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**SPEECH TO
THE AUSTRALIAN ADAM SMITH CLUB**

“FISCAL CONTRACEPTION: ERECTING BARRIERS TO IMPULSIVE SPENDING”

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MELBOURNE**

It's a great pleasure to be here tonight to address the Australian Adam Smith Club.

I should say at the outset that one of the few joys of being in opposition, and let me assure you there aren't many, is the increased freedom to float and debate ideas.

It is a freedom relished by thinkers and scholars like Adam Smith, but sadly one that politicians seldom get to enjoy.

The discipline of government and the rise and rise of “gotcha” journalism place heavy disincentives on politicians engaging in ideas and policy debate.

In Opposition though, these restrictions are more relaxed.

I think backbenchers have a particular role here. Not bound by front bench discipline. Free to publicly raise ideas that may not be policy, so long as they are informed by Liberal philosophy.

Indeed we fail in part of our duty as parliamentarians if we don't promote ideas. In a small way I seek to do this with Andrew Robb through the publication of a periodic journal of ideas called “The PartyRoom,” as does Kevin Andrews with his journal.

Adam Smith

The invitation to speak here tonight gave me cause to re-visit the writings of Adam Smith.

Perhaps what is so great about Smith is that his central idea, that society is better off when each individual pursues his or her own self-interest, is so simple.

There would seldom be a first year economics course in which Adam Smith is not mentioned and taught in the first lecture.

His ideas have stood the test of time. They are as relevant today as they were when the first edition of “*An Inquiry into the Nature and Causes of the Wealth of Nations*” was published in 1776.

I enjoyed coming across a story from Smith's childhood in a biography of him penned in 1895 by John Rae.

Rae recounts that when on a visit to his grandfather's house, a four-year-old Adam was appropriated by a passing band of gypsies. And for a time, could not be found. However, a gypsy woman was spotted a few miles down the road carrying a crying child.

Scouts were despatched and they soon came upon the woman, who dropped young Adam and escaped. The young boy was returned to his mother, which was just as well, because as Rae writes:

“He would have made, I fear, a poor gipsy.”

I was also pleased to discover that in July this year a statue of Adam Smith was unveiled in Edinburgh, arranged by the Adam Smith Institute.

Fittingly, it was funded entirely by private donations.

Fiscal Contraception

I have promised to address you tonight on the concept of “Fiscal Contraception.”

The central theme that this title is intended to convey is that governments are becoming ever more eager to spend taxpayer’s money. They therefore need greater controls – contraception if you will – to shield against what are, for conservatives, unnatural urges and for others, urges to be resisted.

The 5 minutes of political fun to be had in a moment of free-spending just isn’t worth forgoing the long-term benefits to our nation and our economy of reducing government’s role in people’s lives.

When it comes to fiscal irresponsibility, the Labor Party is without peer.

As you all know, but as I am duty bound to repeat, when the Coalition took office in 1996 and opened the books, we found that the budget surplus was not as big as Labor told us it was.

In fact, we found that the budget was not in surplus at all.

It was in deficit to the tune of \$10 billion.

Not only that, but we inherited \$96 billion of net government debt. Debt for which the Australian people were paying over \$8 billion every year in interest.

And the debt in 1996-97 was 17.6% of GDP. That was the challenge we faced when we took government. A debt of 17.6% of GDP today would be \$199 billion.

As the former Treasurer said, like the housemate that throws a wild party, Labor had a great time and left an almighty mess.

A mess that took the Coalition 10 years to clean up.

With the current financial crisis, imagine how much more difficult Australia’s position would be with a large government debt to service.

Despite Labor’s professed economic conservatism and mantra about the sanctity of the surplus, last week *The Daily Telegraph* reported that Mr Rudd was considering sending Australia back down the path of deficit and debt.

The Coalition’s economic record in comparison is excellent.

But over time, the belief that all problems can be solved by state intervention creeps into even the best of governments.

Even we were not immune from lapses in fiscal restraint.

One of the most egregious examples is Harmony Day.

It sounds like a mandated North Korean celebration culminating in a mass choreographed performance. But Harmony Day was actually a creation of the former government.

Harmony Day and its accompanying grants program was established in 1999 to promote the self-evident concept of community harmony.

Over the life of the program, some \$34 million was wasted on grants such as \$35,000 for the Sisters of Mercy in Brisbane for the 'Believing women for a culture of peace' program; an inter-faith, inter-ethnic dialogue for Muslims and Quaker women.

Or \$50,000 to the Australian Wrestling Federation to encourage wrestlers not to sledge each other.

Then there was the \$54,300 for the production of the play "Postcards from Nanna" about the challenges of a multi-ethnic, multi-generational extended family.

One former minister responsible for administering the program justified its existence on the basis that they had attended a Harmony Day event and had a "great time."

The Harmony Day program was a relatively small outlay but a clear sign that the former government was drifting from what should be a core liberal belief in minimising the role of government.

More substantial confirmation was provided by the billions of dollars poured into the different incarnations of industry assistance, such as "Investing for Growth," "Backing Australia's Ability," and the "Automotive Competitiveness and Investment Scheme."

These spending programs were symptomatic of a wider problem.

Too often, governments condition Australians to look to the state rather than themselves for the answers.

The frequently heard cry from citizens confronting a problem in their lives is not "what can I do about it?" but "the government should fix it."

It will take a good deal more political courage for politicians on both sides of the partisan divide to admit that government cannot solve all of society's problems.

Yet the temptation for governments and the expectation of communities is that governments will do something. Usually that "something" ends up being spending in some form.

Bruce Smith – Father of Australian liberalism

This conundrum for policy makers is not new. And it is certainly not new for Australia.

There was one Australian legislator who recognised the problem of over-reliance on government more than one hundred years ago.

He is not well known these days, but he could be regarded as the father of Australian liberalism.

There must be something in the surname. His name was Bruce Smith.

Smith was a businessman, employer's advocate, Member of Parliament and author of a true Australian political classic, *Liberty and liberalism*, which he penned in 1887.

I commend the CIS for republishing this work.

Perhaps his most important message was that governments have limited capacity to improve the welfare of individuals.

He cited one of his ideological allies, John Bright, who said that:

...there is a danger of people coming to the idea...that a government can do anything that is wanted – that, in fact, it is only necessary to pass an Act of Parliament to make any one well off. There is no more serious mistake than that.

Smith knew the notion that government action can always make society better off needed to be challenged.

But importantly, Smith also recognised the necessity of helping people to understand that government intervention can make many situations worse.

Take the enormous taxpayer support of the automotive industry as a modern example.

The distortions created by industry assistance of the nature provided to Australia's car manufacturers over many years show why this level of government intervention is counterproductive.

Spared from the need to be completely responsive to the market, thanks to taxpayer support, car companies in Australia have not reacted to market trends as fast as they otherwise would have.

The result has been a loss of market share and the consequential loss of jobs and investment.

This must have been the sort of government intervention that Bruce Smith had in mind when, as Federal Member for Parkes, he told the Parliament that:

“I have not the exalted opinion of the powers of Parliament. It can transfer things from one person to another, and it can do a great deal of harm.”

In recent years, we have not heard these truths of liberalism enough. It is time for us to once again stand for smaller government, free enterprise and individual freedom.

But I regret to advise that in neither the Labor Caucus nor the Coalition Party Room is there a significant constituency to reduce the size and scope of government.

I found this out the hard way at one of my first partyroom meetings.

I had in my mind my pledge to my preselectors that I would be a voice for less spending and smaller government.

A colleague proposed to the partyroom a new grant program.

I rose to take exception expecting to be applauded. After all, I thought, the Liberal Party is the party of smaller government.

Instead I was jeered and howled down to a chorus of “that's what you'd expect from a Senator. Sit down. Shut up.”

Indeed, it was still a battle for a number of us pushing voluntary student unionism from the back bench.

Clearly there is a great challenge for today's proponents of liberalism.

In short, we need to revive the spirit of Bruce Smith.

To that end, I want to propose four ideas to help reduce the size of government – tools for fiscal contraception, if you will.

Firstly, a rationalisation of government departments and ministries.

Secondly, a new internal mechanism to scrutinise government spending.

Thirdly, a new wave of privatisation.

And finally, more tax reform.

Rationalising ministries

Part of the problem with modern government is that its tentacles have spread further and deeper every year.

The reach of government wasn't always so extensive.

Until around the end of World War One, Commonwealth ministries consisted of only 10 ministers or less.

Today there are 30 ministers and 12 parliamentary secretaries. All (bar one or two) advocates for spending. All advocates for government activity.

Creating ministries and departments to back them up has also become a political tactic.

For example, Labor like to boast that for the first time they have established a Minister for Housing. They tout this as part of their strategy to tackle housing affordability.

I'm not aware of any house that has become more affordable as a result of this announcement.

But watch next time when a Rudd Government minister is asked what they are doing to address housing affordability. I can almost guarantee you that their first response will be to point to the appointment of "Australia's first housing minister."

Quite aside from the specific case, this approach reflects Labor's thinking – that society can't produce outcomes without government intervention, led by a minister and backed up by a bureaucracy.

But other areas of government intervention are more entrenched. We have ministers for industry, tourism, small business, agriculture, fisheries, forestry and energy.

Does anyone imagine for a moment that the economic activities these portfolios represent would not occur without a minister and a government bureaucracy to oversee them?

On one level, we need a debate about the extent to which the various ministers that represent these portfolios should intervene in these areas of economic activity.

But perhaps what is really needed is a debate that Adam Smith would relish. That is, whether we need these government departments and their ministers at all.

Surely an understanding of liberalism can lead to only one conclusion – that business and industry, and all Australians by extension, would be much better off in many cases if government simply got out of the way and left them alone.

We should have a long and hard think about whether we really need all these government departments, whose main function is often to administer the myriad grants programs created by governments and funded by the taxpayer.

Doling out government grants to various industry sectors creates distortions, as I mentioned earlier. It is also unfair, no matter how rigorous the process used to evaluate grant applications. This is because some businesses will receive taxpayer support, most will not.

Financial success for industry and business ought to be determined solely by commercial acumen. Financial reward should come from one source – providing a good or service demanded by the marketplace at a price the market will bear.

This should be the source of income and financial success for business – not the ability to fill out a government grant application better than someone else.

The billions of dollars poured into grants in these areas would be much more efficiently used if they were returned to all businesses in the form of tax relief.

Business tax relief will encourage further investment and create jobs.

I am not advocating wholesale abolition of every single element of these departments.

Governments do need a source of policy advice and analysis.

And some of the departments do have staff performing vital tasks – such as quarantine officers in the Department of Agriculture.

But there is certainly scope for extensive rationalisation.

Another problem with governments when it comes to ministries and fiscal restraint is that of the members of cabinet, only a handful have an interest in reducing spending.

Most ministers have a vested interest in increasing the size and scope of their department's spending activities.

The ministers with an incentive to spend far outnumber those with an interest in restraint.

A rationalisation of ministries will mean fewer ministers looking for new ways to spend taxpayers' money. As a matter of logic, fewer ministers means fewer advocates of spending.

Spending Reduction Committee (SRC)

But those ministers that remain will need to be kept on their toes.

Another barrier to fiscal restraint is that spending programs are not adequately evaluated and reviewed.

The mechanics of government are stacked against treasurers and other advocates of fiscal restraint.

Currently there is an Expenditure Review Committee of Cabinet. It is a great mechanism for putting together budgets, but not for restraining spending.

There is no effective process for reviewing government programs and reducing expenditure.

There should be.

All governments over time become proprietorial about programs.

Government should continually evaluate spending programs with a view to assessing their worth and relevance and abolishing programs that are underperforming or redundant.

The existence of all programs should be justified on an ongoing basis.

Therefore, we should establish a new internal control mechanism – the Spending Reduction Committee.

It ought to be comprised of relevant economic ministers but also backbenchers to give the party room some ownership and a greater sense of responsibility. Ministers would have to appear before and justify existing spending programs.

Whereas the ERC meets in the lead up to the budget, the Spending Reduction Committee would meet throughout the year.

In this way, governments could continuously examine programs and ask whether they are serving their intended purpose, whether they are necessary at all or whether they should have been introduced in the first place.

A new wave of privatisation

Another way to cut government spending is to reduce the size of government itself.

The Coalition achieved much in the area of privatisation. Investing proceeds and paying down debt and removing the conflict between being both regulator and industry participant.

Labor too did good work selling part of the Commonwealth Bank and Qantas. They just blew the proceeds.

The notion that governments should own and operate various enterprises is an obsolete proposition.

Although the recent failure of both sides in New South Wales to support privatisation of the state's electricity industry was deeply disappointing.

There is no good reason why governments need to own various utilities.

The Coalition fully privatised Telstra in the face of stiff opposition. We also privatised Australian Defence Industries, the airports, CSL, the National Transmission Network and the National Rail Corp.

But we should also have privatised the Snowy-Hydro Scheme. And we should have sold Medibank Private.

Conservatives have often floated the prospect of privatising the ABC and Australia Post. There is merit in such proposals.

But the likely strong public opposition means that any government prepared to go down that path would need to prepare the ground and make the case for the change.

A further challenge would be the widespread misunderstanding of the consequences by the public and the inevitable misleading scare campaigns mounted by privatisation opponents.

But one immediate option for privatisation is the Bureau of Meteorology. In 2007 taxpayers forked out \$214 million to run this agency.

Yet there is clearly a market for the information the bureau collects.

The bureau could be sold off, with new private owners free to collect weather data and sell it on the open market.

Taxpayers would receive a windfall gain from the sale and whilst some government agencies would need to purchase weather data and services, there would be a sizable annual saving to the taxpayer.

So far I have mentioned reducing the number of ministries and departments and embarking on a new wave of privatisation as ways of reducing the scope of government.

These ideas can be thought of as reducing the number of avenues for governments to spend our money.

But perhaps the most effective barrier to impulsive government spending is to reduce the money government has to spend in the first place.

A Simpler Income Tax System

The Coalition had an outstanding record when it came to cutting tax. We substantially cut income tax in 2000, 2003, 2004, 2005, 2006, 2007 and the cuts Labor copied from us and delivered this year. And we cut company tax, capital gains tax and tax on superannuation end benefits.

Some of you may recall a few years ago myself and the Member for Indi, Sophie Mirabella, launched something of a tax crusade after the 2004 election.

The press gallery dubbed us the “ginger group.”

Apparently the derivation of this term comes from the historical practice of “figging” – inserting a piece of ginger into the backside of older horses before sale to make them seem livelier and give the impression that they were younger. I suppose that’s the service we were trying to perform for the government.

We wanted to place further tax cuts on the agenda for that term to be a counter for the many spending proposals of other colleagues.

Opposition came from some surprising quarters. I remember a CEO from one of the big four banks coming to see me to tell me his view was that tax cuts shouldn’t happen because they would be inflationary.

The subsequent budget contained further tax cuts. No doubt despite rather than because of our efforts.

At that time I had the view that it was better not to index thresholds lest this take the pressure off government to cut tax more substantially.

But when I see a government forecasting a \$22 billion budget surplus, it’s time to rethink.

If a government with no debt has provided for schools, health and national security and is forecasting a budget surplus of \$22 billion, you can only reach one conclusion.

They are taxing too much. And they have big spending plans.

Unlike the previous government, Labor surpluses will not be used to retire debt or to cover liabilities.

The time has come to index thresholds. If government can't then live within their means, they need to review government programs.

The beast needs to be starved.

We also have a tax system, particularly an income tax system, which is still enormously complex. The two main pieces of income tax legislation total nearly 4,000 pages and over 1 million words.

The problem is, everyone wants a simpler tax system, yet everyone wants exceptions or deductions for their industry, their business or their particular circumstances.

It is the exceptions – the deductions and rebates – that bring complexity into the tax system. Remove the exceptions and you eliminate complexity.

Conversely, many Australians like their deductions, feeling they are getting something back from the taxman.

We could do something revolutionary - introduce a choice of income tax systems.

Under this proposal, based on the Taxpayer Choice Act currently being debated in the United States, individuals would have a choice to pay tax under the current system (and be eligible for its various deductions, offsets and tax benefits) or to switch to an alternative, simplified system.

That is, two income tax systems would operate simultaneously with taxpayers filing returns in their choice of system.

The Simple Income Tax (or 'SIT' for short) could have a higher tax free threshold to compensate for there being no deductions or offsets.

Individuals who choose the SIT would not be eligible for various benefits paid through the tax system.

This has a number of advantages.

The reduced administrative burden of overseeing the SIT would be substantially lower.

The savings to government from fewer deductions and decreased administrative costs should be returned directly to taxpayers in the SIT system through a reduced rate.

Taxpayers filing under the SIT would have no need to pay accountants to prepare their returns or spend hours of their own time keeping detailed records to prove deduction and/or benefit claims.

They would simply submit details of their income for the financial year. Tax returns could even become redundant.

And no one would be forced into the SIT. It would be each citizen's choice.

But unlike the system proposed in the United States, ours can be even simpler.

An individual's total income could be taxed at one rate or fewer rates than the current system.

Conclusion

My thesis is we need to make life harder for government. Fewer ministers, fewer programs, fewer areas of government activity and less tax revenue.

We left the era of free love behind in the '70s.

But the era of free spending for governments, particularly Labor governments, seems to never have ended.

We must do a better job of restraining government spending.

Adam Smith understood this in 1776.

Bruce Smith understood it in 1887.

Now, in 2008, it must be the Coalition that revives the spirit of Bruce Smith and Australian liberalism.

We must restore the faith of legislators in individuals and communities. We must accept that individuals and communities are more capable than governments of solving most problems.

Most of all, we need to argue that the best solution to many issues is greater freedom and more personal responsibility, not nanny statism and government grant programs.

It will be difficult. It will take political capital.

And we need our friends, such as the Adam Smith Club, to hold our collective feet to the fire.

It's a challenge to be enjoyed. Thank you for your attention tonight.