THE AUSTRALIAN ECONOMY UNDER THE COALITION: A SUITABLE CASE FOR TREATMENT

Address by the Hon Gareth Evans QC MP, Deputy Leader of the Opposition and Shadow Treasurer, to Institute of Chartered Accountants Luncheon, Melbourne, 11 November 1996.

I

Sometime in the next two months, the Government will publish its mid term review of the Budget and the economic outlook. This review will include a progress report on the Budget deficit and provide updated economic forecasts for the current financial year. The mid year review will be framed in light of the detailed national accounts data for the September quarter, due to be published by the Bureau of Statistics in a couple of weeks time. While the Opposition doesn't have the analytical firepower of the Treasury and Reserve Bank at its disposal, and we certainly haven't seen the September national accounts, we believe there is every reason to now believe that the Budget forecasts of growth, employment and related indicators will be revised downwards.

My message today is that there has been a significant deterioration in the economy under the Coalition, and that this has been very much a function of the Government's poor handling of the economy since it came to office - talking down the economy to justify a draconian Budget, and then introducing one. Far from being a reward for good economic management, the latest round of interest rate reductions should be seen as a rescue mission by the Reserve Bank - for a low growth, rising unemployment economy desperately in need of stimulus.

We are told by the Government that there will be long-term gain from all the short-term pain - more national saving, reduced public debt, a lower current account deficit and ultimately, as a consequence of an economy with sounder fundamentals, more growth and more jobs. But with the Government itself projecting growth of no better than 3½ per cent out to the year 2000, and unable to offer any hope of reducing unemployment below 8 per cent by then, the gain is looking much more illusory than the pain.

A disciplined approach to public finances of course is important. We in the Opposition agree that the Budget should be returned to balance as soon as possible. But Budgetary shock treatment, deep cuts at a time when unemployment is about 8½ per cent, does not equal good economic management. With more than 800,000 Australians out of work, and when government debt as a proportion of national income has in fact stabilised, growth and jobs should be unequivocally the highest priorities. We believe that the objective of enhanced national saving is best promoted - as a matter of both economics and equity - in a strongly growing economy, with more people in employment and rising community incomes.

II

Nobody should underestimate the extent of the deterioration in the Australian economy over the last eight months. The Coalition inherited from the Labor Government an economy that had been growing for four years at an average of 4 per cent, with inflation averaging 2½ per cent; unemployment had come down in our last three years from 11 per cent to 8½ per cent, with 700,000 new jobs being created, putting us well on the way to achieving our medium term target of 5 per cent unemployment by the year 2001.

John Howard had bequeathed us in 1983 an economy that was on the rocks and breaking up - inward looking and uncompetitive, with high unemployment, high inflation, high interest rates and massive industrial conflict. But we bequeathed back to John Howard in 1996 a structurally sound and internationally competitive economy, which he himself has conceded was "better than just good" - one with high growth, low inflation, falling unemployment, greatly enhanced social equity, and with its fundamental forces better balanced than they had been at any time in the last twenty-five years.

In the last couple of weeks we have seen that same economy, or major sectors of it, being described publicly by a whole range of respected business economists and commentators, as "sluggish" (Saul Eslake, ANZ), "moribund" (Chris Caton, Banker’s Trust), "tough going" (Deborah Stirling, Coles Myer), "under-performing" (Max Walsh, SMH), "not travelling as well as we should" (Michael Heffernan, Shaw Stockbroking) and "virtually stalled" (Ron Silberberg, HIA).

At this stage, the massive contractionary enterprise on which the Government embarked in its August Budget has not had time to bite on anything like the scale it eventually will. What has, then, generated the chorus of anxiety about the present state of the economy? Essentially it is the loss of confidence in the economy, a loss of confidence which has been overwhelmingly of this Government’s own political making. To pave the way for that harsh contractionary Budget, John Howard and Peter Costello right from the outset talked up a storm about Australia’s "fiscal crisis": all we heard about for months were deficits, debts and "black holes". Manufacturing a fiscal crisis where none existed may have been clever politics, but it had a corrosive effect on confidence in the economy.

I say "no fiscal crisis existed" advisedly. Neither Australia’s public debt, nor the level of our Budget deficits, were - or are - at all high by relevant international standards. Of the major OECD countries, Australia ranks on these measures not at the top of the sinners’ tables, but close to the bottom. To make the point very graphically we easily meet - in a way that only one European country can at the moment (Luxembourg) - the debt and deficit criteria laid down for joining the European Monetary Union, viz. no more than 3 per cent of GDP in national Budget deficits, and no more than 60 per cent of GDP in public debt. Australia-wide Budget deficits at the moment total just over 2 per cent of GDP, and our total public debt is just under half the European good house-keeping standard. Let Treasury itself have the last word, in its latest annual review of Commonwealth debt, published just last week:

> *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.* (The Treasury, Commonwealth Debt Management 1995-96).

To put it mildly, these facts are very inconvenient for a Government wanting to generate alarm about the level of Commonwealth debt. Cynics will not be surprised to learn that international comparisons were conspicuously omitted from this year's Budget papers!

Instead of acknowledging Australia's relatively strong fiscal position and implementing a moderate and balanced program of further Budget measures to help restore the Budget to underlying balance - as we have been advocating - the Coalition chose to mount an all-out scare campaign. And the trouble with scare campaigns is that the chickens come home to roost. Just look at the string of economic indicators released over the last month or so:

- The Westpac-Melbourne Institute consumer sentiment index - which shows consumer confidence is 4.3 per cent lower than it was in February, and has fallen by fully 9 per cent since June;

- Trend retail sales growth - which went backwards in September for only the third time since the ABS started collecting statistics in 1962;

- The ABS business expectations survey - which shows business is preparing for the smallest December increase in sales since the survey commenced in 1993;

- The latest National Australia Bank survey - which reports that, weighted for employment size, a net balance of 40 per cent of firms say the Budget will have a negative effect on their business plans;

- The latest capital imports figures, a strong indicator of plant and equipment investment - which were down by 15 per cent in the September quarter compared with June;

- The latest long term unemployment figures - which show the number of long term unemployed people has risen each month for the last 4 months; and

- Last week's Labour Force figures - which show:

  - Unemployment has gone back up to 8.8 per cent (seasonally adjusted employment rose last month, but not enough to make up for the 34,100 jobs that were lost in September);

  - Employment is 8600 below its level two months ago (full time employment is 20,600 below its August level);

  - Trend employment has virtually stalled (it's down to 0.1 per cent, or just 5900 jobs a month);

  - Trend unemployment has risen yet again (it's now above 800,000 for the first time since November 1994); and

  - Youth unemployment has risen (from 26.4 per cent in February (87,000) to 29.6 per cent in October (99,600), an increase of 14.5 per cent).

  And, capping all that off, we have two predictive indicators confirming the general gloom:

- Last week's DEETYA leading indicator of employment - which has fallen yet again, signalling that the labour market will remain sluggish for many months to come; and

- The latest Westpac leading index of economic activity - which, according to Westpac's General Manager, Economics, Mr Bill Evans "offers no immediate prospect of an upswing in the pace of economic growth" and contains the clear message that "a sustained upswing in activity is not likely before the second half of 1997".

It is simply not credible to argue, as the Government tries to still, that there has not been a slowdown in activity in recent months. Of course all economies grow in cycles, but the severity of the current slowdown is very much a reflection of the Government's economic management since March. The simple fact is that a contractionary Budget strategy, involving the destruction of tens of thousands of jobs, accompanied by a political strategy to manufacture a sense of fiscal crisis, was always bound to have a negative impact on confidence and growth.

III

The Government continues nonetheless to claim that any pain in its Budget strategy is short term in character and will outweighed by the gain - that this is just the price that has to be paid for greater public and national saving in the long term, and all the economic benefits this will bring. This assertion is worth exploring in a little more detail, because it clearly continues to command a degree of public acceptance (although I suspect that public acceptance will be rather less once the full extent of the pain involved in many of the cuts comes to be directly felt).

Had time permitted, I would certainly have wanted to discuss such issues as the mindlessness involved in focusing so much of the cuts on research and development, training and infrastructure investment, gutting thereby the very policies that have the greatest impact on long-term economic growth and opportunity.

For present purposes, however, with this discerning audience of accountants, let me focus just on the central question as to how <u>much</u> extra long-term national saving we can in fact expect from this year's Budget. The Government would say the answer is around $7.2 billion. That's the reduction in the underlying budget deficit next year compared with a no-policy-change scenario. However, I'm sure this audience, more than any other, would understand and appreciate that an impressive bottom line can hide some dark secrets. What do we find when we hold the Budget papers up to closer scrutiny?

The first thing is that $640 million of the $7.2 billion comes from reduced Commonwealth payments to the States. However, the cut only applies this year and again next year. In 1998-99 it falls to $300 million, before phasing out altogether. Taking this into account, the ongoing reduction in the underlying budget deficit is down to around $6½ billion.

However, that's just the start. The Government tells us we must focus on the <u>underlying</u> budget deficit, instead of the internationally accepted headline measure, because the underlying deficit excludes asset sales. The logic is that asset sales may help fund the budget, but they don't contribute to national saving. However, if you look at the fine print, you will see that the underlying budget deficit is defined as the headline deficit less "net advances". Net advances include state debt repayments and equity asset sales. The catch is, not all asset sales are defined as *equity* asset sales. And that makes a few more hundreds of millions of dollars difference to the Government's story.

For example, the sale of the Commonwealth's car fleet, DASFLEET, will raise somewhere in excess of $350 million this year. All of this counts towards the underlying budget deficit, but it doesn't make a jot of difference to national saving. The sale of DASFLEET was actually announced by the Labor Government in last year's budget. Now it has been re-announced and claimed by the Coalition. The result is last year's deficit, under Labor, is made $350 million worse, and this year's deficit, under the Coalition, is made $350 million better. To add insult to injury, in a bid to plug the gap in its election funding, the Government has also claimed the sale of DASFLEET as one of the measures that pays for its big spending election promises.

But there's more. Commonwealth property sales also count towards the underlying deficit. Sales of building and land are expected to raise $438 million next year, and total more than a billion dollars over the next five years. None of this adds to national saving.

The Budget also includes a proposal to change the funding arrangements for the construction of the Melbourne Law Courts Building. This transaction saves the Commonwealth $60 million next year, but it doesn't add to national saving. In fact, this measure will increase the Budget deficit after the construction phase has been completed.

Another $300 million of revenues comes from raiding the cash balances held by statutory bodies. Once again, national saving is not increased: all that happens is cash held by statutory authorities is transferred to consolidated revenue. Improving cash management practices may have some merit, but we shouldn't pretend it's a major measure to boost national saving.

Last week the Finance Minister boasted in Parliament about the Budget's "honest and transparent bottom line". With national saving benefiting on just the measures I have listed, some $2 billion less than has been claimed by the Government, that should be seen as a joke in bad taste.

IV

Budget fiddles and non-equity asset sales are not the only things that make the underlying deficit a quite unreliable indicator of the impact of this Budget on national saving. Other measures in the budget, while improving public saving, have offsetting effects on <u>private</u> saving. The leading example of this is the proposed 15 per cent tax surcharge on high income earners' superannuation.

The superannuation surcharge is the single largest revenue raising measure in the Budget, being 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. 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, and that is extremely problematical to say the least, the effect on national saving is zero.

While on the subject of the 15 per cent surcharge, I can hardly avoid reference to the extraordinary mess the Government has got itself into on the question of collection. At the same time as it is talking about reducing compliance costs for business, principally in the taxation area, it has announced administrative arrangements for the collection of the surcharge which have quite literally horrified the superannuation and taxation community.

Super funds will have to provide information to the Tax Office on all 15.7 million superannuation accounts, so that just around 355,000 individuals can be subject to the charge - to elaborately scrutinise 100 per cent of accounts in order to assess the liability of 1-2 per cent of account holders would appear to be, to put it gently, rather a case of bureaucratic overkill.

There are a variety of estimates about the administrative costs involved in collection of the surcharge, but the most reasonable that I have seen is initial costs of around $30 million, and ongoing costs of many more millions. Because of the collection method most, if not all, defined contribution fund members will have their final benefits effectively reduced by this tax increase even if they are not directly caught by it.

Apart from the mechanics of the administrative arrangements, there are also a litany of other contentious issues surrounding the implementation of the surcharge, including compulsory withholding, privacy, the equity of the provisional surcharge arrangements, the question of interest on monies wrongly held by the Tax Office. Labor has already attempted unsuccessfully to have this whole issue referred to the Senate Select Committee on Superannuation; I can assure you we will try again when the legislation itself is introduced.

V

I have been very critical of the Government's economic management record since March, and I think, on all the evidence, with good reason. But you are entitled to ask what would <u>we</u> have done differently?

One answer is that we would have been very reluctant indeed to tear up the cooperative model of industrial relations and wage negotiation that had served Australia so well during the previous thirteen years, in particular making it possible to break the back of inflation and inflationary expectations. With the union movement actively committed, as it was, to wage outcomes consistent with the maintenance of 2-3 per cent underlying inflation, I believe we would not have had to wait four months for the first interest rate cut this year, or so long for last week's second cut. It is uncertainty about wage outcomes (and in the enterprise bargaining more than in the award sector) that, more than anything else, has inhibited the Reserve from bringing Australia's interest rate regime back to more realistic levels. And it is the Government, more than anyone else, that we have to blame for that uncertainty.

So far as the Budget is concerned, there *is* an economically responsible, alternative approach and it's one that we in Opposition will continue to advocate. It does not involve the manic slaughtering of public sector innocents, and the wholesale dismantling of intelligently targeted business support programs. It does involve a Budget of moderate and balanced measures that works for, and not directly against, growth and employment.

The essential argument is that if you aim for and achieve higher growth, each year's deficit starting point is lower, so you can get to eventual balance with a fraction of the cuts that would otherwise be necessary. Moreover, with the higher employment associated with higher growth, the economy generates more savings (through more private income, more government revenue, and less government outlays). So if you put employment first, you have a good chance of solving *both* our continuing economic problems, of saving as well as unemployment.

Even against the background of a higher than predicted outcome deficit for 1995-96, it was the Opposition's calculation at Budget time that, on entirely reasonable assumptions about the growth that would be achievable under a less manic budgetary policy (viz. no more than ½ per cent of GDP extra over the next two years, and ¼ per cent in the third), the no-policy-change underlying deficit would be reduced to around $3 billion in 1998-99. And a target of $3 billion of ongoing fiscal consolidation by the third year of this Parliament <u>would</u>, of course, have been a very much more readily and less painfully achievable target than that which the Government has now set for itself.

John Howard acknowledged last year that growth of over 4 per cent was necessary to actually reduce unemployment. That remains the case, and it is also the case that if growth is maintained up around the 4 per cent mark, instead of the 3½ per cent projected in the Budget, the task of restoring the Budget to underlying balance would be reduced dramatically. To balance the Budget, it is not necessary to hack into effective and valuable programs which help make Australian industry more efficient and competitive. To balance the Budget, it is not necessary to cut training and support for unemployed people. To balance the Budget, it is not necessary to cut valuable social programs like the Commonwealth dental program and child care assistance for low income families. To balance the Budget the critical and overwhelming need is simply to get more growth back into the economy

The aim should be to improve national saving, but to do so in an equitable way that doesn't harm growth or confidence. Enhanced superannuation is the key to improving <u>private</u> saving, and a moderate and balanced deficit reduction strategy is the key to the <u>public</u> side of the national saving equation.

At the end of the day, economic policy always involves choices, and the choices any government makes are determined by the kind of society it wants the country to be. What is driving the Coalition Government at the moment is not compelling economic necessity, so much as an ideological commitment to the smallest possible role for government in the economic and social life of this country.

The Australian Labor Party these days has a very much more sharply focused, and rather more limited, view of the proper role of government than may have been the case in an earlier age. But there remains a big difference between us and our conservative opponents. We don't see virtue in cutting public sector personnel and programs as ends in themselves. We are not blind or indifferent to the pain that budgetary shock treatment is capable of causing -not only to the acutely disadvantaged, but to ordinary mainstream working Australians and the businesses they work in.

And, while we know all too well after thirteen years in office that mistakes can be made, we are deeply conscious of just what a force for national <u>good</u> - for both improved security and improved standards of living - intelligent and well-applied government economic policy can be.

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