ELECTION ECONOMICS: THE BUDGET, THE GST AND SELLING TELSTRA

Address by the Hon Gareth Evans QC MP, Deputy Leader of the Opposition and Shadow Treasurer, to the National Press Club, Canberra, 20 May 1998.

I begin most of my speeches as Shadow Treasurer these days by reminding myself, and sometimes my audience, of the cautionary note once sounded, with his usual delicacy and subtlety, by Lyndon Baines Johnson: "Making a speech on economics is like wetting down your leg", he once said, "It seems hot to you, but not to anyone else." That said, I think I can assume that there is at least one branch of the discipline in which this particular audience may be reasonably interested, and that's Election Economics. So it's on the current hot topics in that area that I will today focus.

In our two years in Opposition, Labor has spent - unusually for some of us, you will no doubt say - much more time listening than talking. And listening to what the community has been telling us has led us to make three basic working assumptions in our response to the Coalition's Budget, and to the larger economic and electoral strategy of which this Budget is just part.

First, that Australians like the idea of getting the Budget back into balance or surplus, because of the good economic housekeeping this seems to represent. But Australians also care about *how* any surplus is obtained, and who pays for it. And they are not very happy with any abdication of government responsibility for jobs and job security, and for health and aged care and child care and education systems that work and are affordable for everyone.

Secondly, that Australians want tax reform, but don't want a GST.

Thirdly, that Australians want the economy to become more efficient and competitive, but don't want the rest of Telstra to be sold, and they're not impressed by any budget surpluses or election handouts that depend on it being sold.

These assumptions, and the interrelated issues which lie behind them, will be at the heart of the forthcoming election battle. If we are right about them - and can state Labor's alternative positions on these issues forcefully and clearly - then the Howard Government has an excellent chance of being the first since 1931 to fall after a single term. If we are wrong about these assumptions, then it may be that, in the immortal words of LBJ's successor, Dan Quayle: "If we don't succeed, we run the risk of failure."

The Budget Surplus: In the Black, But on Whose Back?

Our approach to last week's Budget - and to the two Costello Budgets which preceded it - is to support the achievement of a surplus at this stage in the cycle, but to argue very strongly, as we have been since 1996, that this could and should have been done much less painfully. We could and should have achieved an underlying surplus for 1998-99 not on the back of the unemployed and ordinary families, but on the back of growth and jobs, and with only a very moderate program of budget cuts.

The Cuts: Painful and Counterproductive. It is difficult to underestimate or overstate the pain that has been caused to millions of Australians by the budget assaults of the last two years - the pain to those who have lost their jobs, and those who have lost hope that they will ever find another; the pain of those on hospital waiting lists and dental waiting lists that have blown out by years; the pain of those who have been forced to forego higher education, or the chance of a job, because they can no longer afford child care; the pain of those leaving for good the country town of their birth; the pain of those who fear for how they and their families will be cared for as they grow too old to care for themselves - the "million small deficits in the lives of ordinary people", as Kim Beazley put it so graphically in his Budget Reply last week.

The Budget Papers quantify it all in the starkest of terms. After two years and three budgets of Howard/Costello Government, the Australian community has lost in net terms $3 billion from education, $11/2 billion from health, $11/2 billion from job programs, $800 million from child care and $400 million from aged care, along with hundreds of millions in other programs across the whole spectrum of government activity - and a reduction of 79,200 in the number of people employed by the Commonwealth public sector.

The further tragedy is that so many of the cuts have been counterproductive in policy terms. Citibank's Chief Economist, Stephen Koukoulas, made the point on Budget night that the only way to truly "fireproof" the Australian economy now was to invest in education and training, hardly consistent with the cuts that have occurred. It's not easy to see the vision in cutting all 17 portfolio programs aimed at generating regional trade, nor in the mindless budget cuts to Radio Australia, which mean that 180 million out of 200 million Indonesians no longer have access to the service, at the very time it could have been a vital source of authoritative news and information.

The most economically irresponsible of all the Coalition's budget decisions since it has been in office was to scrap the Labor Government's proposed 3 per cent plus 3 per cent superannuation co-contribution scheme, which would have brought compulsory superannuation contributions up to the 15 per cent level needed to give people a reasonable post-retirement income, put us in excellent shape as a nation to meet the retirement needs of our ageing population, and contributed an extra $400 billion to the national savings pool - a crucial injection if we are ever to be able to meet our recurring structural current account deficit problem, and reduce our foreign debt (which has actually exploded by $28 million under Treasurer Costello).

Labor's Alternative Approach to Returning to Surplus. The greatest tragedy of all in relation to the pain caused by the Howard/Costello budget strategy is that it was all so unnecessary. There has always been an alternative course open to the Government that would have brought us back to underlying surplus in 1998-99 with far more moderate budget cuts. It was a strategy which would *not* have directly cut growth and destroyed consumer confidence, taking more than one per cent off the GDP and employment growth rates being achieved by Labor. And it is a strategy which *would* have seen unemployment continue to fall to the present level of around 6 per cent, with 150,000 more people back in work.

It was a strategy which I first outlined after the 1996 Budget, when I specifically said to the Parliament, and in similar terms to this Press Club, that "We can get the budget balanced within a reasonable time - in fact, within the life time of this Parliament, by 1998-99 - with a much less savage budget strategy...we can get to that by targeting savings of no more $3 billion by that third year".

The proof of that prediction is now clear for all to see in this year's Budget Papers. The Government's claimed surplus for 1998-99 is $2.7 billion: that is built on a series of policy measures, spelt out in the last three budgets and taking effect this coming year, amounting to a net outlays reduction of $5.4 billion. Subtract that $5.4 billion from the $2.7 billion projected surplus, and you have the projected deficit for 1998-99 if there had been no policy changes since Labor's last budget. In other words, you have a deficit which would have been wholly neutralised by the $3 billion savings taking effect this year which I proposed back in 1996!

That arithmetic does not rely on any growth dividend. If the economy had in fact grown at Labor's last term average 4.3 per cent rather than the Coalition's average 3.2 per cent during this period, and we did have 150,000 more people back in work, it is reasonable to suppose that the additional revenue and less social security outlays that would have flowed from that state of affairs would have in fact generated a surplus this year of the order of magnitude the Government is now claiming for itself.

Labor's Credibility: The Track Record in Government. The response of the Government to all this has not been to challenge the arithmetic but simply to assert that Labor in government would not have gone down this path. But there is no credible basis for that assertion. Coming into office in 1983 we inherited from John Howard as Treasurer an absolutely massive deficit, nearly $25 billion in today's dollars, but within four years had converted that into a run of four consecutive substantial underlying surpluses - built in each case on jobs and growth, rather than on savage budget cuts.

The best proof of our will and capacity to have brought the present budget back to underlying surplus by 1998-99 lies in our own past record. Throughout our 13 years of office, Labor achieved average economic growth of 3.7 per cent per annum, and average employment growth of 2.2 per cent, the highest in the OECD, and those rates were even higher in our last term of office, 4.3 and 2.7 respectively. There is absolutely no reason the Coalition could not have, in its first two years, matched our last term record if it chose to do so, and were competent enough to do so.

A huge element in any country's economic management is simply the values of the government of the day, the choices it makes and the priorities it sets. Our priority in office was always to promote the well-being of Australians by generating the maximum sustainable growth, creating employment and distributing income as fairly as possible. We did not always succeed on all these fronts, but it was never for want of trying. The Coalition, by contrast, has deliberately made growth and employment lower priority objectives than reducing public debt and budget deficits and the overall size of government. Reducing public debt and budget deficits are worthy enough objectives if you have a debt and deficit problem - but the difficulty for the Coalition is that by any objective international measures, and by any measurable standard of international concern, Australia did *not* in 1995, any more than it does now in 1998, *have* a public debt and budget deficit problem. (See attached Attachment: *The Real State of Australia's Public Finances.*)

The Coalition's Budget Credibility. If anyone has a credibility problem with this budget's numbers, it's the Coalition, and commentators have increasingly been blowing the whistle on this over the last few days.

The essential assumption, that the economy will grow by 3 per cent in 1998-99 - down from the 33/4 per cent estimated outcome for this year - depends strongly on, first, the assumptions that there will be a significant boost to the economy by AMP shareholders kicking up their heels, which they may not; and, secondly, on the assumption that the worst of the Asian impact will be over by the end of calendar 1998.

The current account deficit, which the Reserve Bank Governor Ian Macfarlane has already predicted will reach 6 per cent of GDP, is forecast by Treasury to average 51/4 per cent for the year. Standard and Poors last week put it gently when it said, "These forecasts remain at the more optimistic end of the general range of expectations among economic forecasters", while Max Walsh put it a little more robustly yesterday when he wrote, "The sharp V-shaped recovery being forecast for Korea, Thailand and Indonesia is not a view that has much support outside the Australian Treasury".

The other key number which lacks credibility is the unemployment forecast of 73/4 per cent by June next year, which we're told will be achieved despite an average for the year of 8 per cent - which can only mean that unemployment must go up again before it can come down. The prediction that it will come down is based on the heroic assumption that employment growth will increase although GDP is coming down, along with private consumption and business investment. A productivity drop might square the circle, but there is nothing in the Budget Papers to suggest this will occur.

There are plenty of other characteristics of this Budget which deserves less than rave reviews. Along with the cuts which have caused so much pain, Mr Costello's surplus has been helped along by his complete failure to do anything about bracket creep - which Treasury has reported to be estimated at some $4.5 billion. And to add to this $4.5 billion return for doing precisely nothing, there is also his windfall gain of some $5.5 billion in parameter changes since the Treasury estimates of January 1997: he was lucky enough to get the benefit of a forecasting error which went in precisely the opposite direction for us in 1995-96.

I cannot help but also speculate a little wryly about what would have been said by most economic commentators had Labor's own net outlays moved in the pattern revealed in this Budget - from minus $6.4 in year one, to minus $0.9 billion in year two, to plus $1.9 billion in year three - particularly at a time when an emerging current account deficit blow-out should have everyone bellowing for more, not less, fiscal discipline. Just a chance pattern, or the deliberate process of election war-chest building and spending that we predicted at the time of 1996 budget?

I take this opportunity to make it clear that there are some components of the Coalition's war-chest on which we will be casting a very beady eye, in particular the Federation Fund: some $464 million of this remains uncommitted at all, and an additional $70.4 million has been committed only in general terms "to fund Federal cultural and heritage projects at a cost of up $5 million per project". We will have our own views on how these remaining funds should be expended, will not feel bound by any election bribery the Coalition feels inclined to offer with them, and will make our own preferences clear at the appropriate time.

Tax Reform: The GST we Don't Have to Have

The Tax Reform Debate. For the all issues thrown up by the Budget, the dog hasn't yet barked on what everyone is expecting to be the centrepiece of this year's election economics, the Government's tax package. The Government's own contribution to the "tax debate" has so far been lamentable. It has refused to put on the table the information, argument, core options and specific proposals that would make an informed, intelligent public debate possible. It has had eighty or more advisers working full-time for nearly a year now in generating options, but continues to hide them from the public.

This is obviously because it wants to go to an election without giving people across the community sufficient time to grasp the full impact upon them of the tax package, in all its complexity.

This is not the occasion to be spelling out in any detail Labor's own approach to tax reform issues: we are not the ones claiming that the whole system is broken, and we are entitled to wait and see what those who are claiming it is put on the table. I can and should, however, make at least these quick points.

> - There is no basis to argue that our tax system is out of kilter with the rest of the world: we levy direct and indirect taxes in just about the same proportion as the industrialised country average, and our overall level of taxation is significantly lower than the OECD average.
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> - Householders and average workers are paying the same in average personal income tax rates now that they have been for the last twenty years.
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> - No-one is about to pay one dollar in two in tax: not even honest multi-millionaires pay that. Average earners now pay one dollar in every three of the extra dollars they earn, while the tax on their total incomes is less than one dollar out of every four they earn. And the vast majority of Australians pay no more than one dollar in every five they earn.

All that said, there *are* some anomalies and problems in the present tax system, particularly in the personal income tax area, although not confined to that, which do need repair and renovation. That's the responsibility of every government, and we would be as attentive to these issues as we were in office over the last thirteen years - when we cut John Howard's top rate of 60 cents to 47 cents, and his bottom rate from 30 cents to 20 cents, and dropped the company rate from 46 cents to 36 cents. In particular, we believe there needs to be a focus on four specific issues:

> - the very high effective marginal tax rates being paid by low to middle income families, as a result of the interaction of present tax and social security scales, which involve significant poverty traps and disincentives to work;
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> - the need to ensure that average weekly earners do not, as a result of bracket creep, pay higher marginal rates than they should be;
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> - the need to stop the erosion of the PAYE system by people who essentially remain employees, establishing themselves as independent contractors, trusts, companies or partnerships; and
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> - in particular, the need to attack tax avoidance by high income earners, particularly through the use of family trusts of the kind employed by Senator Parer and so many of the Coalition's front and back bench, to ensure that they pay their fair share of the community tax burden.

Labor won't be drawn into a demeaning tax auction at the next election, trying to outdo the Coalition with bigger and glitzier tax cut bribes, while leaving the Australian community with more and more inadequate services. We will not need to offer huge income tax cuts to sweeten a GST - putting more into pay packets to try and disguise the fact that even more of it is being ripped off at the checkout counter. We *will* be proposing tax relief, directed to where it is genuinely needed. But we will not be funding income tax cuts for the wealthy by making low and middle income earners pay a heavy new tax on everything they do or buy.

In paying for the tax relief that we will be announcing, we would prefer to make provision for this by other base-broadening and anti-avoidance revenue measures, and rearrangements within the existing tax system. But we do not exclude the possibility of drawing upon some proportion of forecast future budget surpluses, especially given that those surpluses, as presently estimated by the Government, are significantly based on the hidden tax generated by bracket creep.

Labor's Opposition to a GST. Labor has approached the tax reform debate with an open mind about every option except the imposition of a GST. We made up our mind in this respect in 1993, and haven't changed it since, except to harden our position even further, as Kim Beazley did last week in announcing that we would continue to totally oppose a GST in parliament, in or out of office.

A GST is still the "snake oil" that Peter Costello said it was in Novembere 1996 and, as John Howard said three years ago, it should "never ever" be introduced. A GST is not inevitable; it doesn't have to happen; and we in the Labor Party will do absolutely nothing to make it happen. There are many different reasons why we've taken this stand. Let me quickly spell them out.

A GST is inherently regressive and unfair to lower and middle income earners. The winners with any flat rate tax are those at the top of the tree, and the losers are ordinary Australians. An extra $10 for a day at the football means a lot more for a bus driver's family than it does for a lawyer's or dentist's. The unfairness is compounded by the fact that lower income earners consume so much higher a proportion of their income than high income earners. Food bills account for up to 40 per cent of a low income earners income; for high income earners the figure is closer to 10 per cent. And low income earners also spend an average of one-third of their income on rent: ad a new 10 per cent or more tax to that, and to their gas and electricity and telephone charges, and you are cutting a devastating swathe through their capacity to pay for the basic necessities of life.

The higher the GST rate is, the more unfair it is; and the fewer exemptions there are, the more unfair a GST is.

If a GST is used to fund a tax mix shift - with income tax cuts being paid for at the checkout counter - the unfairness will be massively compounded. A GST of 10 per cent, applying to all those areas which the Treasurer has refused to rule out, would generate nearly $30 billion, leaving around $14 billion available to spend on direct tax cuts after the replacement of Wholesales Sales Tax and the banking and financial institutions taxes are accounted for: this figure would be some $2 billion less if fuel excise were adjusted down, as is likely, to ensure that petrol and diesel prices don't rise.

The Treasurer made it clear in the Press Club last week that he saw no reason in principle why that honey-pot should not be there for the taking. But, responding immediately to this show of hubris, ACOSS, the Australian Catholic Social Welfare Commission, the Brotherhood of St Laurence and the Uniting church have made it clear that that's where they have drawn the line - and so they should. We've always been a country which values fairness: why *should* we go along with deliberately designing a tax system which is more unfair?

If the Coalition remains unmoved, here as elsewhere, by fairness considerations, a more compelling argument against a major shift to reliance on a GST might prove to be the move toward electronic commerce transactions, which is bound to gather huge momentum over the next few years. We are embarking on a debate about a tax measure that technology may be sending on its way to obsolescence before it can even be implemented.

It is effectively impossible to deliver a compensation package which will fully compensate all those low and middle income earners for the hurt that a GST will cause them. There is an obvious problem of compensating through the tax system those are not *in* the tax system, or compensating through pension increases those who are self-funded retirees. This last point was made to me graphically by a caller on Cairns talkback radio this week, explaining that he had paid high rates of income tax all his life, and how had to face a GST as he consumed his capital. "They got me coming", he said, "and now they're getting me going".

The further problem is simply that individual and family situations vary so much: people's consumption patterns differ, for example, depending on how old or ill they are, or where they live.

A GST, like yeast, always rises. On all available evidence, a GST - whatever the rate at which it is introduced - is bound at some stage to go up and become even more unfair. Somehow the later compensation packages never seem to be quite as generous as they are claimed to be at the outset. The recently published National Tax and Accountants Association survey of 26 countries with a GST or its equivalent, showed the rate going up in all but three of them. The most familiar examples are the increase of the GST in New Zealand from 10 to 121/2 per cent, and of the VAT in the UK from 10 to 171/2 per cent; the most hair raising is the increase in Denmark from 10 to 25 per cent. As Alan Mitchell put it so succinctly in the *Australian Financial Review* a few days ago: "The real beauty of the tax, as just about every European government will tell you, is that governments can increase the GST rate with less political trouble than they can increase income tax rates".

A GST is very expensive and burdensome for small business to implement and administer. Wholesale sales tax is presently collected and passed on by 75,000 businesses around the country. With a GST, nearly one million businesses - the overwhelming majority of them small businesses - will become unpaid tax collectors. The cost of compliance has been estimated at around $7,000 a year for each of them, with initial setting up and ongoing administration costs. All this worsens the competitive position of small business against big business.

A GST will directly discourage the creation of jobs in the services sector, where employment has been growing fastest. Many have argued that it is self-evidently true that to tax services in a way that has never been done before is a good thing, given the increasing size of this sector in the overall economy. But that doesn't follow at all. What you choose to tax is, like everything else, a matter of deliberate policy choice, and successive Australian governments have not been wrongheaded in the past in placing the emphasis on goods, and in particular on luxuries, alcohol and tobacco. In particular the light taxation of services has been one of the factors critical to the extraordinarily rapid growth, and job growth, in the tourism and hospitality sector.

Nobody should underestimate the destructive impact the GST will have here. I sat down this week with tourist operators in Far North Queensland, and we calculated - taking into account average travel, accommodation, meals, sightseeing, and incidental expenses - that the introduction of a GST would cost a Sydney family holidaying in Cairns for a week an additional $500!

A GST will not do anything to solve the problem of the black economy. Of course it's true that a GST would make many people who have been operating in the black economy pay tax on a number of items they previously consumed tax-free, and as such they would be paying more tax than before. But there is ample evidence, particularly from Canada, that that effect is at the very least neutralised, and quite possibly exceeded, by the fact that a GST draws transactions *into* the black economy. I have had a number of small-business operators saying to me that they expected to find themselves in a real dilemma with the introduction of a GST: they would prefer to play it straight, but feared that their local competition would steal a 10 per cent plus march on them by quietly offering services GST-free. And of course the more that people are drawn into evading GST in this way, the more chance there is that they will then be sucked into income tax evasion as well. A further variation on this theme came from the taxi driver who told one of my staffers recently that he was looking forward to a GST - which he would add to every fare, then pocket!

There is absolutely no reason to suppose that a GST would do anything for jobs, growth or the overall health of the economy. The most healthy economy in the world, the United States, does not have a GST, while Canada and many European countries with continuing high rates of unemployment do. And whatever may be the text book theory, there is no link in practice that anyone seems to be able to establish between a GST and improved private saving, as Treasury Secretary Ted Evans acknowledged in a speech earlier this week. Next door neighbours Belgium and the Netherlands both have GSTs, but while Belgium has the highest household saving rate of the major OECD economies, the Netherlands has the lowest.

The one easily measurable impact of a GST does have is to generate a surge of inflation: how long that continues beyond the first year depends essentially on the success of catch-up wage claims. At a time when we can't ignore the prospect of some resurgence of inflation from a weakened Australian dollar in the wake of the Asian crisis, this is yet another reason for not embracing a GST.

Telstra: The National Asset that should Never be Squandered

The remaining major element in this year's economic election debate - and it has become inextricably mixed up now with the budget and tax reform debate - is the Government's proposal to sell the remaining two-thirds of Telstra. The Government seems to be increasingly conscious of how lamentably weak all its other arguments are, and is pushing them to one side in favour of one big argument: sell Telstra to reduce public debt; sell it save and spend every year - perhaps on tax cuts - the interest on that debt; and sell it so that may be we can spend a chunk of the proceeds on other capital projects.

The Labor Party's position on all this is quite simple. Telstra is a major national asset that should never be squandered, and the Labor Party will fight its sell-off as long as we have the political breath to do so.

The argument that Telstra should be sold to further reduce Australia's public debt is utterly without merit. Australia does have a longstanding private saving problem, which needs further government policy attention, but we don't have a public saving problem. Australia's public debt is already the second lowest in the industrialised world, and there is no economic purpose to be served in aspiring to become a zero net-debt country - any more than it makes sense for businesses and households to operate totally debt free if they can improve their welfare or their business performance by borrowing, and the debt in question is readily serviceable and repayable. Governments should try to avoid, over the course of the economic cycle, borrowing to fund recurrent expenditure, but there is every economic justification for sharing with future generations, who will after all enjoy them, the burden of paying for new capital assets.

It's hard to understand where the national advantage lies in selling to a minority of Australians a great national asset that is presently owned by *all* Australians, and it is even harder to see where the national interest lies in allowing foreign investors to take up fully 35 per cent of the shares: why should foreign interests, holding $20 billion worth of ownership, be delivered $700 million or so of dividends each year when those dividends could be being used to make our hospitals work better and our schools work better and to get people back to work. Once Telstra is lost to public ownership, and to foreign ownership on this scale, it can never realistically be bought back again.

The most compelling argument of all is that it will be a matter of time, and quite likely a very short time, before the dividend stream from Telstra will in fact exceed what we are paying out in interest on the $40 billion or so worth of debt that could be redeemed by its sale, on reasonable assumptions about dividend increases and likely future bond rates. In return for a very short term net revenue gain, the Australian community would - after a very few years - suffer a net revenue loss forever. That isn't good economics, and in the judgement of the Labor Party, not good politics either - it's something the Australian community will simply not accept. It's crazy to sell off an asset like Telstra in a short-term grab for cash, and the Australian people know it.

Conclusion

The key question in the election, what they all these issues really come down to - is what kind of country do we want Australia to be.

How do we want to treat each other, and live together in the wider Australian community? Do we want to live in a way that is cooperative and compassionate, giving priority to well-being and quality of life and employment opportunity for all members of the community? Do we want to give value to public goods and to the idea of public service? Do we want to give priority to long term satisfaction rather than just short term gratification?

Or do we want to live in a way that is confrontational, divisive, focused on private gain rather than public good, and indifferent to the pain and humiliation of those who fall behind?

Labor does have a fundamentally different view of the world from that of our Coalition opponents. We *don't* believe it's right to not care about the unemployed, or to build Budget surpluses on the back of not only the unemployed but the disadvantaged, the needy, the elderly and ordinary Australian families. We don't believe it's right or necessary to introduce a GST, which can only make the tax system more unfair than it presently is. And we don't believe it's right to sell off a great national asset like Telstra for short term financial gain.

We *do* believe it's possible to be a totally responsible and disciplined government in managing the economic affairs of this nation, while still caring about what matters most to ordinary people, meeting their needs and the needs for services of the community as a whole.

We believe that our record in government is overwhelming proof of that, and that everything we've said and done and committed ourselves to in opposition - as we have listened closely now for two years to what Australians around the country have been telling us - confirms not only our intention but our capacity to govern genuinely for all Australians.