be given greater public exposure, supported by full documentation, as they are being considered and developed by government and well before they appear in budget papers.

Reporting of individual measures in the budget in Budget Paper 2 often disaggregates these measures by portfolio, but not by function or sub-function. However, much of the rest of the budget reports by function/sub-function. For improved consistency, there would be value in the individual measures being split by function and sub-function.

4. Reporting of investments in capital versus recurrent expenditure

The discussion paper raises a number of questions in this area and suggests that the current approach to reporting capital expenditure may be deficient. There are a number of comments to offer.

First, the budget papers of the Commonwealth as well as the states are prepared in accordance with international standards — namely GFS — and that should continue. This system already contains — in the operating statement — a distinction between 'expenses' (approximately equivalent to 'recurrent' expenditure) and investments. Budget papers show a 'net operating result', which is essentially the difference between operating expenses (including depreciation of capital assets) and revenue on an accrual basis, before the deduction of investments. When investments (net of depreciation expense) are deducted, the 'fiscal balance' (net lending or borrowing) is derived. Given all this, there is no need to invent another recurrent/capital distinction.

The Commonwealth budget papers, of course, do not emphasise the operating statement approach, preferring to focus on the old-style cash results. Perhaps this should change, although in the Commonwealth's case there is not a great deal of difference between the net operating result and the fiscal and cash balances, as capital expenditure is small relative to operating expenses. (The states and territories do emphasise the operating statement and in their case capital expenditure is relatively much more significant.) But the point is that the information to distinguish between recurrent and capital is already present in the budget papers.

Another issue raised in the paper is whether certain recurrent expenses (such as for education) should be reclassified as capital. This would be inconsistent with the internationally accepted methodology, a retrograde step for the Commonwealth to take, and would open the door to increased expenditure on the grounds that it is an 'investment' when in fact it is a recurrent expense. There is almost no limit to what could be classified as capital expenditure. Defence could be called 'investment' in Australia's security; similarly for police and the justice system. Education could all be called 'investment' as could a substantial part of health. There is no clear end to this reclassification.

Commonwealth grants to the states for capital purposes are classified as recurrent expenditure by the Commonwealth and this is the appropriate treatment. They should only be classified as capital expenditure when finally spent by the states. To do otherwise would be to double-count capital expenditure in the public sector as a whole.

5. Second-round effects

While second-round effects can be significant, the reservations about including them in budget estimates are legitimate. They should, however, be an important element in the government's consideration of policy proposals. This includes proposed tax policy changes, where tax increases are likely to raise less revenue than the first-round estimates suggest, and tax reductions are likely to cost less. Where behavioural changes are likely to have a direct effect on the revenue estimate (such as a capital gains tax increase leading directly to lower rates of capital gains realisation — the 'lock-in' effect) this response should be included in the published estimate. When there are likely to be more indirect second-round effects — such as through the effect on economic growth — the possible magnitude of these effects should be discussed in the budget papers in the case of major policy changes.

6. Tax expenditure statement

The tax expenditure statement is a sound idea in concept, but has become far too broad in its application. The statement should be confined to narrow tax law provisions conferring a benefit that could alternatively be conferred by a government expenditure program. The statement has gone far beyond this by reporting, for example, vast sums of tax expenditure on capital gains tax concessions on principal residences. Moreover, tax expenditure on income from savings should be measured against an expenditure tax benchmark, not as is currently the case a comprehensive income tax benchmark.

7. Publishing budget data

Users of budget papers can find that they need to consult multiple documents (budget papers, final budget outcome statements and mid-year budget reviews, sometimes for multiple years) to construct consistent time series for analytical purposes. Treasury and Finance (or the PBO) should construct and maintain a single on-line data base of all significant budget data series. This should normally be updated three times a year: with the May budget; the September final budget outcome statement; and the December mid-year review. The time series should include spending at a function/sub-function level, all revenue heads, actual and estimated structural budget balances, balance sheet aggregates such as gross and net debt and net financial liabilities, and provide both the latest historical and forecast figures.

8. Other issues

There is currently no systematic tracking of the costs of budget policy measures after their initial announcements, when costings for the budget and forward estimates years are published. It is often the case that the financial impact of measures turns out to differ from the initial estimates and is reassessed by Treasury and Finance. However there is currently no systematic reporting of such revisions. A section should be added to the budget measures document to report significant changes to the estimated financial impact of major measures announced in prior budgets.