

# THE AUSTRALIAN

## The \$250bn cost of Kevin Rudd: a tale of waste and spending

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First time around, Kevin Rudd lacked any understanding of economic policy. Picture: Gary Ramage Source: TheAustralian

### Unfunded fiscal burdens

#### Fiscal liability

UNJUSTIFIED DEBT **\$98-\$157bn**

NBN **\$30bn**

HEALTH AGREEMENT **\$25bn**

**TOTAL \$153-\$212bn**

### Cost of wasted resources

#### Social cost

SOCIAL COST OF FISCAL LIABILITY **\$38-\$53bn**

BOATS **\$12.9bn**

CARBON TAX **\$3.5bn**

NBN **\$17bn**

FWA **\$18.2bn**

**TOTAL \$90-\$105bn**

Source: TheAustralian

Sources: ABS, IMF WEO and [www.tradingeconomic.com](http://www.tradingeconomic.com)

## Profligacy battle: Whitlam v Rudd

Whitlam v Rudd	Per capita spending increase (real \$ 2013)	GDP per capita
1974-75 to 1975-76	\$871	\$33,295
2007-08 to 2008-09	\$2361	\$61,797
<b>RATIO: RUDD INCREASE OVER WHITLAM</b>	<b>2.7</b>	<b>1.9</b>

Source: TheAustralian

Sources: ABS, IMF WEO and [www.tradingeconomic.com](http://www.tradingeconomic.com)

**THE era of Kevin, interrupted by the Julia interlude, has been a roller-coaster ride. Having promised Howard-lite and fiscal conservatism, the excuse of the global financial crisis unleashed a period of rapid growth in government spending, successive budget deficits and mounting public debt under Kevin Rudd's guidance.**

Now, with Rudd's return, Labor has launched a charm offensive that seeks to whitewash the past: it is as if aliens from Mars, fortunately departed, had been in charge. But the damage of that era cannot be wiped out so easily.

And that damage is steep indeed: in the 935 days between becoming prime minister on December 3, 2007, and Julia Gillard's coup of June 24, 2010, Rudd left Australians with at least \$153 billion in unfunded fiscal burdens while wasting \$100bn of the community's resources.

The time has come to count those costs, and to assess their implications for the man who would be king.

By far the most visible component of the costs was the shift from a budget cash surplus, averaging 0.9 per cent of gross domestic product during the Howard years to a cash deficit that exceeded 4 per cent of GDP in 2010.

Associated with a succession of economic stimulus measures, that deterioration proved difficult to reverse, with the commonwealth's balance sheet shifting from \$44.8bn in net assets when Rudd took office to \$161.6bn in net debt this year.

Clearly, part of that \$206bn deterioration in Australia's fiscal position reflected the global financial crisis. After all, the US business cycle peaked the month Rudd came into office, with an initially moderate downturn intensifying into a major international recession in the second and third quarters of 2008, as the American slowdown spread to Europe.

The bankruptcy of Lehman Brothers on September 15, 2008, then highlighted the severity of the problems in financial markets, plunging those markets into turmoil and precipitating three quarters in which the G7 economies' GDP shrank by nearly 7 per cent.

The risks these developments posed to Australia were obvious. But it was also obvious that we were relatively well-placed to weather the storm: the banking system was fundamentally sound; labour market flexibility had not yet been undermined by the Fair Work Act; and China seemed likely to ensure its rapid growth continued, fuelling strong demand for our resource exports.

Moreover, a flexible exchange rate, the very considerable scope for monetary easing provided by then high real interest rates and the strength of the fiscal position Rudd had inherited meant that should conditions deteriorate,

there was ample capacity to respond.

All that ought to have encouraged an approach that was cautious and incremental, relaxing fiscal policy enough to prevent the economy from falling below "stall speed" while retaining the ability to adjust as circumstances changed.

In the event, the response was anything but careful and deliberate. Instead, Rudd unleashed a torrent of public spending that took federal outlays per man, woman and child from \$12,658 in 2007-08 to \$15,609 in 2010-11, with an 11.7 per cent rise in real per capita terms in 2008-09 alone.

That surge was extraordinary by any standard: spending growth had not seen double digits since Gough Whitlam's 1975-76 budget; and in absolute terms, Rudd's per-capita increases in commonwealth outlays were almost three times Whitlam's. But Rudd justified them by reference to Treasury forecasts that pointed to a collapse in output that was sudden, severe and sustained.

Nowhere was Treasury's pessimism more stark than in the May 2009 budget, for which Treasury estimated that even factoring in Rudd's stimulus packages, the unemployment rate would surge from 5.5 per cent in mid-2009 to 8.5 per cent by late 2010, with no improvement in unemployment until mid-2011.

Yet those estimates always seemed implausible: they ignored the lessons of the 1997 Asian financial crisis and the 2001 "tech wreck", which had shown the efficacy of the exchange rate and of interest-rate cuts as shock absorbers for the Australian economy; and they were not easily reconciled with well-specified macro-economic models.

No surprise, then, that they soon proved wildly inaccurate, with the unemployment rate increasing by less than one-tenth of Treasury's forecast.

A prudent, conservative government would have pushed back on Treasury's estimates, much as John Howard and Peter Costello resisted alarmist calls for greater fiscal stimulus in 1997 and in 2001. But Rudd was neither prudent nor conservative. Lacking any understanding of economic policy and given to delusions of grandeur, he proclaimed the end of "extreme capitalism" and approvingly quoted Nicolas Sarkozy's "Le laissez-faire, c'est fini".

Social democracy, he said, would have to "save capitalism from itself"; but salvation never comes cheap, particularly when Rudd is the saviour.

Labor therefore locked in outlays that were not reversed even when the economy returned to trend growth. And that return was speedy indeed. On the back of a 30 per cent fall in the exchange rate - the largest in our post-war history - and a 4.25 percentage point cut in interest rates, growth was at trend by December 2009, while by June 2010 the resource boom had pushed the economy to the limits of its capacity.

Yet the stimulus packages rolled relentlessly on, with the Gillard government merely replacing Rudd's programs by new expenditures as they expired. The result was deficits that could not possibly be justified by the need to protect jobs and avoid recession.

Calculating the precise extent of the excess outlays is inherently complex and controversial. What is clear, however, is that budget outcomes under Labor departed from the historical pattern. In the past, faster growth translated relatively rapidly into improvements in the commonwealth's fiscal position, as governments moved to plug budget holes. But under Labor the deficits continued long after growth resumed.

The difference between those deficits and the budget outcomes that would have occurred had the historical relationship between economic growth and budget outcomes persisted provides a first indicator of the excess spending. For the period to 2011-12, where the momentum in public spending came from decisions that were Rudd's, that difference amounts to \$157bn.

An alternative estimate can be derived from Treasury's review of Australia's long-run budget position. To assess that position, Treasury decomposes the change in actual budget outcomes into a component due to cyclical fluctuations in economic activity and a structural component that reflects changes in taxing and spending.

Even assuming all the stimulus spending was cyclical, Treasury's estimates imply that by 2011-12 the structural deterioration under Labor cumulated to 9 per cent of GDP, equivalent to \$124bn.

Finally, a third estimate can be derived by comparing Australia's post-GFC fiscal performance with that of other advanced economies. This requires calculating a statistical relationship between national budget outcomes, on the one hand, and economic activity and public debt on the other.

So as not to bias the results against Rudd, the European economies, which have had little choice but to cut back drastically on budget deficits, should be excluded; applying the resulting relationship to Australian data then shows what our budget outcomes would have been had Labor been no more fiscally restrictive than governments in countries such as the US and Canada.

Here, too, the conclusions are damning. Given our growth rate and the terms of trade windfall, Labor's cumulated deficits to 2011-12 should have been \$98bn smaller than they were.

In short, out of accumulated budget deficits of \$172.3bn attributable to Rudd, between \$98bn and \$157bn reflected profligacy rather than adverse circumstances.

That amount will eventually need to be repaid through additional taxes. Given that raising each dollar in taxes causes inefficiencies that reduce taxpayers' incomes by an additional 20c to 30c, even the smallest of those estimates translates into a per capita burden of \$5294, while the larger amounts to \$8482.

Yet that is merely part of the first Rudd government's economic legacy. For it was not only the shortfall between spending and taxing that was an issue; it was also the quality of the spending and of the new taxes themselves.

Doubtless, opinions will differ on the merits of individual outlays, but it is beyond dispute that there was far-reaching waste in programs such as school halls and pink batts, with the latter also involving the tragic loss of young lives.

Nor is there much argument that the dismantling of Howard's Pacific Solution, and Labor's subsequent reluctance to address the surge in boat arrivals, has left a trail of high costs, to which must again be added unnecessary deaths.

And the fiasco associated with the carbon tax, which damaged Australia's competitiveness and led Labor to sprinkle around compensation payments it could not afford and can no longer justify, has been all but admitted by the government itself.

To those errors, Rudd added the mistake of thundering into areas that traditionally have been the preserve of the states. Childcare is a striking case in point, where the net effect of imposing an expensive national regulatory framework and upping the subsidies paid to parents using formal childcare centres has been an explosion of commonwealth spending.

But while outlays have risen threefold and are expected to hit \$7bn in 2016-17, use of childcare services has increased only 20 per cent to 25 per cent. Instead of delivering added services, the higher spending has been captured by childcare workers in wage increases and frittered away in ever greater administration and compliance costs.

As a result, childcare fees are rising by more than 10 per cent annually, while daily fees of more than \$100 are now common. Far from increasing labour-force participation, the employment rate of mothers with children under the age of one has actually fallen, going from 25 per cent in the 2006 census to 24 per cent in the 2011 census.

That outcome, in which taxpayers spend a lot but receive little in return, has been paradigmatic of public policy under Rudd. On a plausible estimate, the overall waste thus caused amounts to between \$74bn and \$88bn. But even that number is hardly comprehensive, as it excludes spending that is off-budget. And no program looms larger in that respect than Rudd's brainchild, the National Broadband Network, with its commitment to deploy fibre optic connections to 93 per cent of the population.

The government's chronic lack of transparency makes assessing NBN Co's economics difficult, as it presumably is intended to do. But a careful analysis issued this week by Australia's leading telecommunications analyst, Ian Martin of investment bank CIMB, details the problems plaguing the NBN's rollout.

Martin emphasises NBN Co's politically driven decision to spread deployment thinly, with the resulting "wide dispersal of resources" and "difficulty with achieving scale" greatly increasing the venture's costs and compounding its delays.

No less importantly, however, Martin provides the data needed to calculate the pain those inefficiencies will inflict on consumers and taxpayers.

That pain is anything but trivial: Martin's results imply that at NBN Co's 7 per cent discount rate, the losses the NBN is likely to incur to 2027 have climbed to more than \$30bn, a \$6bn increase since NBN Co's most recent

corporate plan.

But Rudd not only mortgaged the future with unfunded costs and obligations; he also slashed the economy's capacity to bear the burdens he was imposing. For even as Treasury was forecasting a dramatic increase in unemployment, the Rudd government was introducing the Fair Work Act, reducing the labour market's ability to absorb the shocks to which a commodity exporter such as Australia inevitably is exposed.

The FWA's effects, since it became fully operational on July 1, 2010, are strikingly visible: despite the past 15 quarters of economic growth, and a once-in-a-century investment boom, the unemployment rate appears to be stuck at about one percentage point above its level under WorkChoices.

And that figure, which yesterday's increased unemployment forecast merely confirms, is an underestimate, as it does not explicitly account for the 0.5 percentage point decline in the participation rate that cannot be explained by the ageing of the population, or for the rising rate of underemployment - that is, the growing number of workers unable to work as many hours as they would want.

The social toll of unemployment that is persistently 1 per cent to 1.5 per cent higher than it has to be is as severe as it is difficult to express in monetary terms. What can be said, however, is that cumulated across the past three years, forcing 1.25 per cent of the labour force into needless unemployment reduces national income by \$18.2bn.

But higher unemployment, and the dashed hopes and lost income that go with it, are not the only damage caused by FWA. Rather, the number of claims for unfair dismissal and employment termination has nearly doubled since the FWA came into operation. And so has the incidence of industrial disputes and the extent of the ugly violence that accompanies them.

According to the Australian Bureau of Statistics, in 2007 there were 135 disputes that resulted in a strike, with 49,700 working days lost. By this year the number of disputes had reached 218 with 289,500 working days lost. As Macquarie University's Paul Gollan concludes, the FWA "is achieving neither a harmonious nor a conflict-free industrial relations environment. This is despite the fact that the majority of workplaces are not unionised and only 13 per cent of the workforce in the private sector belong in a union".

At least \$120bn in needlessly accumulated debt; about \$100bn in waste from poor quality spending and taxing; \$30bn in losses from the NBN alone; and an industrial relations system that reduces national income by at least \$6bn a year and creates an adversarial climate in the workplace: all that makes Rudd the costliest prime minister in Australian history.

But that he should have proven so is fundamentally unsurprising. For like bad art, poor policy does not happen by accident. On the contrary, it is born of choice: in this case, the choice of a political outlook in which managing the optics of announcements and pandering to the public pressure of the day invariably counts for far more than slow, steady policy formulation based on consultation and a full understanding of the facts.

It is ironic that the cabinet handbook, which supposedly guides government decision-making, explicitly notes that "the principle of collective responsibility can only operate if all members of the cabinet are well informed and well advised: good policy requires informed decisions". But as the resource super-profits tax saga showed, no Australian prime minister has displayed less interest in implementing that guidance than has Rudd.

Putting a dollar value on that disdain for sensible decision-making is impossible. But ask most businesspeople about their experience since 2007 and they will simply shake their heads. Many are struggling with the change to monthly payment of company taxation, lobbed on them without any consultation, and myriad other twists and turns in regulation and taxation that have been sprung without even the semblance of proper process. As Reserve Bank governor Glenn Stevens noted last week, the costs of loss of confidence in the operation of government are large and potentially long-lasting.

Yet the frightening fact is that there is no sign whatsoever that Rudd has learned from the past five years' experience.

Rather, in just 37 days since returning to office, spending commitments have rained like confetti, ranging from greater funding for schools to the PNG Solution, and encompassing everything from a "jobs program" for Tasmania to stadium upgrades in Townsville, a "transformational plan" for the Cairns CBD, a beef industry exhibition in Rockhampton and more money to promote live music performances. Yesterday's economic statement makes the consequences clear: the increase in spending next year is the greatest since Rudd had his hand on the levers in 2008-09.

Tax hikes have proliferated too, including the poorly conceived and even more poorly implemented changes to the fringe benefits tax, the increase in tobacco excise and a levy on bank deposits. But, even so, the budget deficit has blown out and net debt with it: so much for fiscal consolidation, Rudd-style.

That then is Rudd: uninterested in economics, contemptuous of process, the most recent incarnation of "whatever it takes" man in a party tainted by corruption and cronyism. Yes, the Rudd circus may rise to new heights; but the costs it inflicts will only rise with it.

## Unemployment rate and changes to industrial relations regulations



## Post GFC performance of leading economies, 2007-13

