

# The Australian

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## Talk of fiscal rectitude is Labor spin

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**TOMORROW, in presenting the 2012-13 budget, Wayne Swan is likely to repeat the Gillard government's mantra that it has achieved "the fastest fiscal consolidation on record". But the reality is far from the government's claims of shining fiscal rectitude.**

The International Monetary Fund's Fiscal Monitor, released last week, shows that 17 advanced economies have materially improved their cyclically adjusted budget balance since the global financial crisis. Despite stronger than average economic growth, Australia is not among them.

Also according to the IMF, four advanced economies will have a cyclically adjusted budget surplus this year and six by next year. Australia is not among them either.

And 11 advanced economies will have returned to their pre-GFC cyclically adjusted budget balance within four years of their largest post-GFC deficit, with a further five doing so by 2016-17. Yet again, Australia is not among them.

If Australia fails to come within cooee of the "most fiscally improved" podium, it is hardly because we have little scope to do better. In fact, the opposite is true: the deterioration in our budget balance from 2006-07 was the fifth largest for the advanced economies, placing us close to Greece, Iceland and Spain in the fiscal loosening stakes.

Nor is it only by comparison with international standards that the extent of the deterioration stands out: it was also unprecedented in Australian fiscal history. Even in the horror years from 1970-71 to 1983-84, marked by Whitlam's spending spree and the successive oil shocks, eight years of spiralling deficits amounted to a total barely one-third of that which Rudd, Gillard and Swan managed to rack up in just three years from 2008-09.

Instead, what distinguishes Australia from the other advanced economies is that so great a deterioration has not been followed by a larger, speedier return towards budget balance. By 2010-11, for example, Switzerland, Germany and Austria had clawed back \$2 or more for each \$1 of GFC-induced budget loosening and were either in structural surplus or close to it.

And 14 other advanced economies had improved their fiscal position by more than a dollar for each dollar of GFC-induced fiscal expansion. Swan, in contrast, has simply left the structural deficit gaping.

Sure, tomorrow's budget is likely to announce substantial improvements in the budget bottom line. Those, however, are forecasts, and talk is cheap, especially when outturns will not be known before the next federal election. Adding to the scepticism, IMF data show fiscal consolidations typically achieve less than half the promised cuts in expenditure, with the shortfall only partly offset by larger than announced increases in revenues.

But even taking those forecasts at face value, the lesson of history it is that budget consolidation is not a form of fiscal weightlifting, in which the dumbbell, once raised, can be thrown off. Rather, like weight loss, what counts is the durability of the fiscal effort.

There were, for example, some 60 significant fiscal consolidations in the EU from 1980 to 2005, that is, instances in which a country's budget balance improved in a single year by at least 1.5 percentage points of national income. But in only 14 was the improvement repeated in the subsequent year. And in more than two-thirds of the instances, any reduction in indebtedness was either very small or reversed within three years.

Sustained consolidation therefore is the exception rather than the rule. But where it has occurred, three factors have been important.

First, rather than merely postponing outlays, spending restraint has been accompanied by genuine improvements in the quality of public spending. Nigel Lawson's 1984-88 British fiscal consolidation and Paul Martin's 1993-96 consolidation in Canada are cases in point, both outperforming ambitious expenditure reduction targets through far-reaching reforms to spending programs. In contrast, while the Clinton administration significantly reduced the US budget deficit during the period

1993-98, the improvement was due entirely to delayed expenditures and increased tax revenues, and so was dissipated as spending growth accelerated post-1998.

Second, successful consolidations involve reforms that promote economic growth, particularly by increasing labour market flexibility. The private sector can then expand as the public sector contracts, cushioning consolidation's adverse effects on economic activity.

Germany's 2003-2007 fiscal consolidation plan, which reduced income taxes while cutting unemployment benefits, is a textbook example, as it helped increase participation rates and moderate wage demands, thereby underpinning Germany's competitiveness. So too was the Howard-Costello strategy which, at least in that government's first two terms, combined fiscal prudence with industrial relations reforms that bolstered private-sector job creation.

Last but not least, fiscal honesty is essential in creating public support for durable budget rigour. Indeed, effective monitoring of fiscal rules and budget disclosure is estimated by the IMF to be nearly as statistically important in explaining successful consolidations as better than expected economic growth.

Yet these are all areas where this government's record is not reassuring. Far from enhancing the quality of our public finances, few governments have presided over so many botched spending programs and poorly conceived revenue measures. As for promoting private-sector expansion, the Fair Work Act does the opposite, as do the carbon and mining taxes. And the government's budget treatment of the National Broadband Network says it all as far as its fiscal honesty is concerned.

But it did not have to be like that. After all, it was the Social Democrat Gerhard Schroder who led Germany's 2003-2007 fiscal consolidation and began reform of Germany's overly generous social security system. To do so, he sidelined and then eliminated the left-wing finance minister, Oskar Lafontaine, who longed for Keynesian nostrums financed by taxes on the rich. And closer to home, the Keating-Walsh team proved Labor can be second to none in delivering tough, efficiency-oriented, budgets.

So far, however, Swan has given no sign of being a Keating. Yes, like his distinguished predecessor, he has received Euromoney's "best treasurer" award. And yes, in the Wizard of Oz, the cowardly lion, once given a medal for extraordinary valour, discovers he is in fact brave.

But outside of children's novels, the gong does not make the man, any more than it "makes the Hottentot so hot" or "puts the ape in apricot". Rather, as Dorothy tells the Lion, what the Hottentot and the ape "got that I ain't got" is simply this: courage. It will take more than porkies, promises and petulance for Swan to show that.

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