

Paper 3: Are we prepared for the intergenerational challenges ahead?

Report by Access Economics Pty Limited for the
Business Council of Australia

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EXECUTIVE SUMMARY

The second *Intergenerational Report* (IGR2) released in April 2007 considered the longer term outlook for the Federal Budget. However, IGR2:

- ❑ Ignored the tax side of the equation (it simply assumes that the tax take remains a constant share of the economy), and
- ❑ Assumed that today's boost to the corporate tax take as a share of GDP is permanent (as discussed in Paper 2 in this series of reports).

There are problems with both those assumptions.

First, the tax system lacks sustainability on several fronts:

- ❑ The excise on petrol is not indexed, implying a growing hole in revenues over time.
- ❑ Current policy allows those over 60 to funnel income through the super tax system, meaning that – for many people over 60 – the effective top marginal rate of personal tax is now 15%. As the share of the population aged over 60 is just about to jump, that points to a significant deterioration in the sustainability of the Budget position over time.
- ❑ The abolition of benefits taxes means they will not ramp up to replace a hole in super tax revenues from contributions tax as workforce growth slows in coming decades.

Or, in other words, if the IGR2 assumption is one of a constant tax burden, then it implicitly assumes that other taxes will rise to make up the shortfall in these taxes over coming decades. That has not yet been recognised in the national economic debate.

Second, and drawing from the analysis in Paper 2 in this series of reports, there are key risks in assuming that today's boost to the corporate tax take as a share of GDP is permanent. Adding both sets of these concerns together, Access Economics is of the view that the long term assumptions of the second IGR may be too optimistic – leaving policymakers and the public too sanguine with respect to the longer term challenges facing fiscal policy.

What is required is **more rigorous modelling**, unfettered by political considerations:

- ❑ The focus of the IGR should move away from simply considering spending pressures. We should also be looking at modelling revenue and the tax mix. Other countries such as New Zealand have been bolder in this area. Why can't we?
- ❑ The modelling of spending pressures should factor in the likes of income effects and feedback loops. It should also avoid assuming that today's company tax take – artificially pumped up by the commodities boom – stays permanently higher. And where is the modelling on environment and climate change?

One way to help would be to **let Treasury have a freer rein** in the IGR design and analysis – by making Treasury and not the Australian Government responsible for these reports.

Another way of getting a better handle on upcoming pressures **is to have more regular and comprehensive updates. Five years is a long time between drinks.**

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1. THE LONG TERM – ARE WE AS PREPARED AS WE CLAIM TO BE?

- ❑ The first paper in this series of reports focuses on whether we are getting an appropriate bang for our buck from the Australian Budget.
- ❑ The second paper discussed the degree to which the Budget is sensitive to the economy, focussing on the pumped up corporate tax take driven by the China boom.
- ❑ This paper looks to the horizon, asking whether we are as prepared as we should be for some key challenges.

The long term outlook for Federal finances is considered in the *Intergenerational Reports* required under the *1998 Charter of Budget Honesty* – a law which requires the Australian Government to examine and report on the long term sustainability of government policies.

The first IGR came out as part of the 2002-03 Budget and, despite its flaws, proved effective in progressing public debate on economic policy in Australia – focussing attention as never before on the intergenerational consequences of current policies and practices.

The second *Intergenerational Report* (IGR2) was released in April 2007, updating the long term demographic, economic and spending projections over the next 40 years.

However, IGR2 had a number of flaws:

- ❑ Like IGR1, it essentially ignored the tax side of the equation (it simply assumed that the tax take remains a constant share of the economy), and
- ❑ Assumed that today's boost to the corporate tax take as a share of GDP is permanent.

There are problems with both those assumptions.

Further, there are a number of other areas where the modelling in IGR2 has been found wanting – such as health and the environment.

In addition, the five years between the release of the two IGRs saw a torrent of policy spending from Canberra. The original IGR suggested that, forty years' hence, the shortfall on primary balance due to a combination of ageing and health cost related pressures looked like blowing out to 5% of national income.

Yet in the five and a half years since the release of the original IGR the previous Australian Government made policy decisions – such as a series of tax cuts and big boosts to family benefit payments – costing an astronomical 7.7% of national income.

Adding these concerns together, Access Economics is of the view that the long term assumptions of the second IGR may be too optimistic – leaving policymakers and the public too sanguine with respect to the longer-term challenges facing fiscal policy.

1.1 AUSTRALIA'S INTERGENERATIONAL COMPACT

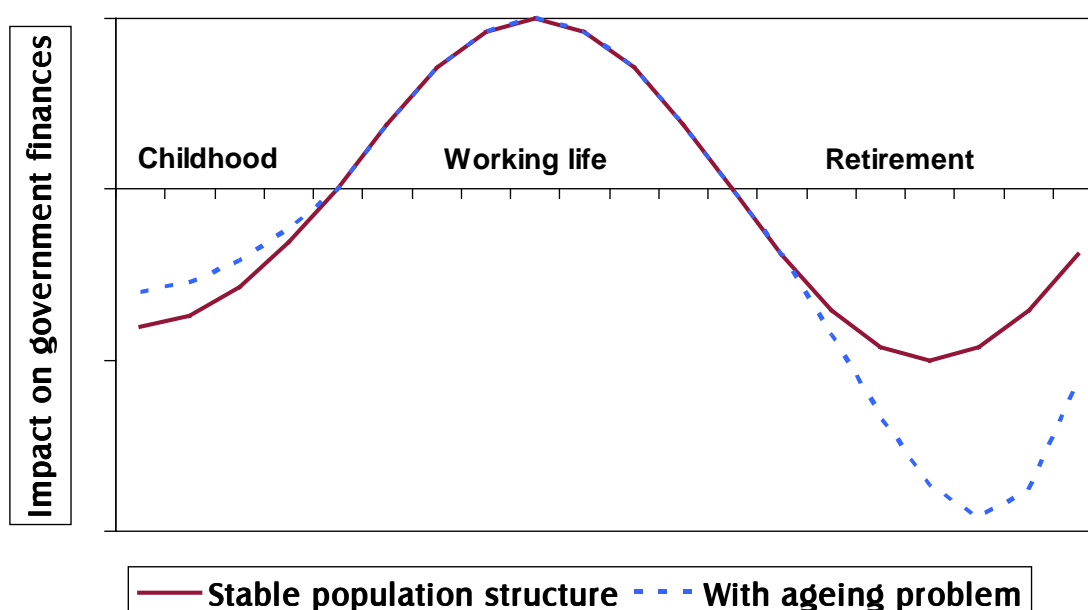
Life cycles can be usefully divided into three: childhood, working age and retirement.

These *three ages of mankind* are important because, as a society, we treat them differently.

In essence every society makes an intergenerational compact with itself.

- ❑ We subsidise investment in children by subsidising the education costs of children, and also their health costs.
- ❑ Society also subsidises retirement, by paying pensions to the less well off and by subsidising the healthcare costs of the ill and aged.
- ❑ Society then pays for these subsidies to the young and the old by taxing workers.
- ❑ There is therefore a government budget balance over the life cycle, as workers (who typically have a positive impact on government finances, paying more in tax than they receive in services) subsidise the young and the old (for whom the opposite is true) – see Figure 1-1.

FIGURE 1-1: THE CHANGING INTERGENERATIONAL COMPACT



However, as the Australian Government's *Intergenerational Reports* (IGRs) effectively noted, key **quantity** and **price** effects will change the nature of Australia's current intergenerational compact with itself.

1.2 THE QUANTITY CHALLENGES AHEAD

On the quantity side, it is now well known that Australia has an ageing population structure which will pose a burden in the future. As IGR2 says:

“Australia’s population is projected to grow and continue to age over the next 40 years with the fastest rates of growth in the numbers of people aged 65 and over...These demographic changes will lead to a reduction in the proportion of the population of traditional working age, 15-64 years. As a consequence of the subsequent flow through to the proportion of the population who work, this is projected to reduce the average rate of economic growth in the next 40 years” (IGR2, 2007).

In fact, as the combination of falling death rates and associated rising life expectancy combines with the demographic bulge of the baby boomers to indicate that, in 40 years time, the number of Australians aged 65 and over is projected to increase by more than two and a half times, while those aged 85 and over will go up by a factor of 5 between 2007 and 2047.

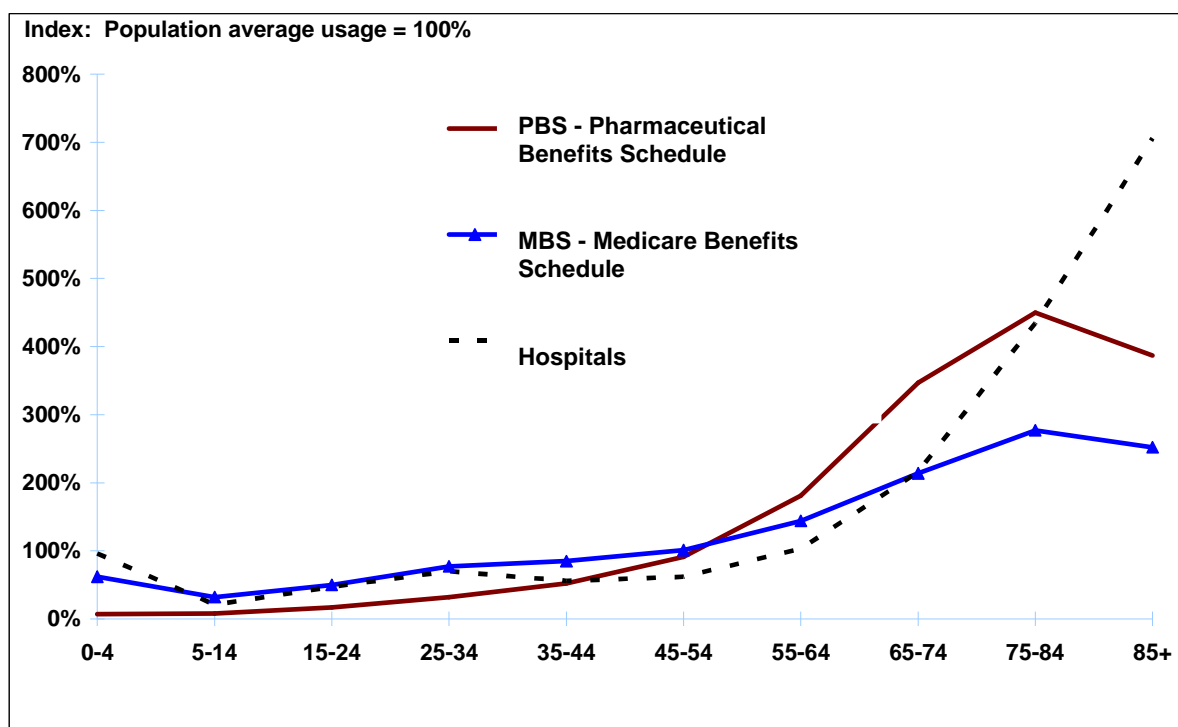
These demographic factors will place more pressure on the workforce or the relatively more productive part of the economy.

That quantity impact, other things equal, means that the pension and health care subsidies extended by society to the aged will pose a relatively heavier burden in the future than they do at the moment. It also means we need to be careful about extending this type of support today – as once in place it is hard to roll back.

1.3 THE RELATIVE PRICE RISKS

Along with the change in the quantity demanded of various goods and services implied by an ageing population structure in Australia, there are also relative price effects at work. The *Intergenerational Reports* noted that health care costs, which make up a large proportion of Australian Government subsidies to the aged (see Figure 1-2), have tended to grow at a faster rate than economy-wide prices in recent decades.

FIGURE 1-2: RELATIVE USAGE OF HEALTH SERVICES, BY AGE



This is a largely separate process from the demographic effect described immediately above:

- ❑ As noted in IGR2, non-demographic growth (such as the listing of new medications on the Pharmaceutical Benefits Scheme – Figure 1-2 – and greater use of diagnostic procedures), rather than population growth or changes in the age structure of the population, is likely to be the key driver of health spending pressures – contributing *three-quarters* of the projected increase in health spending. These new medications and new medical technologies are likely to be expensive.
- ❑ When we take all spending into account, roughly two-thirds of the projected increase in real spending per person over the next 40 years is driven by factors other than ageing.

Or, in other words, both quantity and price effects are set to operate to raise the cost of society's subsidy to those in their 'third age', leading to large, rising and ultimately unsustainable Australian Government deficits (the official estimates of the worsening primary balance – that is, the Budget balance before allowance for interest payments on debt – are shown in the following section).

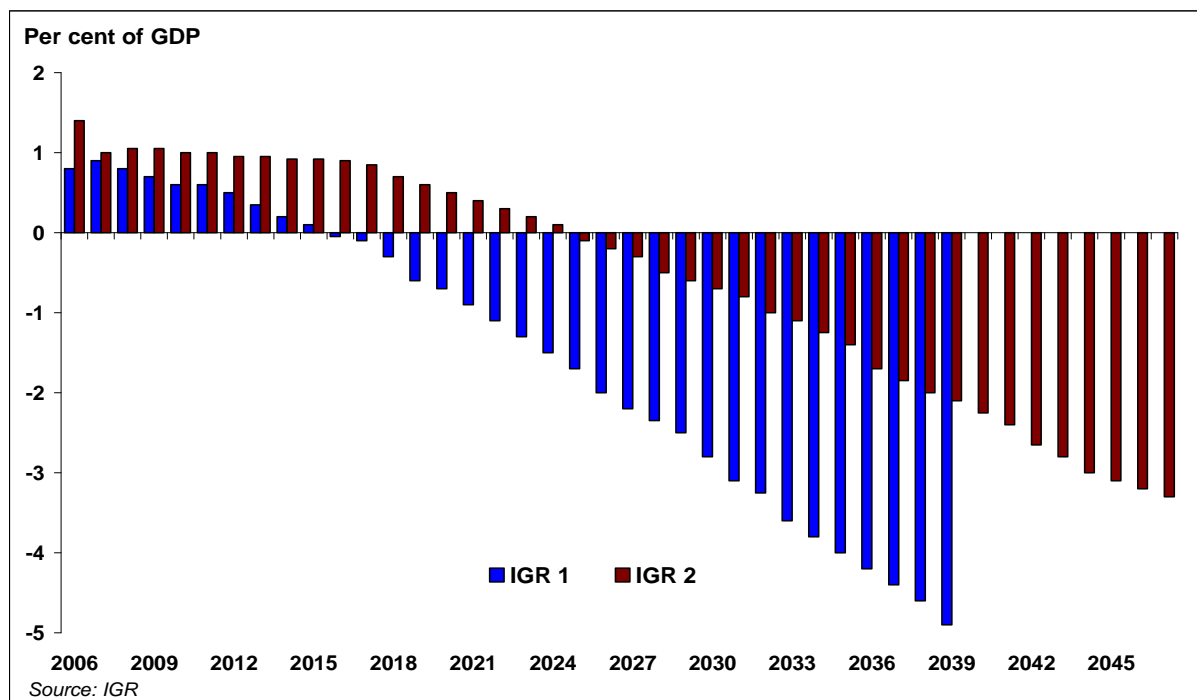
1.4 THE LONG TERM VIEW

Implicit in the discussion in the 2002 and 2007 *Intergenerational Reports* is that these price and quantity effects imply that a deal-breaker is required so far as Australia's current intergenerational compact between its citizens is concerned.

- ❑ They imply that if in the future we wish to sustain a new intergenerational compact, it will have to involve either reduced services per person relative to national output per head, or average rates of tax will need to rise.

The IGR results (and the 40 year average they imply) are effectively a measure of the long run structural Budget balance. They abstract from the bump and grind of the economic cycle by focusing on Australian Government primary deficits (fiscal deficits less net interest costs) on the assumption that current policies are maintained.

FIGURE 1-3: IGR1 v IGR2 BUDGET PROJECTIONS



The release of the *Second Intergenerational Report (IGR2)* in April 2007 from Federal Treasury updated the 2002 initial release. Five years ago the initial report pointed to underlying tension in Australia's intergenerational compact with itself.

Both the first and second IGRs make the point that numbers of the old are set to increase notably in coming decades, and that the particular area of spending most subsidised by government – health spending – is still seeing faster than average cost increases.

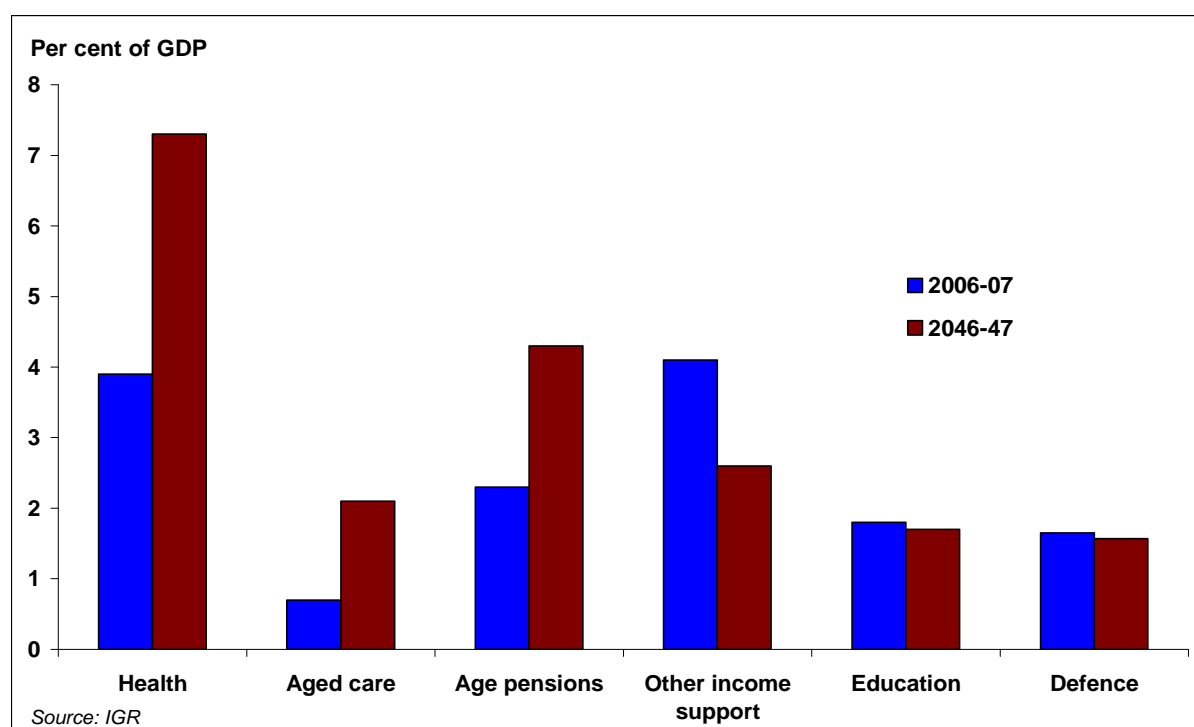
Both IGRs have also noted that the implication of these demographic trends was that the Australian Budget balance would get better before it got worse. In particular, participation rates may initially rise if the matured-aged work for longer (cutting expenses as a share of national output), while there may also be savings on education and other youth-related spending as numbers of young Australians remain relatively stagnant in the coming decade.

However, both IGRs also point to the eventual emergence of what may eventually become very large Australian Government primary deficits (fiscal deficits less net interest costs) if action is not taken to counteract that.

The mix of an increased relative quantity of older people with the increased relative price of the health subsidies they receive points to the potential for Australia's intergenerational compact with itself coming under strain in coming decades.

Not surprisingly, there are expected to be particularly large increases in spending on each of health, aged care and age pension payments.

FIGURE 1-4: PROJECTIONS OF AUSTRALIAN GOVERNMENT SPENDING BY CATEGORY



But whereas the initial report five years ago pointed to a short fall of 5 percentage points of national income on the Federal Budget four decades hence, the latest update (which, we note, was in an election year) trimmed that back to around 3.5% of GDP.

A number of factors have changed, including faster than expected increases in participation among mature aged Australians, a small lift in birth rates, a lift in expected migration, and (adding to expected future costs) a further lift in life expectancy.

However, two key assumptions dominated the difference between the projections last time and the projections this time.

- ❑ First is the assumption that the policy changes to the Pharmaceutical Benefits Scheme introduced after the last IGR have been sufficient to wind back the growing increase in spending on pharmaceuticals by 1.3 percentage points of GDP.
- ❑ The second factor was the assumption that about half of the recent leap in the terms of trade continues into the future, meaning that the high expenditure of the future can be spread across a bigger base of national income. The latter assumption slices an additional 0.3 percentage point of GDP off the projected future fiscal deficit.

As Figure 1-3 shows, the net impact of these changed assumptions are very significant, both delaying and reducing the effect of population ageing on the fiscal balance.

This rosier picture painted in IGR2, coupled with the veritable revenue bonanza brought about by the commodity price boom of recent years, **allowed the previous Australian Government to fall into a sense of budgetary complacency – acting as though the good times would just roll on indefinitely.**

Yet the *Intergenerational Reports* – while being a useful way to think about the long term sustainability of current Government policies – are not perfect.

It is therefore worthwhile considering the criticisms of the IGR.

1.5 ARE THERE HOLES IN LONGER TERM REVENUES?

The *Intergenerational Reports of 2002 and 2007* both assumed that revenue will be a constant share of national income over time. However, some areas of the tax take are open to erosion over time under current policy settings:

- ❑ Petrol excise is frozen.
- ❑ The super tax take will fall relative to national income as the proportion of retirees rises.
- ❑ The abolition of benefits tax on super creates a hole in the personal income tax system.

That poses a problem. It suggests that there are already known holes in the future fabric of revenue raising in Australia at the same time as the overall revenue take is expected to fall due to an ageing population.

1.5.1 PETROL EXCISE

Petroleum products excise comes from petrol and diesel, plus a small further amount from crude oil (the latter includes North West Shelf output not subject to the Petroleum Resource Rent Tax (PRRT) – and is therefore growing rapidly – plus onshore and coastal fields).

Petroleum products excise is dominated by sales at the pump, and the taxing of those is a fixed amount per litre, because the previous Government abolished petrol excise indexation to the CPI in 2001:

- ❑ In 2001-02 the abolition of fuel excise indexation cost Federal coffers a little under \$400 million. By 2005-06 that cost had risen to almost \$2.0 billion.
- ❑ In 2006-07 it is estimated at \$2.5 billion, in 2007-08 Access Economics projects that gap at \$2.9 billion, in 2008-09 it is \$3.3 billion and, by 2009-10, it is projected to reach a stunning \$3.7 billion. Each of those costs is a function of CPI inflation – and of bad policy.
- ❑ **In 40 years' time the resultant revenue loss will be 1% of GDP.**

Petrol excise should be indexed to the CPI. The failure to do so is bad policy – all the more so given the climate change debate and related calls for carbon taxes. The new Government should revisit the recommendations of the 2001 Fuel Taxation Inquiry chaired by David Trebeck.¹

1.5.2 SUPER TAXES

There have been two trends favouring growth in super benefits over time:

- ❑ Our ageing population means that the number of retirees is growing.
- ❑ A maturing super system is delivering higher average benefits to those retirees.

That combination means that both (what was) the benefits 'tax base', and the number of retirees approaching current tax thresholds will grow rapidly over coming decades. Prior to the recent reforms, taxes on super benefits were therefore projected to more than triple as a share of the economy by 2020.

That growing revenue from taxes on super benefits would have come at just the right time for the Government, helping to ease the Budget pain from pensions and health costs. Indeed, that was the basic fiscal message of the 2002 and 2007 *Intergenerational Reports* – that we don't need tax money now, but we do need it in later decades. Instead, the recent changes to the taxation of super deliver a larger share of the pie to older Australians, putting even more pressure on younger taxpayers as our population ages.

Pre-1988, super was mostly taxed at the benefit stage. That had two advantages – it was possible to get a better handle on lifetime accumulation (allowing super taxes to be other than at a flat rate), and it meant that the revenue arrived at a time when IGR-related spending demands were climbing fastest.

However, the latest policy changes further frontload the taxing of super, meaning that they imply the super tax take falling as a share of national income at the same time as demands on national income will be rising.

- ❑ While removing taxes on super benefits has a small impact on short term revenues, the long term costs are far greater.

¹ The main recommendations of the Inquiry were (1) that fuel be taxed on the basis of energy content and that this regime also apply to currently exempt fuels; (2) the reintroduction of twice yearly indexation of all fuel excise and customs duty; (3) replacing the existing Diesel Fuel Rebate Scheme, Diesel and Alternative Fuels Grants Scheme and excise concessions and remission systems with a Business Fuel Credit Scheme; and (4) the abolition of the Fuel Sales Grants Scheme and the Petroleum Products Freight Subsidy Scheme. In response, in May 2002 the previous Government stated that it "will not reintroduce fuel excise indexation. The indexation of fuel excise was abolished in March 2001 in response to community concerns about high petrol prices and the Government will not be revisiting this issue."

1.5.3 PERSONAL INCOME TAXES

While income tax receipts are currently low among the over 60s, there were reasons to expect that base to grow over time as:

- ❑ Population ageing leads to a rapid relative expansion in the number of potential taxpayers in this group.
- ❑ Increased participation leads to higher labour incomes.
- ❑ Past savings and investments, including the maturing of the super system, lead to higher asset levels, and associated investment income.

However, the 1 July 2007 changes to super taxes have, in essence, traded future increases in revenue from older Australians for further increases in labour force participation among those aged over 60. Increased asset and income levels among retirees may now show up in increased super income, which will be tax free for most retirees.

Added to that, the new arrangements provide a ‘loophole’ in the income tax net. Any potential increases in income tax from older workers are likely to be avoided through ‘salary sacrifice’ arrangements. Workers over 60 can now contribute up to \$100,000 per year to super, and be taxed at the flat 15% contributions tax rate on that. Any earnings or benefits paid to these workers as a result would then be tax-free.

At the extreme, there is little or no reason for most Australians over 60 to pay more than 15% tax while working, or any tax at all after retirement. In other words, and as Figure 1-5 emphasises, **while the changes will help to combat the economic challenges of an ageing population by boosting labour force participation, they add to long run fiscal pressures – perhaps significantly – by removing a large and growing share of income from the tax base.**

FIGURE 1-5: NUMBERS OF THOSE AGED 60+ AS A SHARE OF THE TOTAL LABOUR FORCE



INTERACTIONS WITH INCOME TAX – A HYPOTHETICAL EXAMPLE

After the transition to the proposed system, a 60 year old earning \$200,000 per year could make a deductible contribution of \$50,000, saving \$22,500 in income tax and instead paying \$7,500 in contributions tax.

In the next year, this amount could be taken as a retirement income stream, with no tax payable on investment returns, and in some cases even the residual asset on the death of the beneficiary would be tax free. This process could then be repeated each year until the individual is no longer working.

While such examples may not be representative of the majority of super fund members, they do represent a rapidly growing group, and this example highlights the potential income tax 'loopholes' created by removing the complex arrangement surrounding super benefits.

1.6 OTHER CRITICISMS OF THE IGRs

1.6.1 INCOME EFFECTS

Apart from quantity and price effects, **the IGRs have tended to ignore a key income effect.** In particular, critics have argued that continued productivity growth will raise average incomes in Australian society well above today's levels, meaning that any need to raise tax rates to pay for a rising number and relative cost of the elderly would be easily achievable.

- ❑ This argument assumes that something like the productivity growth achieved in the 1990s will continue into the future. However if the Australian and State Governments do not rise to the challenge on the reform front, then the strong productivity growth Australia achieved during the 1990s may not continue at the same rate in coming decades.
- ❑ There is also a problem with the assumption that rising average rates of tax can be readily accommodated even if steadily rising productivity translates into rising average incomes for Australians.
 - Taxes distort decisions by families and by businesses, and the rate at which that distortion occurs rises faster than the average rate of tax increases. Or, in other words, **the deadweight burden of taxation on the Australian economy and the living standards of Australians will rise relatively fast if society chooses to try to tax its way out of the problems identified for coming decades.**
 - Raising taxes to fund holes in public sector finances may merely worsen the existing disincentive effects of today's tax rates, as the resultant disincentive effects reduce the growth in the overall national economic pie to (the cost of all Australians). That is because economics reminds us that taxes eat into the incentive to work, and therefore threaten the much needed lift in job market participation by Australia's mature aged workers over coming decades.
- ❑ Moreover, the income effect associated with higher productivity can cut both ways. For example, the Australian Government's *Intergenerational Reports* also fail to factor in the expectations and demands of baby boomers and following generations in regard to living standards in retirement. Not only will the relative price of health care increase, there may also be demands for increased relative expenditure on a range of goods and services, both public and private. Future retirees may well have much higher expectations in regard to what they want and need during their period of retirement – for example, the standard of retirement homes. Related to that, the IGRs **did not adequately introduce the income effect into modelling key spending areas such as health.** As GDP grows and incomes rise surely there would be some link to the demand for health services – especially when we bear in mind that government is a luxury good for which demand grows as incomes rise.

1.6.2 FUTURE HEALTH SPENDING

Although the quantity effect of population ageing on the relative number of aged Australians in coming decades is clear enough, **the assumption that the past increase in the relative costs of health will continue into the future may not hold true.** In effect, some critics have argued, health care technology and management practices may stem or even reverse the tide in the relative rise in health care costs to governments and the wider society.

- ❑ This first criticism may have some validity. It is possible that the future of relative prices increases for health products and services will not look like the past.

- ❑ However, in the absence of a better predictor and of any easing in the rate of increase of community expectations and of health costs, the assumption in the IGR that past trends in relative health costs will continue appears to be defensible enough.
- ❑ Predictions of a slowdown in the pace of relative health cost inflation have been around for some time, but to date the long term lift in the relative cost of health care provisions appears to have remained intact.

1.6.3 ENVIRONMENT AND CLIMATE CHANGE

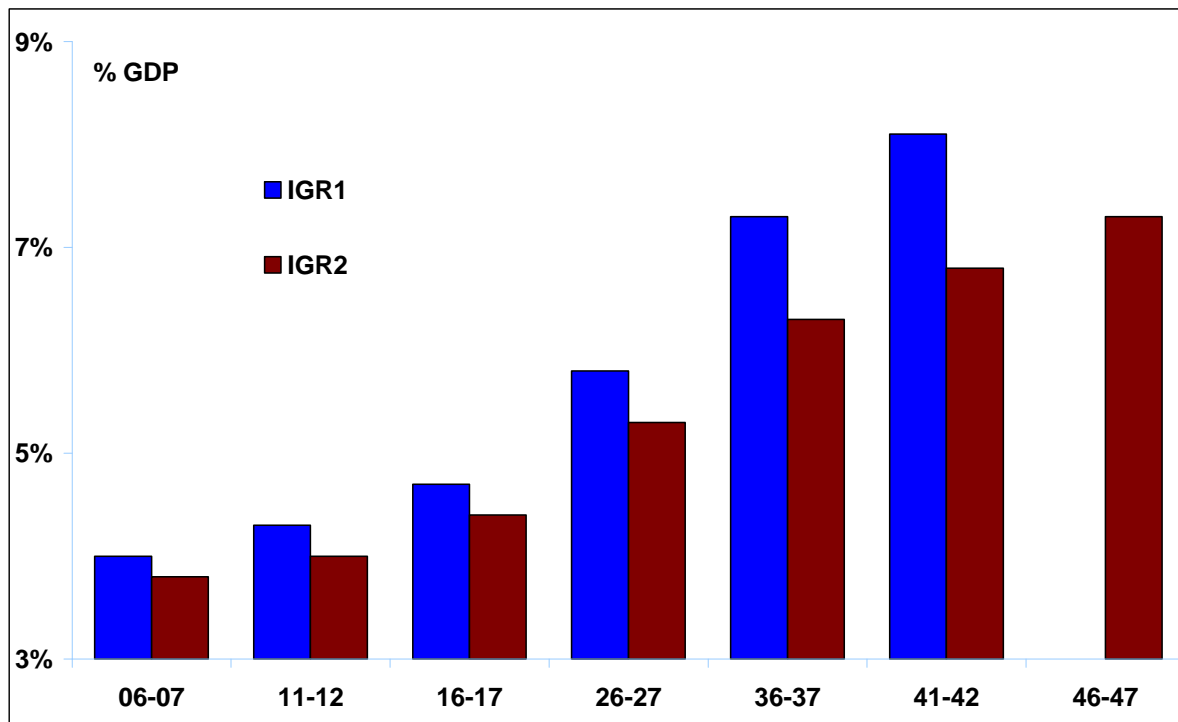
The IGR **effectively ignored spending on the environment and climate change in its modelling**. It lumped key areas of spending such as the environment and defence into ‘other spending’, which was assumed to remain constant as a share of GDP over the next 40 years.

- ❑ Modelling future spending pressures relating to the environment and climate change has been limited due to issues such as lack of data and uncertainty of the policy instruments that governments will choose to deal with environmental problems. It is also unclear exactly what environmental outcomes we should be aiming for – for example, what does sustainability really mean in this context? These issues need to be fleshed out rather than simply ignored.

1.6.4 FEEDBACK LOOPS

The IGRs did not take into account ‘feedback loops’ in a range of areas, including health and medicines spending, where growth in one variable would influence the growth in other variables in the model. For example, potential offsetting savings in other parts of the health sector as a result of spending on new medicines are not taken into account, such as lower hospitalisation levels.

FIGURE 1-6: PROJECTIONS OF PBS SPENDING OVER TIME AS % OF GDP – IGR1 vs IGR2



Such effects are difficult to identify and quantify. Yet to ignore them risks wrong policy options. For example, much of the policy focus at the time of the release of the first IGR was in reining in the then runaway pace of growth in PBS spending. Five years down the track, at the time of the 2007 IGR, Treasury was able to notably wind back its earlier forecasts for the pace of PBS growth – as Figure 1-6 shows.

That was almost certainly appropriate. If, however, spending on pharmaceuticals helps to ward off more acute difficulties later – and hence rather more expensive hospital treatment – then the policy response may have been wanting.

Or, more broadly, there are typically long run advantages to public spending being more on ‘prevention’ rather than ‘cure’.

1.6.5 OTHER LEVELS OF GOVERNMENT

The IGR focuses on the Australian Budget alone, with the success or failure of any policy change being solely judged by its impact on the Australian Budget. However, the States too will face spending (and some revenue) pressures in coming decades, albeit probably not to the same extent as the Australian Budget.

Moreover, shifting costs to the States or to households does not really deal with emerging costs of an ageing population and relatively rapid health care cost inflation – it merely shifts the responsibility for paying for these costs.

1.6.6 ACCOUNTABILITY AND TRANSPARENCY

The ***Intergenerational Reports*** are products of the Australian Government and therefore can be subject to political influence. While prepared by the Treasury, ultimately the Government of the day controls the final message. This can potentially limit the depth and impartiality of the analysis.

- In contrast, the New Zealand equivalent of the IGR – its *Statement on the Long term Fiscal Position* – is the domain of its Treasury. This has arguably allowed them to have a freer hand in analysing public finances and added to transparency. For example, the New Zealand Treasury even publishes its IGR model on its website:
<http://www.treasury.govt.nz/ltfm/>.

The above criticisms of the IGRs could potentially have been remedied if Treasury were allowed to have a more frank and fearless role in assessing the long term implications of current government policies – particularly on the revenue side.

2. CHANGES TO GOVERNMENT POLICIES SINCE THE 2002 IGR

While surging company taxes have served to strengthen the medium term Budget position, offsetting changes to policy by the previous Government have meant little improvement in the Budget surplus since the original IGR projections were released.

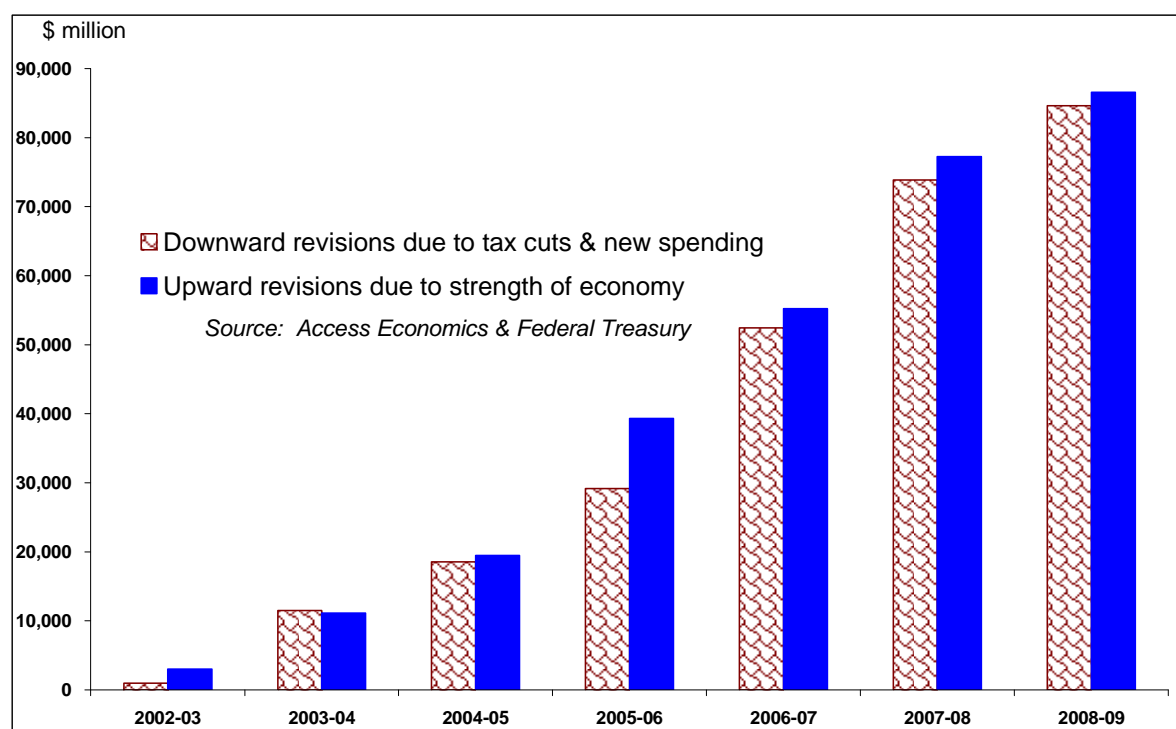
When Treasury prepared the first IGR in 2002, it focused on the likely impact of ageing and the rapid pace of cost growth in health on government spending.

In contrast, it assumed no change in government policy and that taxes would remain a constant share of the economy.

Since the 2002 IGR was released, revenues have been growing rapidly, riding a mining-led boom in corporate profits (and resulting in corporate tax). In fact, the underlying position of the Federal Budget has been revised upward no less than eleven times since the IGR was released. These revisions have resulted in an *economy-driven* net revenue gain since the 2002 IGR was released of \$87 billion for the 2008-09 financial year.

As discussed in Paper 2 in this series of reports, Federal Treasury's figuring effectively assumes that the recent boost to revenues is permanent across the four decades covered by the IGR projections.

FIGURE 2-1: ANNUAL COST OF NET NEW POLICIES ANNOUNCED SINCE THE 2002 IGR



However, spending and tax cuts announced by the previous Government since the 2002 IGR was released have been huge. There has been a *policy-driven* revenue cost, with a series of

cuts to personal income tax and continued strong growth in new spending largely offsetting the increased revenues and lower welfare payments delivered by the strong economy.

As Figure 2-1 shows, policy decisions by the previous Government since the 2002 IGR are now running at a cost of more than \$85 billion a year, or some 7.7% of GDP.

- ❑ In the short term, these two trends have cancelled each other out (as Figure 2-1 also shows), with increasingly costly tax cuts and spending being offset by stronger tax revenues on the back of surging global commodity prices.
- ❑ However, recent policy changes are a greater concern going forward, as corporate taxes may wane if commodity price gains prove to be rather shorter-lived than the demographic challenges Australia faces.
- ❑ Indeed, the OECD's 2006 *Economic Survey of Australia* noted that commodity prices had delivered an additional 1¾% of GDP in revenues to the Government in 2005-06 – the equivalent of an \$18 billion hole in the Budget once commodity prices return to their longer term average (see the OECD's discussion at page 34).

2.1 CAN WE FIX IT? YES WE CAN

The long term outlook embodied in the April 2007 IGR is likely to be too optimistic.

The IGR projections assume that all of the recent leap in corporate tax revenue continues into the future, and there are also a number of areas where the IGR modelling could be improved – particularly revenue and health.

What is required is **more rigorous modelling**, unfettered by political considerations:

- ❑ The focus of the IGR should move away from simply considering spending pressures. We should also be looking at modelling revenue and the tax mix. Other countries such as New Zealand have been bolder in this area. Why can't we?
- ❑ The modelling of spending pressures should factor in the likes of income effects and feedback loops. It should also avoid assuming that today's company tax take – artificially pumped up by the commodities boom – stays permanently higher. And where is the modelling on environment and climate change?

One way to help would be to **let Treasury have a freer rein** in the IGR design and analysis – by making Treasury and not the Australian Government responsible for these reports.

Another way of getting a better handle on upcoming pressures **is to have more regular and comprehensive updates. Five years is a long time between drinks.**