

ECONOMICS AND POLITICS IN 1998

Address by Gareth Evans, Deputy Leader of the Opposition and Shadow Treasurer, to CEDA/Telstra Economic and Political Overview Conference, Melbourne, 30 January 1998.

Politics and economics always seem to be inextricably mixed in Australia. This year is no exception, for three reasons in particular.

First, the timing of the election - within the July-November double dissolution window - is going to be much influenced by the Government's assessment of the impact on the Australian economy of the Asian economic crisis. Secondly, whenever the election is held, John Howard has insisted that a crucial issue by which his Government will be judged is his forthcoming tax package. And thirdly, whether Howard wants this as a major election theme or not, the electorate has already made it clear that a crucial vote-determining issue for it will be the relative capacity of the two major parties to address jobs and job security.

There is not much that Labor in Opposition can do to influence the timing of the election, but we will certainly be prepared to publicly address the issues of substance as soon as we have to. We haven't been sitting on our hands in this regard over the last 18 months. The Platform endorsed last week in Hobart was the product of more consultation and coordination than any predecessor I can remember, and contains far more meat, in terms of pointing the way to what Labor would be likely to do in government, than has been generally identified or acknowledged. But then press commentators always find consensus boring, and its products hardly worth reading...

That said, the Hobart Platform is nothing like the last word on what we would do in government. Much detailed work remains to be done - not least on tax - in fleshing out and costing detailed election policy proposals. And to the extent that the Platform does already contain what appear to be some precise, easily quantifiable commitments, the Parliamentary Party of course retains the discretion as to how far and fast it will move in implementing them. It is childish to put a price tag on everything in the Platform document, as the Government is already doing, and pretend to translate this into real world budgetary impact. Our job in government, taking the economy as we find it, will be to assess precisely how far the real world in fact *allows* us to go - over the short, medium and long term - in translating aspirations into actual delivered programs.

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What kind of real world economic environment would we confront coming into office later this year? The truth of the matter is that the outlook for the Australian economy today is probably more uncertain than at almost any time over the past two decades. The main source of that uncertainty is, of course, Asia, where economic conditions have been deteriorating at an alarming rate. For us much will depend particularly on developments in North Asia: how quickly South Korea can bounce back to strong growth; whether Japan will finally kickstart its stagnant

economy; and whether China can continue to ride out the storm relatively unscathed, without embarking on a competitive devaluation of its own later in the year.

Nobody can possibly quantify at this stage with any precision the implications for Australia of the Asian crisis, but whereas most private sector economists four months ago were talking optimistically about a negative impact on our growth of not much more than a $\frac{1}{4}$ of a percentage point in GDP, the consensus now is closer to 1 per cent plus.

The Government's claim is that Australia's domestic economy is now strong enough for none of this to be of real concern: we have been "fireproofed" by the brilliance of the Coalition's economic management. But this piece of hubris deserves to be greeted with a large horse laugh.

In the first place, the benefits we are currently seeing from interest rate reductions taking effect, and domestic demand finally picking up to something closer to a respectable rate of growth, are likely to be quite short lived. Current business and consumer surveys are pointing to an erosion of confidence again, and a likely mid-year economic slowdown. That is certainly the message from last week's Westpac leading indicator, and a similar picture is emerging from the National Australia Bank business Survey and Westpac-Melbourne Institute consumer sentiment index.

Consumer confidence, as measured by the Westpac-Melbourne Institute index, is lower now than last year when economic pessimism was widespread in the wake of the Government's first Budget. And the latest NAB survey for December 1997 shows business conditions declining across a range of indicators, with the forward orders index falling 3 points; the trading conditions index falling a further 4 points after going down 8 in November; the profitability index falling 2 points; and the employment index falling by a substantial 11 points. The big fall in the employment index is a particularly worrying sign, as the NAB here has a good record of closely tracking jobs growth in the economy.

All of these anxieties will be reinforced by Moody's decision yesterday to downgrade the outlook for Australia's credit rating from "positive" to "stable", referring in the process to the continued erosion of business confidence in Australia, and the likely effect of this on investment decisions.

So - although it is still early days - the evidence is that the Howard Government is already failing to inspire confidence among the Australian community that we can successfully negotiate the economic crisis in Asia with the smallest possible amount of damage to our economy. If you think this makes more likely a dash to the polls around July, before the loss of momentum becomes too evident to the electorate, then you clearly have sufficient grasp of the principles of basic cynicism to be a good politician - or journalist!

Secondly, while it is a fair argument - and I will return to it - that improved national saving, including through the Budget, is necessary insulation against current account deterioration, it is always a matter of judgment as to just how much such insulation is required - especially when there are serious downside consequences elsewhere from overdoing it. And there are an increasing number of people, not just in the Labor Opposition, who are now much less

impressed than they previously might have been with the Coalition's call in this respect.

The Coalition chose to make a meal of the 1996-97 deficit it inherited (less than half the size, though it was in real terms, of the deficit we inherited from Mr Howard in 1983) by embarking on a major fiscal contractionary exercise, and accompanying it with confidence destroying "black hole" rhetoric. Consumer spending duly collapsed, growth fell right away, and there was a devastating negative impact on employment.

Had the Government addressed the situation in a more moderate, intelligent and balanced fashion - with smaller cuts (of say \$1 billion in 1996-97 and \$2 billion in 1997-98), and maintaining growth at a percentage point higher, the budget would have come back to underlying surplus by 1998-99. And if employment growth had been maintained, consistently with that, at the 2½ per cent or better we achieved in our last term, the unemployment rate at the end of this Parliament would have been at around 6½ per cent - well on track for our target of 5 per cent by 2001, not struggling to beat 8 per cent as at present.

The tragedy is that the doomsday rhetoric and budgetary performance of the Coalition was simply not justified when Australia had stronger government finances than all but two or three other OECD countries - and met, for what it's worth, both of the European Monetary Union criteria, for public debt and budget deficits, in a way that at the time only one European country, Luxembourg, was able to manage. Sometimes hair shirts have to be worn, but this simply wasn't such an occasion.

The truth is that the Coalition has done a very poor job of preparing the Australian economy to weather the Asian crisis. Given that those who have been burning the most in our society are the three quarters of a million unemployed, the most significant way in which the Government could have fireproofed the Australian economy would have been by getting our unemployment rate down. The Howard Government squandered dreadfully, in its first two years in office, a golden opportunity to make substantial further inroads into Australia's unemployment problem.

When Labor left office in 1996, the trend number of unemployed people had fallen by an average 55 000 a year over the previous term. However, in just under two years of Coalition Government, the trend number of unemployed people has fallen by a miserable 1400. At this rate - and staring now, as we are with the impact of Asia, at a falling away again in our current growth performance - Australia's unemployment problem will not be solved in our lifetime, or the lifetime of our grandchildren, but only in that of our grandchildren's great-grandchildren!

The third aspect of the Government's response to the Asian crisis that deserves attention is its apparent total indifference to the need for any response to the plight of those specific sectors of the Australian economy likely to be hardest hit by the events in Asia. Last week Cabinet held its first meeting for the year. The meeting was widely billed in the media, presumably at the instigation of Government spin doctors, as the launching pad for the Government's response to the Asian currency crisis.

However, after two days the only significant announcement from the Government was an

initiative to provide the Export Finance and Insurance Corporation with a \$300 million national interest facility to support trade with South Korea. This is a worthy initiative, and is supported by the Opposition, as we supported the Government's commitment to the IMF packages for Thailand, Indonesia and South Korea. But, overall, the Government's response to a significant threat to our economy was remarkably threadbare.

There were no initiatives to support the tourism industry, which is an increasingly important sector of our economy, and which is now facing a massive loss of business from Asia: no plan to help the industry attract visitors from other parts of the world to compensate for the loss of Asian visitors. Instead the Prime Minister said he could see no role for the federal government and that the industry could stand on its own two feet. There was no word on federal government assistance for our universities which, having had the stuffing knocked out of them in successive budgets, are now facing a major loss in revenue from Asian students. The Government was absolutely silent on developing proactive export support initiatives - of the EMDG and DIFF variety - to help exporters build up markets outside Asia, or help maintain their market share in Asia. And there was no announcement from the Government to demonstrate that it was aware of the big new threat to Australian industry of increased dumping from those Asian countries increasingly now anxious to shift export product at almost any price.

All we hear from the Prime Minister is the parrot cry that the Australian economy is not particularly vulnerable to an Asian downturn because our domestic economy is strong - backed by the ever insouciant Industry and Tourism Minister, Mr Moore, who is asserting on the record that there is "no evidence" that the Asian crisis is having "any significant impact" on the Australian economy.

But most of the people can't be fooled very much for even some of the time by even the most assiduous government spinning. If Mr Howard and his colleagues think that they can escape censure with a mid-year run to the election tape, before things get too much worse, then they may have another think coming.

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How would a Beazley Labor Government perform on economic management? The most basic message I can give you is simply that we would be responsible. Those of us likely to be in senior economic posts have been in government - and members of successful Governments - long enough to be acutely conscious of the economic and political risks of being anything else *but* responsible.

The Platform chapter on Economic First Principles spells it out more clearly than I can ever recall in any party's manifesto. Yes, our overwhelming priority is the well-being of people; and yes, that means employment generation and rising incomes through a strongly growing economy. But, yes, we also understand that both inflation and the current account are crucial constraints on growth, and are ignored at any government's and nation's peril.

Inflation is not a problem now, and is not looming as one for the foreseeable future. That is

essentially because Labor's all out assault on it in the late 1980s was conspicuously successful. I am not suggesting that all our policy at the time, especially on interest rates, was right. One can reasonably question whether the recession was in fact one we had to have, and whether breaking the inflation stick necessarily required tearing down half the forest. But nobody can deny that inflation has now been within the Reserve Bank's target range not just for the last two years, but the last six; nor that inflationary expectations have been dramatically dampened, and that the Coalition simply inherited Labor's achievement in this respect.

There is of course a question mark now about the exchange rate impact of the Asian crisis on Australian inflation, but it's a fair bet that what we will lose in this respect in higher import prices from Europe and North America will be largely offset by what we gain in lower priced imports from the Asian region. Again, any possibility of domestic growth generating inflation pressures in the next year or two seem likely to be dampened by the negative impact on Australian growth of the major slowdown now expected in the region.

The other main constraint which a Labor Government would have to fully recognise and respect is the *current account*. And this *is* a matter of real and growing concern for Australia in the context of the Asian economic crisis.

It seems inevitable that there will be a sharp fall in export demand from Asia in the months ahead. Even though the crisis has not so far been reflected in official export figures, there are already indications of the current account coming under renewed pressure. In particular, the income component of the current account deficit has begun to rise again in the September quarter last year, the most recent for which statistics are available, the net income deficit was 19 per cent higher than in December 1996.

Labor's Platform recognises the need to continue to build Australia's national savings to reduce our reliance on foreign debt - which has been rising rapidly under the Coalition, notwithstanding its campaign chest beating - and ensure that the current account is maintained within a sustainable range.

The big difference between us and the Government is that we don't believe that public saving, as distinct from private saving, should be seen as the sole element in this equation. We haven't much enthusiasm for building national savings by hacking into human resource investment programs, health care, and government services and jobs in rural and regional Australia. Nor can we see the net contribution to national saving made by budget policies which reduce private saving by reducing private income through deliberately lower growth. Nor can we see any merit at all in abandoning the superannuation co-contribution scheme - which would have translated, by the year 2020, into a \$400 billion addition to the national savings pool.

All that said, the prospect of a rising current account deficit this year certainly reinforces the need for a prudent and steady approach to fiscal policy. Large current account deficits financed through foreign debt can leave an economy vulnerable to adverse swings in financial market sentiment. While we are unimpressed with twin deficits theory in its crudest form, Labor well understands the need for fiscal discipline.

Our new Platform endorsed in Hobart last week makes it absolutely clear that a Labor government will be committed to the sound management of public finances. Given Australia's traditional dependence on foreign capital, we acknowledge the need for the public sector to contribute to overall national saving by aiming for budget surpluses when economic conditions are favourable. And on present Government parameter forecasts, I see no reason why surpluses couldn't and wouldn't be delivered by Labor throughout a Beazley Government's first term.

This is not the occasion to be spelling out in any detailed way our position on tax. That is for later in the year. But let me make it clear that, notwithstanding all the profound scepticism we have about Mr Howard's attempt to don a mantle of statesmanship here that he has been conspicuously unable to acquire elsewhere, we do readily concede that the Australian tax system needs reform. As I said at our Hobart conference, it *always* needs reform in the sense of ongoing repair, maintenance and occasional renovation.

If, for example, Labor had not changed the income tax scales when we were in office (as we did in fact seven times) the top marginal tax rate would still be 60 cents rather than 47 cents in the dollar, because that is where John Howard left it when he was Treasurer; and we would be collecting now around \$30 billion more revenue annually!

The biggest challenge for tax reform is to maintain the integrity of the income tax system. High income individuals must pay their fair share. We need to deal with the overuse of trusts as a device for tax avoidance. We need to stop the erosion of the PAYE system. And we need to address the welfare-to-work interface issue, where the unhappy reality is that Australian families at the bottom end of the income scale are paying grotesquely high effective marginal tax rates.

The second challenge is for the tax system to be fully sensitive to business needs, with the taxation of inputs into exports one area requiring to be addressed.

And in Federal-State financial relations, there is a real challenge as to how to achieve a sensible balance to ensure the effective delivery of public services to all Australians, without undermining the Commonwealth's capacity for effective fiscal management: we remain open to debate about options which would secure greater revenue for the States.

One area where, as you well know, we are not open to debate, is a GST. We oppose it for a great many different reasons that we have spelt out in the past, and will again as the need arises, including its impact on smaller businesses. But the basic reason is simply that a GST, however you construct it and attempt to compensate for it, is inherently regressive and unfair so far as lower and middle income earners are concerned - and even more so when you go down the no-exemptions route endorsed this week by Mr Costello, which means a GST on literally everything, including food, clothing, health care and education.

We do need to address the income tax scales, as we have in the past, but we won't pay for tax cuts by charging ordinary Australians a new tax on everything they do or buy.

As Mr Costello was heard to say a year or so ago, before he was silenced by his leader on the GST issue, put not your trust in 'snake oil' merchants! That's not a bad piece of advice when it comes to economic management generally, and it's one that you will have no occasion to apply to us in government. We are, after all, from the Labor Party, and we're here to help you.