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Deceptive attack on Howard's record

HENRY ERGAS THE AUSTRALIAN JANUARY 14, 2013 12:00AM

Illustration: Sturt Krygsman Source: The Australian

YOU don't need to be a professor of economics to know John Howard was more fiscally prudent than Silvio Berlusconi. And if an econometric study suggested the opposite, you would look very carefully at its data and methods before placing much weight on its results. Unless, that is, you were the Fairfax press and the ABC.

That the ABC wouldn't bother to do so may come as no surprise. But one expects better of The Age's Peter Martin, who is a decent person and a respected professional. However, that didn't stop Martin beating up the claim that an International Monetary Fund staff working paper found Howard to be fiscally imprudent while exonerating the Whitlam government of any such charge.

Bad enough that Martin described the paper as representing the views of the IMF, which a disclaimer on its front page prominently warns against doing. Even worse, he cannot have read the paper carefully. For had he done so, he would have spotted obvious problems with the conclusions he imputes to it.

The paper's focus is on fiscal sustainability: governments' ability to repay their debts without crippling national economies. As the paper emphasises, fiscal sustainability is not always easy to define or measure. But an approach widely used by governments and international organisations, including the IMF, compares the growth in the burden of public debt to the rate of growth of the economy as a whole. On that criterion, the Howard government was a paragon of fiscal virtue, with performance slipping subsequent to Kevin Rudd's election.

The paper, however, explores a new measure of fiscal sustainability, using data from a broad range of economies. Its approach examines the way governments respond to changes in public debt; in particular, it measures whether increases in debt lead to an offsetting reduction in budget deficits (or an increase in budget surpluses) and so are potentially self-correcting: much as one might examine whether a family that took on more debt then reduced its spending, allowing it to comfortably service its borrowings.

As a general matter, that approach can work poorly when government debt is low. That is because a government that persistently holds debt to low levels obviously does not face the problem of improving its budget position so as to offset debt increases. Techniques that identify fiscal virtue by examining the response to rising debt will therefore be biased against those governments.

Instead, much like confusing temperance with a drunkard who periodically goes on the wagon, they risk most readily ascribing virtue to those governments that, having let deficits spiral, are forced into drastic corrective action.

That said, the paper does develop three specific tests to pinpoint periods where significant shifts in fiscal policy occur. One of those tests selects 2003 and 2005-07 as years of Australian "fiscal imprudence".

That is the result Martin's story emphasises. But what Martin doesn't note is that the paper's other tests did not confirm that finding, and that the test he privileges is statistically unproven and, on the authors' own admission, unconventional. Indeed, that test gives many bizarre results. For example, it not only finds Italian governments to be consistent models of fiscal rectitude, but also singles out 2002-05 as years of fiscal prudence in Britain, even though that was when the Labour government's budget deficit blew out of control.

Precisely because of the difficulties of placing much weight on any such measure, the paper provides a table that combines its tests - and which does not identify any fiscal imprudence in the Howard years.

You wouldn't know that, however, from Martin's reporting. Nor would you know that the test he privileges uses data on gross, not net, debt (that is, gross debt minus gross financial assets).

Usually that will not matter, as the two vary together. But the distinction does matter, possibly substantially, for the Howard government.

That is because as net debt fell to zero, the Howard government faced a situation where it would not be issuing government bonds; but the interest rate on those bonds plays an important role as a reference point for financial markets, for example, in setting prices for bonds issued by corporations.

The government therefore continued to issue bonds, thus retaining gross debt, but offset those issues with purchases of other financial assets, so that net debt kept falling.

With gross and net debt thus moving separately, a test that only examines gross debt would incorrectly conclude the government imprudently failed to push fiscal consolidation as much as it could and should have done.

To make matters worse, the estimates on which Martin relies do not actually relate to the commonwealth government alone. Although you wouldn't know it from Martin's reporting, they combine the commonwealth and the states. And the years covered by the test were a period in which the Labor states were amassing debt, with rising debt in Queensland and NSW exceeding the increase in commonwealth gross debt.

It is consequently simply incorrect to impute the outcomes of this test to the Howard government, as it jumbles together the fiscal performance of the commonwealth and the states.

To highlight these points is not to criticise the paper's authors. After all, that is how knowledge develops: scholars present provisional results, soliciting responses that stress-test their findings. And this paper is scrupulous in clarifying its assumptions and giving full public access to the data on which it draws.

But that only makes it all the more regrettable that the Fairfax press would so misleadingly present its results.

Rather than help readers understand their limitations, it used selective reporting to indulge its dislike of the Howard government.

That is not to claim the Howard government's spending and taxing decisions were invariably wise. On the contrary, many were very poor indeed, though they pale in comparison with pink batts, school halls and the NBN. But the quality of public expenditure is not what the IMF working paper, which concentrates on the level of public debt, is about, and to suggest otherwise is misrepresentation.

Fairfax's readers are therefore owed an explanation.

As for "your ABC", its charter obligations and reliance on taxpayer funding should have made it wary of descending into poorly informed politicking.

But clearly, it couldn't resist the temptation. That merely confirms the need for a rigorous review of the ABC's role, management and operations. And the sooner, the better.