BLACK HOLES, BLACK HEARTS AND MISPLACED PRIORITIES: THE GOVERNMENT'S ECONOMIC RECORD

Address by the Hon Gareth Evans QC MP, Deputy Leader of the Opposition and Shadow Treasurer, to CEDA Dinner, Sydney, 20 February 1997.

The Australian economy may or may not be on the verge of significant pickup. Retail spending has slumped badly in recent months, consumer confidence is low and the outlook for private consumption expenditure (which dwarfs private business investment in its economic impact) is very problematic. But non-dwelling construction is strong, housing looks to have turned the corner, imports of capital goods have accelerated, and recent news on job vacancies and employment growth has been more positive than for some time.

If the economy *is* moving into a faster growth phase, that is unambiguously good news for the country as a whole, and Labor will unambiguously applaud it. Our traditional supporters certainly don't need any more hard times, and we don't as a political party either want or need hard times in which to thrive politically. On the contrary, we unequivocally welcome the greater freedom of action that good times allow us - to deliver strategies for overall increases in the standard of living of all Australians, and greater equality of opportunity and outcomes for those in special need.

All that said, if the economy is looking up the Coalition Government cannot claim much credit. Unlike the broken-backed economy John Howard bequeathed to his successors in 1983, he received back from Labor in March last year an economy that was structurally sound and internationally competitive, and which he himself conceded was "better than just good" - one with high growth, low inflation, high but falling unemployment, greatly enhanced social equity and with its fundamental forces better balanced than they had been for over two decades. Since then inflation and interest rates have dropped further, but so too have growth and the prospects for an early end to the scourge of high unemployment. The economy overall has been struggling since the last election, and some new growth momentum is desperately overdue.

The view from the Opposition bridge may not be the most totally objective one in town, but we believe that, as the Government approaches its first twelve months in office, a strong case can be made that its record is not at all impressive. There are at least eight main items on the charge sheet.

1. Our biggest economic problem has got worse.

The fundamental problem in the Australian economy at the moment is clearly not the old enemy, inflation. Years of hard effort seem to have finally succeeded in changing the culture of inflationary expectations, and I am not sure that even the Reserve Bank believes its lingering rhetoric about the danger of that being disturbed by a major wages breakout in the foreseeable future.

Nor is the fundamental problem budget deficits or the level of public debt: on both of these counts our performance is, for example, way better than necessary to qualify us for membership of the European Monetary Union, something that in Europe itself is now true for only one country (Luxembourg)! Treasury itself said after the last Budget:

> *Australian general government net financial liabilities as a per cent of nominal GDP are relatively low by international standards, being lower than all OECD countries other than Japan, and lower than the OECD average.*

Nor do we have an unmanageable problem with the current account deficit or our foreign debt: although levels of both are higher than we would ideally like, they are perfectly capable of being reduced over time to more comfortable levels by the kind of moderate budget balancing and private savings enhancing strategies being advanced by Labor.

The fundamental economic - and human - problem that we do continue to have is unemployment. With 800 000 people wanting work and unable to get it, 200 000 long-term unemployed and 100 000 youngsters unemployed, there is simply no ground for the kind of complacency which has led this Government to settle for an unemployment level of 8½ per cent out to the turn of the century and beyond, without any target or discernible strategy to reduce it.

Whereas unemployment had fallen from (an indefensible) 11 per cent to 8½ per cent in our last three years of government, unemployment has in fact risen under the Coalition Government. Since the last election, 180 000 people have entered the labour force, but over the same period only 159 000 jobs have been created, leaving almost 21 000 more unemployed today than there were in March. Full time employment is 10 800 lower than it was at the time of last August's Budget, with virtually all the jobs growth in recent months being in part-time employment. Even though there was some growth in employment last year, the total number of hours worked actually fell compared with 1995.

The Government has been using the latest labour force figures for January to boast that it is on track to achieve its employment forecast for this financial year. But these forecasts are only consistent with unemployment, now at 8.6 per cent, being maintained steadily at around its current rate. It is like a football team predicting that it will lose by ten goals, and then bragging about that prediction being met!

2. Fiscal policy has been misdirected.

The primary economic effect of last year's Budget cuts was to strip close to ½ per cent off the growth that would otherwise have occurred in the economy this financial year and next. And the main impact of the Government's "black hole" campaign in the run-up to the Budget - cynically designed to justify the breaking of multiple pre-election promises - was to knock a deep hole in consumer confidence, with further adverse consequences for national growth: within five months, the new Government turned the strong consumer confidence in the economy that was evident last March into a tide of pessimism. And despite the interest rate cuts since, confidence is still as low now as it was at the time of the August budget.

So instead of achieving the 4 per cent-plus growth that we had averaged in Labor's last three years of office, and which is necessary if any significant inroad is to be made into current unemployment levels, the Australian economy has been limping along at not much better than 2 per cent for most of this financial year, and will struggle to do better than 3 per cent for the year overall. The Treasurer's mid-year review predicted a pick-up to a sustained 3½ per cent thereafter, but that is simply not fast enough to meet our unemployment reduction needs. The Coalition's first year in office has been a wasted year for jobs.

There may be times when severe budgetary action is needed, and slower economic growth cannot be avoided. Current account deficits and inflation can sometimes get out of hand. And many countries around the world are right now grappling with massive government debt and unsustainable budget deficits which require resolute action. However, the point must be made again that Australia is *not* one of those countries. Last year's budget papers show how Commonwealth government debt in Australia has stabilised as a proportion of GDP and was set to fall in coming years without the Government's budget cuts

There was absolutely no need to manufacture the illusion of a budget crisis to justify harsh fiscal measures. They had more to do with satisfying an ideological agenda to permanently reduce the role and scope of government in Australian society than with sound economic management. The focus could and should have been on a moderate ongoing program of deficit reduction - with quality measures to improve national saving over the longer term while maintaining strong growth in the short term.

In addition to all that, the particular fiscal measures that were adopted were, by and large, unfairly socially regressive. This is another aspect of the Government's political agenda in relation to last year's Budget, to which I will return later.

3. Monetary policy is excessively tight.

The basic difference between Labor's approach to monetary policy and the approach of the Coalition (and, it appears, that of the Reserve Bank itself) is that we believe that, in circumstances of high unemployment, it is at least as great a sin to grow the economy at slower than its sustainable potential as it is to grow the economy unsustainably fast.

Given that monetary policy operates with lags so variable as to make its management more a matter of art rather than science, there will always be argument about the judgments involved. Many would certainly argue that with the Australian economy as open as it is, with a high continuing need for infrastructure investment, and as dependent as it still is on capital inflows, there may be a case for real rates being somewhat higher than in most other OECD countries. But whatever the force of that argument may be, it has to be balanced out against the awful human reality of very high unemployment, and the need for the maximum possible sustainable growth rate.

Official thinking has turned in favour of leaving interest rates where they are for the immediate future. The concern is that a cut now will not bite until later this year when the economy is maybe already gathering momentum. But that upswing may be delayed, or not be as quite as strong as anticipated. What we do know for certain is that growth in the economy has been, to use the Reserve Bank's own description, no better than "moderate". Sustained moderate growth may be acceptable at very low levels of unemployment, but with unemployment at its current high level we must do better.

The three cuts in official interest rates since late July last year have been very welcome. But there is a very respectable case for the Reserve Bank to go further and make a fourth rate cut to ensure that growth does pick up as soon as possible to at least the 4 per cent rate needed to make significant inroads in unemployment. That case has been outlined recently in some detail by the Metal Trade Industry Association. Among its findings:

- "Australian monetary policy is still producing real interest cash interest rates, [that is] cash rates adjusted for inflation, more appropriate to the buoyant Asian economies than the fragile progress underway in Australia";

- "Most of the 150 points cut to the nominal official cash rate has been offset by lower inflation and a higher dollar since mid-1995. Only a small amount, some 30 to 60 points, of the nominal cuts [remain] to stimulate the Australian activity after these inflation and exchange rate offsets [are] allowed for"; and

- "Monetary conditions facing small business now are scarcely distinguishable from typical conditions during the 1980s".

On the basis of these and other findings the MTIA concludes that "...there is no case for halting the series of nominal rate cuts. Only a minor amount of stimulus has been imparted to date, which in turn is being offset by the short-term effects of fiscal austerity". The Labor Party is very much in sympathy with that view.

4. National savings objectives are not being sensibly advanced.

There is widespread recognition across the community that Australia needs to become less dependent on foreign capital. One possible response would be to raise the foreign investment drawbridge and simply prevent foreigners from investing in Australia. This approach always has some popular appeal, but it is not a practical option. Turn off the flow of foreign capital, and investment in Australia would contract sharply. Economic growth would plummet, and unemployment would soar.

The alternative to raising the foreign investment drawbridge is to boost national saving. By doing so we ensure that more of our investment spending is financed domestically. In addition, with higher national saving the economy can grow at a faster rate without triggering unsustainable current account deficits. The Labor Opposition continues to argue that the best way to generate additional saving is simply through faster growth - which will put more privately saveable income in the pockets of the community, and help both the revenue and outlay sides of the public savings equation.

The Coalition Government says that it prefers to focus its public saving efforts on Budget cuts. But how much extra national saving will there be from the measures the Government has so far put in place? The answer is a lot less than you would expect - and not because the Government has now fallen into its very own Costello "black hole", with the $3 billion blowout in its projected underlying deficit for this year. Let me explain why.

Asset Sales. The Coalition has been full of "budget honesty" rhetoric about how it would never count the proceeds from asset sales against recurrent expenditure. Instead of the internationally accepted headline measures, we have been constantly told that we must focus on the *underlying* deficit because this provides a better measure of the impact of the budget on national saving. The logic is that the money raised from asset sales is really a transfer from the private sector to the public sector which adds nothing to national saving.

Well, maybe so. But if you look at the budget fine-print you will discover that the Government defines the underlying budget deficit as the headline deficit less a category called "net advances". These include state debt repayments and equity asset sales. The catch is that not all asset sales are defined as *equity* asset sales. The Government has skilfully employed this loophole to slip in literally billions of dollars of asset sales to reduce the underlying deficit. The examples of non-equity asset sales include more than $350 billion for the sale or refinancing of the Government's car fleet, DASFLEET; more than a billion dollars of sales of buildings and land; and the sale of extremely valuable radiocommunications spectrum rights for hundreds of millions of dollars.

Superannuation Surcharge. Other measures in the last budget, while improving public saving, have offsetting effects on private saving. The proposed 15 per cent tax surcharge on high income earners' superannuation is the leading example of this. This is the single largest revenue raising measure in the budget, expected to raise $480 million next year, rising to $530 million in four years' time. It may improve the underlying budget deficit, but the impact on national saving is uncertain at best, and more likely negative. For every dollar taken by the government from superannuation, private saving falls by a dollar. Unless high income earners increase their saving to compensate for the extra tax, the effect on national saving is zero. Add significant administrative costs into the equation and the impact on national saving may be negative.

The surcharge could have been introduced in a relatively efficient manner by acknowledging that it was, in fact, a tax. The Government, however, has insisted on maintaining the fiction that it is a "charge", not a tax. This has involved the Government imposing the most extraordinarily cumbersome and costly arrangements for its administration and collection - eroding confidence in superannuation at a time it needs to be increased.

Professor Bob Officer, Chairman of the Government's National Commission of Audit and not exactly a Labor partisan, is in no doubt about the terrible mess the Government has made of the surcharge issue. Addressing CEDA in Melbourne last month, he concluded: *"...the government changes to superannuation have done nothing to assist the savings record of the country, and the changes have increased the deadweight costs of administration of superannuation funds without any clear benefit for equity or savings".* So much for the long-run gain from the single biggest revenue measure in the Coalition's first budget!

***One Nation* Superannuation Co-contribution.** If the Government goes ahead in its second Budget with the abandonment, now so widely flagged, of the promised use of the $4.5 billion *One Nation* tax cuts for a 3 per cent superannuation contribution, this will be another spectacular example of making a public saving gain at the expense of private saving.

It seems very likely that this funding (building from $1 billion in the first year to $4.5 billion by 2000-2001), will be applied partially to straight-out deficit reduction, and partially to some so-called saving incentives - that are not likely to encourage the poor to divert scarce disposable income into additional saving at all, and not likely to encourage the rich to do more than possibly change the form in which existing savings are held!. The rapid build-up of a major new addition to the private savings pool, with major benefits flowing to ordinary wage and salary earners on retirement, looks effectively certain to be thrown away - for an outcome which I have already publicly described as combining lousy political morality with lousy economics.

5. Sensible labor market policies have been abandoned.

The Coalition Government has been failing in quite a number of other budgetary areas apart from the fundamental one of savings performance. Few will be of more lasting significance to the Australian economy than the areas of education and training. Instead of funding to schools, universities and vocational institutions being enhanced, it has been cut; instead of higher education fees and student support programs being structured to encourage more study, the converse has been true; and $1.8 billion has been chopped from the *Working Nation* constellation of labour market programs, which had been designed to make it possible for unemployed people, and particularly those unemployed long-term, to haul themselves out of the trap of social security dependence and to acquire employable skills the country needs.

Labor in government did have what was, in effect, work-for-the-dole schemes, particularly those like New Work Opportunities and the Landcare and Environmental Action Program (LEAP). But each of them was constructed on the basis of two-way-street obligations: where those employed were provided with meaningful work experience, useful training, and a reasonable financial return for their efforts, and in a great many cases received as well from their experience the kind of psychological boost necessary to equip them for entry or re-entry into the work force proper.

These work opportunities may not always have been themselves "real jobs" in the full sense of that term, but to emphasise this is to miss the point: they were an important way of ensuring that "real jobs" could be filled as demand was reinvigorated. And there were scores of thousands of such opportunities given. It is not easy to be equally positive about the likely utility of the 3000-5000 places to be filled by the Bob Woods Memorial Rock Painting Scheme - resurrected on the run by the Prime Minister to distract attention from the ethical and memory problems he was then experiencing. We in the Opposition will do our best in the Parliament to make the Coalition's scheme less half-baked, more useful and more workable - but, given its origins, we cannot be very confident we will succeed.

6. Sensible industry development policies have been abandoned.

Other major budgetary casualties under the Coalition have been in the areas of industry development and support, where a whole variety of measures introduced by the Labor Government have been capped, downsized or abolished in the interests of assaulting so-called business welfare - for example, export support measures like DIFF and Export Market Development Grants; nearly $2 billion in research and development support; a series of specifically targeted industry bounties; $150 million in regional development funds; and budgetary support for Austrade and AusIndustry.

The extent of the Government's imagination when it comes to thinking about such issues as dramatically enhancing our value-adding capability was laid bare in an extraordinary statement last month by the Minister for Primary Industries. Mr Anderson's view, which he has not subsequently retreated from, was that Australia should focus more on improving its exports of raw materials rather than developing processing industries! [*Weekend Australian* 11-12/1/97, p. 9]

The business lobbies are gradually emerging from their shell-shock and trying to mount a case for intelligently focused support strategies in various sectors and regions. Thus we have seen the BCA arguing last week, with unprecedented sharpness and energy, that the Coalition should *"reverse the widely held perception that official policy attitudes toward investment and industry are ad hoc, inconsistent and incoherent, occasionally antagonistic and dominated by short-termism".* And the ACM, for example, is reported today as being deeply unhappy with the Government's approach to industry policy generally, and to the automotive and pharmaceutical industries in particular.

This is not the occasion to spell out in detail the Labor Opposition's approach to these issues: we will be doing that later. But we have already made it clear repeatedly, during the budget debates, that we do see in the Australian context - particularly given the problems involved in turning opportunities into jobs for a widely scattered, small and relatively immobile population - a case for well thought out and carefully targeted government support. The point is not to hark back to traditional inward-looking protectionist measures for *local* markets, but rather to think in terms of outward-looking intervention supporting growth into *global* markets.

As Simon Crean has often said, the object is not to prop up poor performers, but to work with industry and the regions to develop and support industries and firms that embrace best practice and are internationally competitive. There is not the slightest sign so far of the Coalition understanding, let alone embracing, this approach.

7. Budgetary pain has been shared unequally.

A Government determined, for better or worse, to embark on a major fiscal consolidation effort always has choices as to how that task will be implemented. The Labor Opposition's argument from the outset has been not only that the Coalition choices have been wrong-headed, in terms of the economic priorities that have been embraced, but that they have also been fundamentally black-hearted - calculated, with not many exceptions, to impact particularly on those who could afford the impact least.

In the first place, the choice to make large budget cuts squeezed into a short time frame was bound to have serious consequences for growth and jobs. There is no need to repeat here what has already been said about the impact of the Government fiscal strategy on unemployed Australians, but it is difficult to understate the human consequences for the hundreds of thousands of individuals involved, and their families.

The main point I want to make here is that the various specific measures in last year's Budget affecting household incomes and community services have fallen particularly unfairly on lower income earners. The budget may have served the Government's political and ideological agenda of making middle Australians feel a little less relatively disadvantaged, but it did not do much for social equity.

A distributional analysis undertaken by researchers at the University of Melbourne, modelling the impact of dozens of significant budget measures that directly impact on households, provides some very revealing insights in this respect. The analysis, by David Johnson and Otto Hellwig, takes into account the sweeteners in the budget (such as the family tax initiative) which add to household incomes, as well as the billions of dollars of cuts in areas such as health, education, social security and social welfare.

The basic conclusion from the research is that, on average, the budget directly *reduces* household incomes by $3.50 a week. Extending the analysis to include government spending on social programs, it is estimated that average household social wage income falls by an average $7 a week. This is a significant finding, although it should not surprise too many people: a budget with substantial cuts to government spending and large increases in revenue is bound to reduce average household incomes.

The more significant findings relate to how the impact of budget measures is distributed across households. Here the Government's first budget is revealed as highly uneven in its impact. High income households do not escape reductions in income, but proportionately the heaviest burden falls on low income households, particularly those dependent on unemployment benefits or disability pensions.

For example, the incomes of households with disposable incomes between $1 000 and $1 200 a week are reduced by an average $8.30 a week (or 0.67 per cent of average household income). In contrast, low income households earning $300 to $400 a week lose an average $13 a week (or 2½ per cent of their disposable income).

The incomes of middle income families with dependants are less substantially affected by the budget. But it is still the case that the benefits of the family tax initiative are eaten away by cuts to child care, health and education. What John Howard may appear to have put in the pocket of most middle Australian families is being taken right out of another pocket by Treasurer Costello in higher education fees, higher child care costs, Austudy changes, higher pharmaceutical costs and a series of imposts the States have had to impose to make up for the shortfall in their own funding from the Commonwealth

8. Claims to greater economic honesty and competence have become jokes in bad taste.

All that by no means exhausts the charges that the Opposition would want to lay against the Coalition's economic management record to date. But in order not to unduly wear out my welcome, let me rest content on this occasion with just two parting shots.

The first goes to dishonesty. As I have had occasion to say in the House, it really does require a fair degree of chutzpah to introduce a legislative Charter of Budget Honesty, claiming to lift budgetary integrity to heights unapproached by your predecessors, when you have just been responsible for introducing arguably the most dishonest budget since Federation - based as it was around not only the fiddles and fixes I have already described in relation to superannuation and the definition of asset sales, but some scores of broken pre-election promises, amounting to some $17 billion over four years.

Lest we forget, these promises involved such gems as to maintain existing level of Commonwealth funding to the ABC; make no cuts in funding for public hospitals; maintain expenditure on labour market programs in real terms; maintain the 150 per cent research and development tax concession; maintain regional development funding of $150 million over four years, and maintain the level of Commonwealth funding to universities. Not to mention the unequivocal promise to introduce no new taxes and no increases to existing ones - now broken by the Medicare levy surcharge, the superannuation contribution surcharge and the earlier increase in certain import duties (unless, of course, you accept Mr Costello's assurance that none of things really involve taxes at all!).

My final charge goes to incompetence. If you are going to make a major production number of Labor's so-called budgetary 'black hole', it rather behoves you not to fall into one of your own. The deterioration in Labor's last budget was almost entirely the product of revised economic forecasts, not least the very mixed budgetary blessing of lower than expected inflation. Poor judgment by Treasury no doubt; but malfeasance certainly not; and certainly not a crisis demanding the confidence-shattering pyrotechnics of Messrs Costello and Howard from April to August last year.

Revised forecasts for inflation, wages and unemployment always have substantial implications for budget forward estimates. Revisions of this kind last year *were* used by the Treasurer to manufacture the illusion of a budget crisis. We had, you will recall, Mr Costello speaking lasciviously of sloth, waste and intergenerational child abuse. But this year he initially attempted to portray a similar shortfall from lower than expected inflation as a wholly positive development. One can admire the gymnastics, but not the hypocrisy and double standards.

While around $1 billion of this year's Costello/Howard black hole was dug by the Government's own post-Budget indiscipline and Telstra Bill bribery, most of the blow out was the product, yet again, of Treasury and Tax Office forecasting errors, for which senior officials have been duly publicly chastised. So much for the principle of ministerial responsibility - although one can understand Mr Costello not wanting to personally own up to *anything* very much after a first year in office which had seen him losing the confidence of the States over his Premiers Conference debacle; losing the confidence of the international financial community over his Greenspan indiscretion; and losing the confidence of the Prime Minister over his misplaced machoism on double dissolutions.

Governments and individual ministers *do* have to accept the political responsibility for the major errors that occur on their watch. Smart governments and ministers, however, do their best to ensure that such errors don't recur, and build structures and systems to minimise the risks. But there is no evidence that Messrs Howard or Costello are being very smart, in particular in their alliance to ensure an ever-increasing concentration of economic advice and decision-making under the wing of the Treasurer and Treasury, to the exclusion of other players. The most recent example has been the legislation recently before Parliament to formally establish the Productivity Commission as a single body reporting only to the Treasurer - replacing the former EPAC, Industry Commission, and BIE, reporting respectively to the Prime Minister, Treasurer and Industry Minister.

The truth of the matter is that Treasurer Costello has wholeheartedly embraced the combination of instincts and outlooks that has become known over the years, for better or worse, as the 'Treasury agenda': bone dry; intolerant of competing reviews; increasingly less institutionally contestable; and demonstrably very often just plain wrong. If this Coalition Government is to avoid in twelve months time the kind of report card that I have been writing for it here (with, of course, as much objectivity as I can muster!), then it will need to give some long, hard thought as to how Mr Costello's Treasury, and all those fundamentalists who sail in and with her might gently be brought back just a little closer to the real world going on around them.