



# RESEARCH NOTE

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## Commonwealth Saving: What is It?

### Major Findings

- The Budget Balance does not fully convey the Commonwealth's saving performance.
- Commonwealth saving is that part of recurrent income not spent on recurrent expenditure.
- Measures which reduce the Commonwealth budget deficit do not necessarily increase Commonwealth saving.
- Measures which increase Commonwealth saving do not necessarily increase national saving.

### Introduction

This note explains what *saving* is in the context of the Commonwealth budget and looks at its utility in raising national saving. It does not canvass when or why saving is desirable.

*Saving* is that part of income which is not consumed. Governments gain income from taxes and from other revenue sources, such as dividends from government business enterprises. Income from such sources is *recurrent* income. The sale of assets, which registers as a *deduction from outlays* in the budget figures, is not a form of potential saving as assets are the result of past saving.

### National Saving

National saving is the sum of household, government and corporate saving. Households are the

prime source of national saving. As the graph below indicates, since 1972-73<sup>1</sup>, household saving has been stable but showing long term decline. Corporate saving, mostly retained earnings, is relatively unimportant in national saving. Government, particularly Commonwealth, saving has generally been more important in determining immediate fluctuations in national saving.

### Government Saving

*Recurrent* expenditure is expenditure on non-capital items. If government's recurrent expenditure is below its recurrent income it is saving, as any extra expenditure will be on capital items and thus constitute investment. (In such a case, saving is turned directly into investment without any financial intermediary.) Conversely, a government can 'dis-save' while running a budget sur-

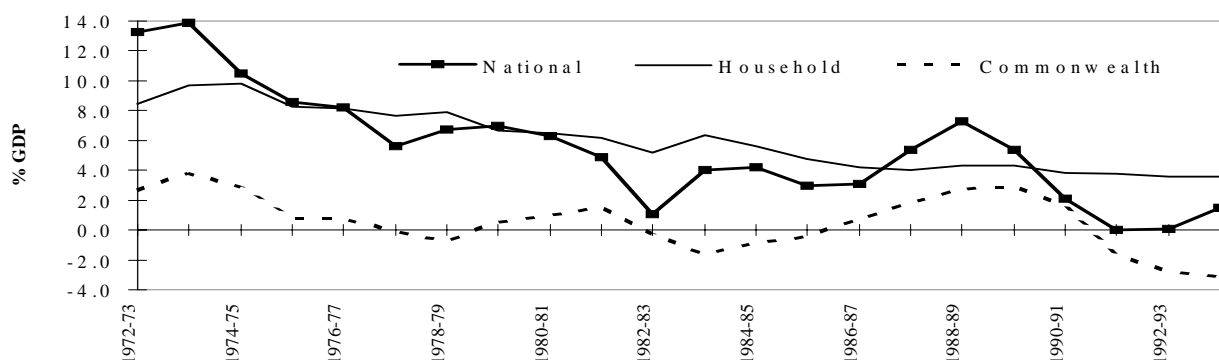
plus, if recurrent expenditure is financed via asset sales, as recurrent expenditure will still be above recurrent income. Therefore, the budget balance does not state the Commonwealth's saving performance.

In *Budget Statement No. 3* (1995-96), Table VI, Commonwealth budget sector<sup>2</sup> outlays are classified by economic type.

From the table below, we can see that the Commonwealth's budgeted saving performance for 1995-96 was to make a call on national saving of \$2.9bn for recurrent expenditure.

If Commonwealth saving is to be increased, the Commonwealth can either

(Net) National, Household and Commonwealth Saving  
1972-73 to 1993-94



	1994-5 (\$bn)	1995-96 (\$bn)	
current outlays	120.3	127.3	<i>recurrent expenditure</i>
+ <i>capital outlays</i> (net of asset sales)	2.4	-3.5	
= <i>total outlays</i>	122.4	123.7	
<i>tax revenue</i>	105.3	119.3	
+ <i>nontax revenue</i>	5.0	5.2	
= <i>total revenue</i>	110.3	124.4	<i>recurrent income</i>
budget balance	-12.2	0.7	
recurrent income	110.3	124.4	
- recurrent expenditure	120.3	127.3	
= Commonwealth budget saving	-10.0	-2.9	

1. *increase* recurrent income while holding recurrent expenditure steady
2. *cut* recurrent expenditure while holding recurrent income steady
3. *cut* recurrent expenditure while *increasing* recurrent income.

While equivalent in their effect on *Commonwealth* saving performance, they are not equivalent in their effects on *national* saving performance due to differing effects on other sectors' saving, particularly given that the Commonwealth's prime revenue source is taxation. This is because increasing tax revenue reduces the income available for saving by other sectors. Cutting recurrent expenditure can also reduce other sector's income, but Commonwealth transfer payments (\$105.9bn or 86% of current outlays for 1995-96) are unlikely to be major sources of saving by other sectors.

Furthermore, as noted by recent EPAC studies<sup>3</sup>, the Australian income tax system is highly dis-

tortionary against cash saving, due to the high reliance on income taxes and taxation of that part of interest payments which compensate for the effects of inflation (ie. the income tax system includes a capital tax on cash saving, a tax which is particularly apparent to taxpayers through the operation of the provisional tax system). This increases the likelihood that households will cut saving rather than consumption if there is a tax induced decrease in income.

### **Saving and the Budget Balance**

There are various steps the Commonwealth can take to reduce a budget deficit which have little or no effect on national saving. For example, privatisation simply absorbs private saving. Similarly, increasing debt repayments from other governments transfers saving, it does not add to national saving. Again, increasing dividend receipts from government business enterprises merely reduces their saving through reducing retained earnings. The first

two actions reduce the budget deficit by reducing net capital outlays without affecting even the Commonwealth saving performance. The last action increases Commonwealth on-budget saving by transferring saving from off-budget enterprises.

### **Conclusion**

The Commonwealth's saving performance is a separate issue from the budget balance. The Commonwealth is currently 'dis-saving' and thus directly reducing national saving. Increasing the level of Commonwealth saving by cuts in recurrent expenditure or increases in taxes, particularly on households, are not neutral in their effects on national saving. Steps which reduce the budget deficit may or may not increase Commonwealth saving. Even if they do, they may or may not increase national saving.

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<sup>1</sup> The graph, taken from ABS data, provides Commonwealth general government sector saving. It thus excludes Commonwealth business enterprises. It is net national saving because depreciation of fixed assets is not included.

<sup>2</sup> The 'budget sector' is simply those Commonwealth agencies and Departments whose expenditure and revenue are covered in the budget. Excluded are 'off-budget' agencies such as government business enterprises.

<sup>3</sup> Pender, Howard and Ross, Steven, EPAC 1993, 1994.