

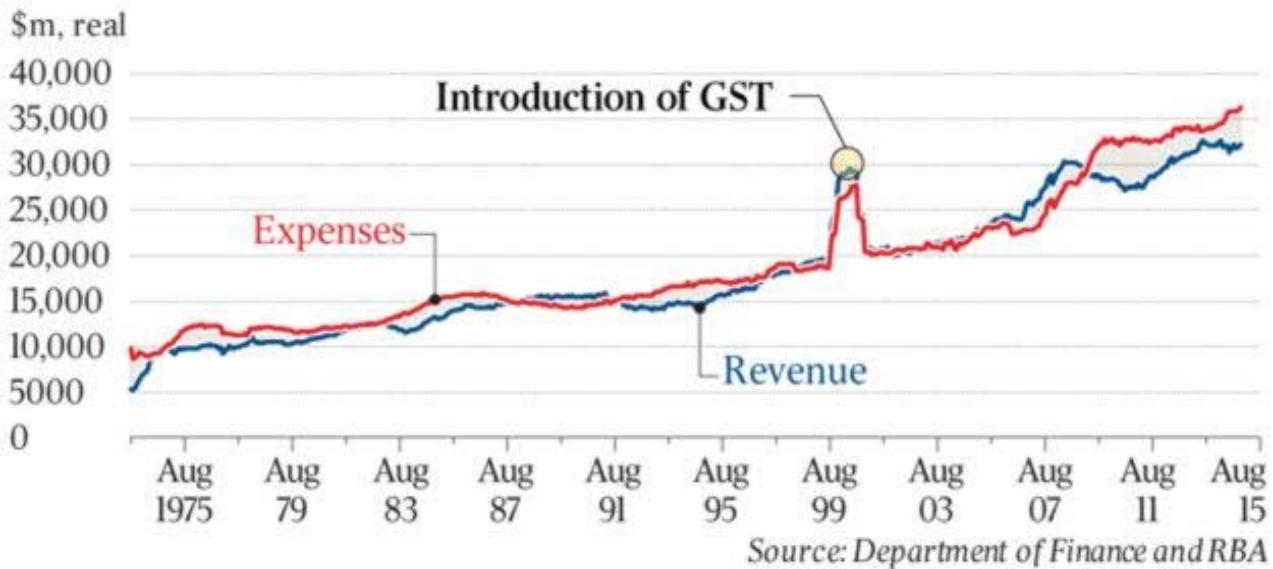
## THE AUSTRALIAN

# It's time to get over our civil wars and close the expenditure gap

HENRY ERGAS THE AUSTRALIAN FEBRUARY 16, 2015 12:00AM

## MIND THE GAP

Commonwealth monthly Revenue and Expenses  
(real, 12-mth moving average), 1973-2014



Mind the gap. Source: TheAustralian

**IT'S the simplest measure of all: the cash the commonwealth spends each month compared to the cash it receives, stretching back to 1973.**

As the graph shows, never has the gap yawned as wide for as long. And with spending at an unprecedented high, it shows no sign of closing.

On the contrary, as expenses climb while revenues flat line, this is the “what is to be done?” moment. But with the economics fiendish and the politics more so, the government seems at sixes and sevens.

A nip-and-tuck budget is the likely outcome: controlling outlays mainly by a slice here and a trim there, while allowing fiscal drag to restore revenues. But that leaves the underlying problems unaddressed. And if it fails, the government’s credibility will be shattered, as will the prospects for sensible budget repair.

To say that is not to counsel heroics. Yet there is plenty the government can do to make a fresh start on reforming spending. And in each policy area, the goal should be broader than merely saving money.

Rather, the government’s mantra should be “less expensive but more effective”, restructuring poorly designed programs so that they provide, and are seen to provide, more with less.

That is what the government promises its child care announcement will deliver. Ideally, its new approach

will also set a framework for reforming family tax benefits. But the need for change goes much further.

The age pension, which accounts for almost 10 per cent of commonwealth spending, is a case in point. With outlays on the pension rising by around 4.5 per cent annually in real terms (more than twice the growth rate of per capita incomes), slowing the increase in pension spending is obviously attractive. However, it is neither politically sustainable nor socially sensible to freeze the pension in real terms, as last year's budget proposed.

Instead, the government should bring greater transparency and predictability to the pension, while imposing clear fiscal disciplines. Each year, the government actuary should publish an estimate of the pension liability for the decades ahead; the Parliamentary Budget Office should report on the implications for the budget and for equity between generations; and while the pension would be indexed to CPI, there should be an independent review of its adequacy every three years, assessing the scope to increase it in real terms.

Once those measures are in place, the government could gradually convert the scheme into a properly funded pension plan, as in the Nordic countries, with automatic, phased adjustments for national income and life expectancy.

So too for the National Disability Insurance Scheme. Providing a reasonable quality of life to those afflicted by brute hard luck is a test of basic decency. The risk, however, is that "eligibility creep" will escalate spending on the NDIS, with budget constraints then provoking cuts that hit the truly disadvantaged.

Moving to a fully hypothecated scheme, in which the NDIS has to live within the income raised by the special purpose levy, would prevent ever-expanding eligibility while guaranteeing it a revenue stream. Sure, economists hate hypothecation, because it reduces budgetary flexibility; but with a hostile senate, and a public that has lost trust in government, linking spending directly to getting can hold the key to reform.

Health also needs restructuring. With growing pressures on public hospitals, the government was wrong to scrap that part of Labor's health reforms which allocated hospital funding to the states on a case mix basis, so limiting the commonwealth's contribution to a predetermined share of the "efficient price" for each type of treatment. However, in reinstating the move to case mix funding, it should ensure the mechanism encourages states to use private hospitals where their "efficient price" is lower than the public sector's price.

At the same time, the government should rely on the case mix approach to reform the private health insurance rebate, making it a fixed dollar amount for each insured person's risk type, so giving a larger subsidy to those who are most costly to cover.

Because that fixed amount would not rise whenever an insurer jacked up its premiums, as the current rebate does, it would remove the incentive for price gouging. And means-testing the rebate (so that lower income earners would have a higher proportion of their PHI costs covered) would help give every Australian a choice of health insurer, instead of forcing poorer families to rely solely on the public system.

Greater choice should equally be the lode star of school funding reform. Here too, the freeze announced last year on outlays after 2017 is unrealistic and inefficient. It would be better to retain the basic structure of the Gonski reforms but put in place a process for correcting the arbitrary manner in which the funding

levels were set, so that funding genuinely follows the student, is neutral between sectors and recognises the cost of equity goals.

Last but not least is defence, where expenditure should not be determined as a set share of GDP but through rigorous threat assessments. The Defence White Paper ought to provide a basis for moving in that direction and for establishing mechanisms that make it an ongoing part of the budget process.

None of that is to ignore the importance of reforming revenues too: however, without spending reform, it is impossible to know just how large the revenue gap is. And yes, reforming spending is frustratingly hard. That our politics has degenerated into civil war by other means only makes it harder.

But Napoleon put it best: in war, when you vow to take Vienna — take Vienna. That yawning gap between outlays and receipts is this government's Vienna. It would be a pity if it became its Waterloo.

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