Up, Up And Away Goes Deficit

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Canberra Times 18th May, 2009

When Wayne Swan says it will be seven years before the budget is back into balance you know he means he can never achieve this. Still less can he build the surpluses to pay back the hundreds of billions of dollars of debt budget deficits will accumulate in the interim. Restoring balance means taking tough decisions in terms of cutting spending. This is difficult for the ALP, which is genetically programmed against reining in spending unless it is defence spending and there is little enough of that left to be whittled away.

The present level of deficits is a 35-year legacy of expenditure increases. Having commenced a major spending spree and pressured business to increase wages in the teeth of a serious world recession, Gough Whitlam won an early re- election in 1974 claiming, with the baying support of the media, that the latest set of statistics proved "we have turned the corner". Within days of his re-election, the corner we had turned was exposed as a blind alley and the economy tanked. Whitlam then installed Bill Hayden as Treasurer but Hayden's razor gang was too little too late and an early election forced on Whitlam saw him thrown out in a landslide. Runaway inflation and cascading spending deficits needed sterner remedies than Whitlam, even with reconstructed government, could offer. Whitlam oversaw spending growth that raised the Commonwealth's share of GDP from 20 to 25 per cent. Overall spending as a share of GDP is the quintessential budget figure against which the Rudd Government must be judged. The Fraser Liberal government from 1975 allowed scope for the conservative Treasury department to apply corrective restraints on spending but still presided over a blow-out in the Commonwealth's share of expenditure to 28 per cent of GDP. In the 1983 election, this allowed Hawke to portray the Fraser government as irresponsibly spendthrift. The Hawke government and later the Keating government was in office for 13 years. Its many reforms to competition and limited privatisations together with a benign international economy saw it presiding over relatively buoyant growth. Even so, it failed to rein in the share of government in GDP which remained at close to the 28 per cent it inherited.

These comparisons suggest the achievements of the Howard government were creditable. In the main the Howard government continued and accelerated the reforms to markets (including labour markets) that Hawke/Keating had commenced. But Howard took a more disciplined approach to spending, which as a share of GDP was reduced to under 24 per cent.

This and continued global economic buoyancy resulted in relatively strong economic growth. From the latter part of the Whitlam government until the past year, there was an understanding that government expenditure had a negative influence on the economy's performance. The ALP, while dabbling in winner-picking industry policies, for the most part presided over a freeing up of markets. This induced economic growth from which a portion could be taken to satisfy the party's natural support base. The ALP lost office under Keating when this went too far in the context of a slower international economy. The difficulty we now confront is that the bastion that promoted responsible fiscal policies, the

Treasury, now encourages increased spending and has even been a leading promoter of introducing increased costs in pursuit of lower carbon dioxide emissions. The Treasury Secretary, Ken Henry, has given full license to Rudd's exorbitant expenditure give-aways.

Henry even urged that these to be concentrated on the consumer rather than on infrastructure. The latter at least has some payoff albeit likely to be inferior to leaving the funds with the private sector in terms of increased productivity. There has never been a case in the past when the Treasury was anything other than a bulwark against the natural proclivity of politicians to spend. This therefore is a particularly dangerous period for the Australian economy. The present Prime Minister has clearly expressed his own view that increased expenditure is the means of sheltering Australia and allowing the economy to rapidly emerge from the world downturn. He and Treasury in supporting this position both see the appropriate policy framework as being driven by an "accelerator" which is associated with the Keynesian economics approach. Under the accelerator theory a demand deficiency is countered by an injection of government funding which causes demand to rise and eventually to become self propelling as firms respond to this with increased investment. The problem is that the demand injection comes either from creating money or from borrowing.

In the first case it will end up with inflation, perhaps galloping inflation.

In the second case it will siphon off savings that would otherwise be used for investment and thereby cannibalise the available funds that would be available for investment as pockets of demand emerge and equipment might be replaced. Hence fiscal deficits will undermine a recovery, perhaps, as was seen in Japan in the 1990s and US in the 1930s, totally prevent it occurring.

An alliance of politicians with strong predilections in favour of spending to buy votes and influence, and the public service agency that was previously the Praetorian Guard of the public purse is particularly dangerous to the national wellbeing.

It leaves an incoming government adrift from the necessary advice in restoring economic health and with the need to replace much of the current public service leadership.