Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates 3-5 June 2008

Question: bet 69

Topic: **Productivity & Growth in Australia**

Hansard Page: **E20-E21**

Senator Coonan asked:

Senator COONAN—I will be brief on this, but there are a few more things I want to ask about. If you were to rank giving the $20 billion say as tax cuts as targeted transferred payments or presenting them as government own purpose spending, which in Treasury's view is more likely to improve the productivity and growth of Australia and which the least likely?
Mr Ray—I am not quite sure that I am following your question. What are we ranking?
Senator COONAN—How do you characterise the $20 billion tax cuts? Do you characterise it as a targeted transfer payment or is it government own-purpose spending? That was really the premise on which I put the question. Which is more likely to improve the productivity and growth of Australia and which is the least likely? Is there any difference?
Mr Ray—I think I know where you are going but if I am not going in the right direction, stop me.
Senator COONAN—Yes.
Mr Ray—Whether or not you have a tax cut or a spend, a payment, what would be the different effect?
Senator COONAN—Yes.
Mr Ray—I think you would need to look at that in the context of the overall budget. It is hard to make comments about particular elements like that. As you know, over the last few years we have been building some capacity in the department to analyse the impact on labour supply decisions of various programs, including tax cuts. The previous government and this government have published some of those estimates.
Senator COONAN—Could you take it on notice and just have a think about it, if you can provide a view? I know you have done your best now, but I am just—
Mr Ray—I probably have not done my best.
Senator COONAN—Would you do your best then?
Mr Ray—That is because you probably asked—
Senator MURRAY—Too much honesty is bad.
Senator COONAN—Mr Ray is always honest.
Mr Ray—Because I think what you are asking me for is a treatise on fiscal policy which would take a long time but I am happy to take it on notice to see what we can provide.
Senator COONAN—Short of a tome, what you could do would be appreciated. Could you please provide us with a breakdown of the effects on the fiscal and underlying cash balances, in per cent of GDP and dollars, of the changes in the accounting treatment in the budget and the re-indexation on the basis of CPI rather than the non-farm GDP deflator?
Mr Martine—Just to answer the second part of your question first, as we were discussing previously, the change from non-farm GDP deflator to CPI is simply one

of reflecting in the historic series to calculate real growth trends. The actual indexation of all government programs, whether it is defence or age pension or departmental costs et cetera, has remained unchanged. That is what feeds through to the budget bottom line. The discussion we are having about non-farm GDP versus CPI is simply one of how you calculate a real increase in the spending number but the actual impact on the budget remains unchanged from that.

Answer:

1. *Short of a tome, what you could do would be appreciated. Could you please provide us with a breakdown of the effects on the fiscal and underlying cash balances, in per cent of GDP and dollars, of the changes in the accounting treatment in the budget and the re-indexation on the basis of CPI rather than the non-farm GDP deflator?*

As noted in Statement 3 of Budget Paper 1 (page 3-24), the new accounting framework adopted at Budget has no impact on the underlying cash balance. As shown in Table 5 of Statement 3 (page 3-12) recognising the GST as a Commonwealth government tax improved the fiscal balance by $1.1 billion (0.1 per cent of GDP) in 2007-08, $1.2 billion (0.1 per cent of GDP) in 2008-09, $1.1 billion (0.1 per cent of GDP) in 2009-10 and $1.3 billion (0.1 per cent of GDP) in 2010-11.

Using CPI instead of the non-farm GDP deflator to deflate payments and expenses is only of relevance to the *presentation* of growth trends. The actual indexation of government programs (which feeds into underlying cash balance and the fiscal balance) remains unchanged.

2. *If you were to rank giving the $20 billion say as tax cuts, as targeted transfer payments or presenting them as government own purpose spending, which in Treasury's view is more likely to improve the productivity and growth of Australia and which the least likely?*

It is not possible to state definitively that one of these approaches will always be more effective than the others in improving productivity and growth.
Rather, to determine the most effective approach, it is necessary to compare the marginal benefit of each of the policy options on a case by case basis. As different policy options can impact on the economy in different ways, the optimal policy approach will depend on the prevailing circumstances, with a range of factors to be taken into account, including:

- the timeframe in which an outcome is sought;
- prevailing macroeconomic conditions;
- the specific characteristics of the policy options.

In the end, fiscal policy requires trade-offs at the margin. At any point in time, the benefits of, say, a particular tax cut need to be weighed against the benefits foregone by not deploying a particular transfer payment or a particular expenditure program.