Chapter 3

Assumptions in the terms of reference given to the National Commission of Audit

3.1 This chapter will examine the assumptions that are implicit in the terms of reference guiding the commission's work. These assumptions around government spending and the current and projected economic environment are:

- government spending is too high, poorly targeted and inefficient – often referred to by members of the government as government spending being 'out of control' or the government 'living beyond its means';
- there is a structural deficit which must be turned into a surplus by cutting government expenditure;
- the commission should focus on recommending cuts to Commonwealth expenditure, including privatisation of government assets, rather than ways of raising government revenue; and
- the commission should make recommendations for government to achieve a 1 per cent of GDP surplus to be delivered prior to 2023-24.

3.2 The assumptions underlying the commission's terms of reference have been challenged through the committee's inquiry.

What is the truth about the level of government spending?

3.3 The terms of reference state that there is a need for all current Commonwealth government expenditure to be reviewed and consolidated. The terms of reference suggest this is necessary as Commonwealth expenditure has increased significantly over the last two decades, compounded by an expansion in the size and scope of government programs.[1] The terms of reference also suggest that government spending has been wasteful and inefficient resulting in the government 'living beyond its means' and accumulating debt.[2]

Is government spending is too high?

3.4 The committee heard evidence from the Business Council of Australia (BCA), regarding its submission to the commission, which stated '[e]xcessive government administration and bureaucracy can no longer be sustained'.[3] The submission contains the BCA's view of government spending and the current state of the Australian economy:

1 National Commission of Audit, Terms of Reference, p. 1.

2 National Commission of Audit, Terms of Reference, p. 1.

3 Business Council of Australia, *Submission to the National Commission of Audit* (December 2013) at www.bca.com.au/publications/submission-to-the-national-commission-of-audit

> After 22 consecutive years of economic growth, Australia's fiscal position is weaker than it should be.
>
> - The most recent budget figures suggest that Australia will have an underlying deficit of around $30 billion in the current financial year or around 2 per cent of GDP.
> - The most recent estimates also suggest cumulative consecutive deficits of almost 18 per cent of GDP by 2015-16, making it effectively impossible to achieve the Commonwealth Government commitment to run budget surpluses on average over the medium term.
> - Over the same period, government debt is expected to reach a peak of $370 billion while net debt will pass $200 billion.
> - Despite this, the Commonwealth Government's expenditure remains above historical levels at 25.3 per cent of GDP this financial year, or about one percentage point higher than historical levels.[4]

3.5 The committee explored the level of government expenditure with the BCA, given that expenditure appeared to be stable, with expenditure at 25.1 per cent of GDP in 1996 and 25.3 per cent of GDP in 2013. The BCA emphasised they were 'looking at a historical 10-year average of expenditure.[5]

3.6 The committee also heard evidence from Mr Phil Bowen, Parliamentary Budget Officer of the Parliamentary Budget Office (PBO), about the level of government spending. He stated that '[a]s a proportion of nominal GDP, expenditure has tended to be reasonably stable over the longer term, as real growth in spending has tended to track real growth in GDP. However, over the last decade real growth in spending has well and truly outstripped real growth in GDP.'[6]

Is government spending modest?

3.7 A number of witnesses disagreed that Commonwealth spending was 'out of control', suggesting that government spending was reasonably small and efficient not only by historical Australian trends but also looking at international comparisons.

3.8 Mr Tim Lyons of the ACTU, referred to evidence from the OECD[7] that Australian expenditure on government and levels of debt was modest by international standards:

> It is important to note that the size of Australian government, whether measured in terms of revenue or expenditure as a proportion of GDP, is modest and small relative to other OECD countries, and that our debt is

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4 Business Council of Australia, *Submission to the National Commission of Audit*, p. 25

5 Mr Jarrod Ball, Acting Chief Economist, Business Council of Australia, *Proof Committee Hansard*, 5 February 2014, pp 26-27.

6 *Proof Committee Hansard*, 5 February 2014, p. 55.

7 OECD, *Economic Outlook 2013 Volume 2* (November) at www.oecd.org/eco/economicoutlook.htm

> modest and sustainable and remains on track to be repaid by 2023 even on the basis of existing policy settings...[8]

3.9 Dr Richard Denniss, Executive Director of The Australia Institute, supported looking at the efficiency of government spending but suggested that government expenditure was not out of control:

> I am very interested in the efficiency with which government money is spent, but there is no evidence in international law or historically to suggest that Australia is spending too much money. Indeed, to the extent that we have any problem with our public finances at all, it is quite clear—again from both historical and international points of view—that we have a fundamental problem with collecting revenue. [9]

3.10 Mr Stephen Koukoulas, Managing Director of Market Economics, stated that current rates of spending are broadly comparable to historical trends of Australian government expenditure:

> The latest numbers, the budget outcome for 2012-13—the one that was handed down by the current Treasurer and finance minister at the end of September—confirm that government spending as a share of GDP was 24.1 per cent. Going back over history that is, within a few decimal points, the average of the last 30 or 40 years. It is not higher; it is not lower. When we look at the 2013-14 numbers, which have that bouncing up to almost 26 per cent, there are a couple of things in there that account for that and I think you have already heard a lot about the Reserve Bank payment, which is about [0.6] or [0.7] per cent of GDP, and it does start to incorporate a few of the policy measures as well on infrastructure spending and those sorts of things. So it is probably a little above average.
>
> …I think the more important discussion is where that money is being spent.[10]

3.11 Mr Koukoulas also gave some examples of what would happen if a government was not 'living within its means' that contrast sharply with the current state of the Australian economy:

> [i]f a country is living beyond its means you get a jump in government bond yields that are unsustainable. You get a currency crisis where your currency is falling and the central bank cannot really control it. They are the sort of dynamics that, in an open, floating exchange rate such as Australia has, with very open and deep capital markets, will provide the punishment for an economy that is mismanaged. Australia actually has the opposite of that at the moment.[11]

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8 *Proof Committee Hansard*, 5 February 2014, p. 8.

9 *Proof Committee Hansard*, 5 February 2014, p. 13.

10 *Proof Committee Hansard*, 5 February 2014, p. 48.

11 *Proof Committee Hansard*, 5 February 2014, pp 49-50.

Long term pressures

3.12 Mr Ian McAuley noted that increasing Australian government expenditure had been responding to demographic shifts and the subsequent pressures this placed on government services:

> Again we have heard allegations that Australia is high-spending. We do not see that evidence. In fact, as far as we can see, there is something of a long-term downward trend in Australia, certainly in Commonwealth spending. And there has been quite a significant squeeze in what we call the government's own-purpose revenue. Public revenue splits two ways—into transfers and own-purpose revenues. Own-purpose revenues cover services such as education, health care, infrastructure. Naturally, in an ageing population you tend to get increases in transfers—particularly the age pension—and that has tended to crowd out other areas of public expenditure. It does not do that greatly but it is a worrying trend in that those vital economic services are [bearing] the brunt of the squeeze.[12]

3.13 The significance of demographic trends, such as the ageing of population, driving government expenditure was also noted Mr Bowen of the PBO:

> [T]he latest [Intergenerational] report showed quite clearly that the ageing of the population would have a major impact on fiscal sustainability. We are seeing it impacting in the areas of the age pension and age care, obviously, but also health care, where expenditure is growing significantly faster than the real economy. I will not comment too much on this; I think it is an area that Treasury may well be able to comment on more than I can today. But it is clearly a fundamental structural shift that will have to be addressed one way or another.[13]

Tax expenditures

3.14 The committee heard evidence suggesting that Australia's budgetary position could be improved substantially by removing or recalibrating Commonwealth expenditure on tax exemptions and concessions. Moreover, some witnesses noted Australia's tax expenditure is high by international standards. Dr Denniss referred to a recent International Monetary Fund (IMF) report recommending that governments around the world roll back tax expenditures to support fiscal consolidation programs. According to this report Australia has the highest tax expenditure to GDP in the world.[14]

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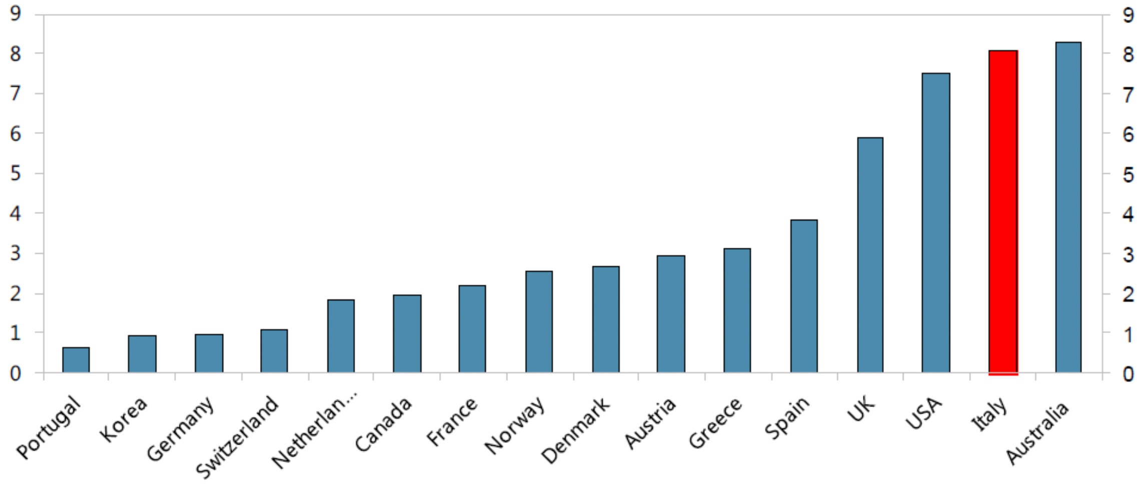
12 *Proof Committee Hansard*, 5 February 2014, p. 37.

13 *Proof Committee Hansard*, 5 February 2014, p. 60.

14 Dr Richard Denniss, *Proof Committee Hansard*, 5 February 2014, p. 21; Justin Tyson, *Reforming Tax Expenditures in Italy: What, Why, and How?* IMF Working Paper January 2014, Figure 1.

Figure 1. Tax Expenditures in Selected Advanced Economies
(Percent of GDP)



Sources: OECD (2010); United States, National Commission on Fiscal Responsibility and Reform (2010).
Note: Higher values may arise from more comprehensve reporting (recent estimates for Italy are higher due to change in benchmark).

3.15 Witnesses particularly focused on superannuation concessions. Mr Cowgill from the ACTU stated:

> Another [avenue to address the decline in revenue] that we note is the large, growing and highly inequitable superannuation tax concessions that overwhelmingly benefit high-income earners. We note that some Treasury analysis that was released last year shows that the very highest-income earners receive more government support for their retirement in the form of superannuation tax concessions than low-income earners do in the form of the aged pension. We say that is inequitable, it is unsustainable and it has put a large and growing hole in the Commonwealth budget.[15]

3.16 Dr Denniss focused on removing tax concessions as a way of lifting Commonwealth revenues by 'tens of billions of dollars additional revenue with no upward pressure on the rate of tax at all.'[16] He stated that the superannuation concession was a large and growing expense for the Commonwealth:

> The biggest one, the elephant in the room, is of course tax concessions for superannuation, which are now tipped to hit $60 billion—sixty thousand million dollars—by 2016. Let me be clear, this is the fastest-growing area of expense in the Commonwealth. This is it. This is the main game. You can have inquiries into the DSP [Disability Support Pension], you can have inquiries into the dole, the thing that is growing the fastest in the dollar terms is the tax concession system for superannuation.[17]

3.17 Mr McAuley agreed with this position, and went on to highlight some other areas that should be looked at, including energy taxes, comprehensive road charging

15 *Proof Committee Hansard*, 5 February 2014, p. 9.

16 *Proof Committee Hansard*, 5 February 2014, p. 13.

17 *Proof Committee Hansard*, 5 February 2014, p. 9.

and increasing or restoring gasoline indexation – all of which were covered by the Henry Tax Review of 2010.[18]

Debt and deficit

3.18 Also underlying the terms of reference for the commission is the view that there is a structural deficit which must be turned into a surplus.

3.19 Mr Shepherd told the committee that action is required to address the amount of debt Australia has:

> We are facing the sixth year in a row of budget deficits. Without action, deficits are in prospect for many years to come. This situation is not going to fix itself. *The Magic Pudding* is a fable. Unless we fix this problem now, we will consign to our children and their children a legacy of unsustainable largesse. Former Prime Ministers Hawke and Keating understand this point and recently urged the government and the community to accept that hard decisions on the budget need to be made now, in the national interest.[19]

3.20 Mr Shepherd added:

> If we are prepared to make the necessary adjustments now in our approach to government, we will have time to readjust and remain on the path of prosperity and rising living standards for all Australians.[20]

3.21 However, several witnesses stated that Australia's deficit is a small one and that, if managed well, government borrowing can have a positive effect on the broader economy.

3.22 Dr Dennis argued that a reasonable amount of government debt was a not a negative thing in itself. Rather, he suggested responsible government spending could be seen in a more positive light, as government investing in future assets:

> Living within your means does not mean borrowing as much as you want and wasting it on things, but, if you are borrowing money to build assets that are going to return value for you over the life of those assets, then that is economically a good thing…[I]t might be hard to politically agree what is a good investment and what is a bad investment, but directors of companies argue about those things as well.[21]

3.23 Other witnesses were even more positive about the state of the Australian economy, with some pointing to the possibility of the Commonwealth being in a much better position in 2023-24, even without significant spending cuts.

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18 *Proof Committee Hansard*, 5 February 2014, p. 44, referring to *Australia's future tax system* (2010).

19 *Proof Committee Hansard*, 15 January 2014, pp 1-2.

20 *Proof Committee Hansard*, 15 January 2014, p. 2.

21 *Proof Committee Hansard*, 5 February 2014, p. 16.

3.24 For instance, Mr Cowgill, ACTU, spoke of the possibility that the Australian economy would be in surplus by the early 2020s if the current rates of growth continued, referencing three sets of projections:

> In our submission…we show three different projections by three different organisations of the fiscal outlook. The first is by the Business Council in its *Action plan for enduring prosperity*. The second is from a Treasury working paper of 2013 on the structural budget balance. The third is by the International Monetary Fund [IMF]. All of those projections anticipate Australia having a surplus or, in the case of the IMF, a structural surplus of somewhere in the vicinity of one per cent by 2023.[22]

3.25 However, Mr Cowgill also conceded that this outlook differs from the Mid-Year Economic and Fiscal Outlook (MYEFO) delivered in December 2013:

> The MYEFO outlook is different. My understanding is that the difference in MYEFO arises from a change in the assumptions that underpin the projection of the fiscal outlook. My understanding is that previously it had been the norm for projections to be done on the assumption that over the long run the economy would be around its trend pace and that the unemployment rate would be equal to what the Treasury estimates to be its lowest sustainable rate. My understanding is that in MYEFO that has now changed and the projection methodology now involves saying, 'If the anticipated rate of economic growth at the end of the forecast period is below trend then we will just assume that it will remain below trend by the same amount over the whole projection period.' If you put that assumption in, you come out with a substantially worse fiscal outlook.[23]

3.26 This perspective was also drawn out by Mr Koukoulas, who argued that the 2013-14 MYEFO was too pessimistic and the fundamentals of the Australian economy were in better shape than it suggested:

> Perhaps the best assessment of the state of public finances in Australia is given from the international credit rating agencies. All three major rating agencies—Standard and Poor's, Moody's and Fitch Ratings—assess Australia as AAA risk with a stable outlook. They held this assessment even after seeing the seemingly pessimistic view presented in the MYEFO in December.[24]

3.27 Mr Koukoulas emphasised the need for more context to be taken into account when looking at the positive or negative value of budget surpluses for the Australian economy:

> The government, opposition, and economics profession need to work hard to change this misconception that surpluses are always good and deficits are always bad. There should be no value judgement that suggests budget deficits are good or bad without context being placed around the economic

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22 *Proof Committee Hansard*, 5 February 2014, pp 10-11.

23 *Proof Committee Hansard*, 5 February 2014, pp 10-11.

24 *Proof Committee Hansard*, 5 February 2014, p.47.

> and fiscal position...It would be an economic policy failure in the extreme for any government to be aiming to run a budget surplus if the economy was in recession and the unemployment rate was rising. Here a budget surplus is unquestionably bad, while a deficit would be good, even if it was merely the result of the government allowing the automatic stabilisers on revenue and expenditure to kick in. Similarly, if the economy was in a well-established period of trend growth with low unemployment and evident inflation pressures, a budget surplus would be good and a deficit would be bad.[25]

Public versus private delivery of current government services

3.28 The terms of reference include direction to the commission to look at areas in which services currently delivered by the Commonwealth or state governments may be more efficiently and cost-effectively delivered by private enterprise.

3.29 Evidence received by the committee questioned whether private delivery of services would be beneficial, both for the Australian economy in general and for social policy outcomes. For instance, ACTU stated that:

> We also take issue with a number of the terms of reference which really are one way towards an in-principle view that matters such as outsourcing and contracting out are always more efficient. We detail in the submission that recent experience both here and in the UK has shown that privatisation and outsourcing have not always proven to be efficient and cost-effective means of delivering services.
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> We note and go through in some detail that factors such as vendor dependency, provider concentration and gaming can in fact make private provision more expensive, less flexible and more prone to perverse and unintended outcomes for service users than public provision. In other words, the assumption that private is superior to public in all cases is, in our view, misplaced.[26]

3.30 Mr McAuley told the committee that he was concerned about potential government privatisation, especially as in many areas the public sector delivered services more effectively and efficiently than private enterprise:

> So, yes, it is possible to cut further in Australia, but it is economically inefficient to do so if we start getting into those areas where, intrinsically, the public sector does a better job. There is not a great deal of recognition, in the terms of reference of the Commission of Audit, that there are areas of market failure, where public funding or provision is a clearly superior area.[27]

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25 *Proof Committee Hansard*, 5 February 2014, p.46.

26 Mr Tim Lyons, Assistant Secretary, ACTU, *Proof Committee Hansard*, 5 February 2014, p. 8.

27 *Proof Committee Hansard*, 5 February 2014, p. 37.

Is the real problem declining Commonwealth revenue?

3.31 The committee heard evidence suggesting that the commission should be concentrating not only on potential cuts that could be made in the Commonwealth budget, but also on improving government revenues. However, the commission's terms of reference focus on the review of government expenditure and are largely silent on matters of government revenue.

3.32 When questioned on whether there is scope for the commission to consider government revenue as part of its review, Mr Shepherd informed the committee:

> We will deal, in some cases, with revenue issues, but we are cognisant of the fact that the government is intending to issue a white paper on taxation. So, obviously, that would be a far better process for dealing with the revenue side of the equation.[28]

3.33 Mr Peter Crone, head of the commission secretariat, disagreed with the proposition that the terms of reference and its focus on government expenditure mean that the commission is being asked to operate with 'one arm tied behind [its] back':

> I would not say that tax is completely absent. For example, the commission has been asked to comment on the current architecture of Commonwealth-state financial relations, and obviously a very big part of that is related to tax. The revenue from the goods and services tax all goes to the states. The states do not have enough of their own source revenue to provide the services that their citizens require. We have been asked to have a look at that, and we will.[29]

3.34 The importance of looking at both revenue and expenditure was emphasised by Dr John Daley, CEO of the Grattan Institute, appearing in a private capacity:

> Although the National Commission of Audit's terms of reference are focused on government expenditure, it is important that any budget reform looks at both sides, profit and loss.[30]

3.35 Dr Daley explained the need to look at revenue and expenditure together:

> [I]f you look at the history of governments that have successfully substantially improved their budget positions, almost always that reform involves both spending cuts and tax increases, and I think there is a real political economy reason for that.
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> …
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> Obviously the Commission of Audit is not the only thing that the government will use in thinking about what it will do in order to repair its budget, but if you were trying to find a comprehensive package to improve

28 *Proof Committee Hansard*, 15 January 2014, p. 4.

29 *Proof Committee Hansard*, 15 January 2014, p. 24.

30 *Proof Committee Hansard*, 5 February 2014, p. 2.

> the Commonwealth budget position, I absolutely think that the revenue side of the budget needs to be part of the story.[31]

3.36 Mr Lyons agreed that revenue should be a focus for the government and the commission:

> [T]o the extent that we face a fiscal policy challenge we say it is related to a problem of revenue and not expenditure and that such a challenge requires a longer term strategic vision about the future structure of the Australian economy and how we raise revenue, not short-term political fixes in the context of one year's budget.[32]

3.37 Dr Denniss also stressed the need to look at revenue, particularly simplifying the current tax arrangements to close down loopholes in the system:

> Indeed, to the extent that we have any problem with our public finances at all, it is quite clear—again from both historical and international points of view—that we have a fundamental problem with collecting revenue. My submission to you is to focus on achieving a simple and efficient tax system by removing the enormous and inequitable tax concessions and loopholes that currently exist in the system. This will allow the collection of tens of billions of dollars in additional revenue with no upward pressure on the rate of tax at all. An enormous amount of legal and accounting time goes into the exploitation of those loopholes. That is an opportunity cost for the economy, and again economics would suggest that a simple system would be one that has fewer, not more of those.[33]

3.38 Mr Phil Bowen, Parliamentary Budget Officer, commented that the current diverging trajectories of Australian government expenditure and revenue should be looked at:

> **Senator BUSHBY:** We have heard that the overall relative position of Australia's debt position is not too bad compared to other countries but that it is the trajectory that is the issue here rather than our absolute position. Is that correct?
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> **Mr Bowen:** I think I could agree with that. At the moment we have two divergent trends. Revenue is going one way and expenditure is going another. That, in the long term, is not a sustainable position. Really, it is a matter to be considered now, and into the medium term, before we get to the long term.

3.39 However, Mr Bowen also told the committee that it was too simplistic to blame deficits on decreasing revenues alone.[34]

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31 *Proof Committee Hansard*, 5 February 2014, p. 3.

32 *Proof Committee Hansard*, 5 February 2014, p. 8.

33 *Proof Committee Hansard*, 5 February 2014, p. 13; see also Mr McAuley, *Proof Committee Hansard*, 5 February 2014, p. 37.

34 Mr Phil Bowen, *Proof Committee Hansard*, 5 February 2014, p. 58.

The possible effect of spending cuts on the economy

3.40 Witnesses cautioned that cuts in expenditure at the wrong time and in the wrong places could harm the economy.

3.41 Dr Peter Burn, Director of Public Policy for the Australian Industry Group, also drew out the consequences of poorly targeted cuts to capital expenditure:

> I would say that—with the first round in particular and as a temptation generally—there can be an emphasis, when you are cutting expenditure, on capital expenditure, the impacts of which do not show up for some time. So, in a fiscal consolidation, I think you have to be very wary of making cuts in your capital program where the costs of that will be transmitted further down the line to a poor state of national infrastructure, for example, that you then have to make up in some way.[35]

3.42 Dr Burn advised the committee that the government should stagger fiscal consolidation:

> Our concern about the fiscal consolidation and the impact on the macro economy really relates to the coming financial year, 2014-15. We think that cuts could be announced, that consolidation could be announced, over the period of the forward estimates, for example, with the emphasis on later years if the economy is thought to be capable of picking up over that period, and that cuts announced with the measures implemented—in the sense that the savings would accumulate over time—could all be done this year.[36]

3.43 Dr Denniss advised that harsh cuts to government expenditure would lead to higher unemployment, shrinking government revenue and, perversely, a larger deficit:

> There is absolutely no doubt that massive expenditure cuts by the government at this point in the economic cycle will lead to higher unemployment. There is actually no doubt that massive spending cuts now will also lead to a significant reduction in government revenue, as the economy slows faster than it otherwise would. In turn, the deficit will likely get bigger the faster and the harder they cut. I was asked the question before: should governments ever try to cut their spending? My response was yes, but when? There are better times to do it and there are worse times to do it.
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> As the economy is beginning to slow and as unemployment is already beginning to rise, I would put to this committee that about the dumbest time to make big cuts to government spending would be right now.[37]

Is 1 per cent of GDP by 2023-24 an appropriate target?

3.44 The terms of reference for the commission state:

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35 *Proof Committee Hansard*, 5 February 2014, p. 35.

36 *Proof Committee Hansard*, 5 February 2014, p. 35.

37 *Proof Committee Hansard*, 5 February 2014, p. 20; See also Mr McAuley, *Proof Committee Hansard*, 5 February 2014, p. 41.

> [T]he Commission of Audit has a broad remit to examine the scope for efficiency and productivity improvements across all areas of Commonwealth expenditure, and to make recommendations to achieve savings sufficient to deliver a surplus of 1 per cent of GDP prior to 2023-24.[38]

How was the target chosen?

3.45 Mr Shepherd advised that the commissioners were not consulted and did not have any input in the terms of reference.[39] However, Mr Shepherd expressed the following view on achieving a surplus of 1 per cent of GDP by 2023-24:

> Personally, and I think the other commissioners would agree with me on this, that seems to be a sensible target that would in fact get the budget to a sustainable level. It is not over-reaching or under-reaching. I suppose one could argue whether it is 1 per cent, two per cent or half a per cent, but we would think it is a fair and sensible target.[40]

3.46 When pressed as to whether a surplus of 1 per cent of GDP by 2023-24 is appropriate, Mr Shepherd stated:

> [I]t is a question for government. Our report will go to the government. It will consider it, it will decide whether or not to accept any or all of our recommendations and then, if it does decide to accept our recommendations, it will take it to the parliament. That is the process.[41]

Modelling

3.47 The committee explored the modelling being used by the commission to achieve the 1 per cent of GDP figure that underpins its recommendations. Mr Shepherd was non-committal as to whether the commission would rely on modelling by Treasury or the Department of Finance (Finance):

> We will decide when we put in our final report, which we have not done yet—it is still in preparation—what modelling we will rely on. We have modelling, certainly, from Treasury, and we have modelling from Finance, but as independent auditors we have to apply our own judgements to those.[42]

3.48 Aside from Treasury and Finance modelling, Mr Shepherd indicated that commission would rely on the 'experience and knowledge of each of the members of the commission' as well as the submissions received as recommendations are developed.[43]

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38 National Commission of Audit, Terms of Reference.

39 *Proof Committee Hansard*, 15 January 2014, p. 3.

40 *Proof Committee Hansard*, 15 January 2014, p. 3. See also *Committee Hansard*, 15 January 2014, p. 25.

41 *Proof Committee Hansard*, 15 January 2014, p. 3.

42 *Proof Committee Hansard*, 15 January 2014, p. 4.

43 *Proof Committee Hansard*, 15 January 2014, p. 4.

What is the target in a dollar figure?

3.49 When questioned by members of the committee on whether the commission had a dollar figure for the 1 per cent of GDP for 2023-24 which it was using for the purposes of its recommendations, Mr Shepherd stated:

> We will certainly have in our report to the government an indication of what we see that means by then, but we have not finalised our report yet. That will of course be contained in our report. [44]

3.50 Mr Crone noted that the current dollar figure for 1 per cent of GDP is $15 billion.[45] Mr Shepherd agreed with the suggestion that the figure in 2023-24 would be 'significantly higher than $15 billion', adding '[w]e would hope that the economy does grow by then'.[46]

3.51 Evidence to the committee from Mr Crone appears to suggest that the commission is using a dollar figure for the purposes of its recommendations. However, according to Mr Crone, that figure is not yet finalised and Mr Crone was not prepared to disclose any figure under consideration by the commission:

> I do not have the number in my head to the nearest decimal point [for 1 per cent of GDP in 2023-24]. We have got an idea of what the size of the economy is in 2023-24, and 1 per cent of that would obviously drop out.
>
> …
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> I think it is part of the internal workings of the commission. This will be included in our report. We will make assessments and judgements about how the economy is growing, factors that will increase, factors that will impact on that…
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> …
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> …That figure has not been bedded down finally. We are still doing our deliberations, and I do not think it is appropriate for me to share that at this stage.[47]

3.52 Later, in response to further questioning by members of the committee, Mr Crone indicated that '[i]t is possible' that the commission is not working with a fixed dollar figure, but rather a range of figures based on various assumptions.[48]

3.53 At a later hearing of the committee, evidence from the Treasury suggested that their modelling indicated that the Australian GDP in nominal terms would be $2.6 trillion in 2023-24, meaning 1 per cent of GDP would be $26 billion.[49]

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44 *Proof Committee Hansard*, 15 January 2014, p. 4.

45 *Proof Committee Hansard*, 15 January 2014, p. 4.

46 *Proof Committee Hansard*, 15 January 2014, p. 4.

47 *Proof Committee Hansard*, 15 January 2014, p. 33.

48 *Proof Committee Hansard*, 15 January 2013, p. 33.

49 Mr Nigel Ray, *Proof Committee Hansard*, 15 January 2013, p. 69. See also Department of Finance, answers to question on notice, 15 January 2014 (received 3 February 2014).

Is this target appropriate?

3.54 Witnesses suggested that the Australian economy may be in surplus before 2023-24 if current growth trends continue – even without substantial cuts to government spending.

3.55 As noted above, Mr Cowgill's referred to BCA, Treasury and IMF projections which all suggest that the Australian economy will be in surplus in the early 2020s.[50]

3.56 Mr Koukoulas also suggested that the target of 1 per cent surplus by 2023-24 was not necessarily an overly ambitious one – especially as the last MYEFO was too pessimistic about the state of the Australian economy.[51]

Conclusion

3.57 The committee supports the general principle that government spending should be responsible, well-targeted and efficient. During the course of the inquiry, concerns and evidence have emerged which call into question the key assumptions underlying the terms of reference given to the commission. This evidence means the committee has serious reservations that the terms of reference provided to the commission by the government are flawed and misleading.

3.58 It is possible that short sighted cost cutting recommendations based on these terms of reference will have the potential to harm the Australian economy and negatively affect the lives of many Australians.

3.59 Regarding the assumption that government spending is 'out of control', the committee heard that Commonwealth expenditure is actually at a reasonable and modest level – both by Australian historical and international standards. The committee also heard that the current level of debt and state of the economy is not a reason for hasty cuts.

3.60 In the committee's view, leaving the consideration of government revenue for a separate review process conducted in isolation is not likely to provide a holistic evidence base for effective decisions.

Recommendation 6

3.61 The committee recommends that the government broaden the remit of the National Commission of Audit to include explicit consideration of government revenue.

3.62 The committee understands that Australia's budgetary position could be improved substantially by removing or recalibrating Commonwealth expenditure on tax exemptions and concessions, such as industry and superannuation, and believes this should be included in the work of the commission.

50 *Proof Committee Hansard*, 5 February 2014, pp 10-11.

51 *Proof Committee Hansard*, 5 February 2014, p. 47.

Recommendation 7

3.63 The committee recommends that the commission look at current tax expenditure to find possible areas of budgetary savings for the Commonwealth.

3.64 The committee recognises that, over the long term, demographic changes such as the ageing of the population will require considered measures to be put in place. However, the committee is concerned that there is a real danger that the commission will recommend cuts that are poorly timed and targeted which could result in lasting harm to the economy and the community.

3.65 It also supports the principle that government expenditure should be reviewed regularly to make sure programs are relevant, well-targeted and to ensure emerging issues are quickly addressed.

3.66 The committee believes that in the event savings measures are accepted by the government, they should be appropriately timed to provide sufficient time for government to consider any unintended consequences and take into account any improvement in the economy which is outside current expectations. This would also allow the government the time and fiscal space to appropriately respond to any rapid and/or unforseen changes in the domestic and international environments.

3.67 The committee further believes that prior to their implementation, all the savings measures that are accepted by the government should be examined by the appropriate Senate committees. This would allow for a thorough examination of each measure and for proper consultation with affected stakeholders.

Recommendation 8

3.68 The committee recommends that in the event of savings measures being accepted by government, they should be appropriately timed so any unintended consequences can be addressed in a measured way and the government is better able to respond to any rapid changes in the domestic and international environments. These savings measures should also be examined by the appropriate Senate committees prior to their implementation.

3.69 The committee is particularly concerned that any recommendations for privatisation of services currently delivered by the Commonwealth should ensure no degradation of services.

3.70 The committee is further concerned that any recommendation for privatisation of services currently delivered by the Commonwealth should not lead to an increase in costs to the public to access these services, or to the loss of jobs in those privatised services.

Recommendation 9

3.71 The committee recommends that any recommendations made by the National Commission of Audit to privatise services be subject to a full cost-benefit analysis which examines the effect on services, costs to the public, and jobs.

3.72 The commission's terms of reference specify that it is to make recommendations to achieve savings sufficient to deliver a surplus of 1 per cent of GDP prior to 2023-24. This is the only figure in the terms of reference to guide its work, so how this target was derived, whether it is an appropriate and reasonable target, and the associated assumptions which underlie that figure as a target are very important.

3.73 The committee examined the rationale for the 1 per cent figure with the commission who indicated the figure was presented to it by the government but in the commission's view it seemed to be a reasonable target. The committee believes the government should provide clarity on how the 1 per cent figure was selected and what assumptions it is based on.

3.74 The committee also believes that the government should provide clarity on the pathway to bringing the budget back into surplus and state when the budget would first get back into surplus prior to reaching the 1 per cent target by 2023-24. This information would show what level of budget consolidation would be required in order to reach the desired surplus target.

3.75 The committee further believes that if the commission uses a different set of modelling to that provided by the Treasury, that the government should release the full modelling assumptions and methodology as well as a statement as to why the Treasury modelling was unsatisfactory.

Recommendation 10

3.76 The committee recommends that along with the publication of the commission's reports, the government provide detail on how the target in the terms of reference of a surplus of 1 per cent of GDP was selected, and detail of any alternative modelling that may have been used by the commission.

Future work of the committee

3.77 The commission's terms of reference provide a broad remit to examine the scope for efficiency and productivity improvements across all areas of Commonwealth expenditure. In future hearings and reports the committee will focus on key areas of the commission's work and the substantive issues of concern raised in submissions.

Senator Richard Di Natale

Chair