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Pledges we cannot stick to

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LABOR'S policy decisions since 2007 increased commonwealth revenues across the 10 years to 2016-17 by $78 billion. At the same time, however, they increased spending by $138bn.

The result, according to last week's economic statement, is a cash deficit that in the next two years alone will exceed $54bn, while the structural deficit (which corrects the budget position for the level of economic activity) is about 9 per cent of gross domestic product.

The longer-term outlook is gloomier yet. Today's structural deficit seems set to worsen by four percentage points of GDP (equivalent to more than $2500 a person annually) across the period to 2022-23, with rising outlays on healthcare and pension entitlements being substantial contributors. Even that assessment does not reflect the full extent of spending commitments.

For example, DisabilityCare Australia's costs are still highly uncertain, as is the final bill for the Gonski package, but there are good grounds for thinking both will exceed initial projections.

As for defence, announced plans for the Australian Defence Force are unaffordable within present funding projections. And published estimates of the structural deficit ignore likely multi-billion-dollar losses on Labor's National Broadband Network.

In short, wherever one looks, we are making promises to each other that we cannot keep. Sure, to avoid facing that fact, we could continue borrowing, in an inter-generational Ponzi scheme ultimately doomed to collapse. But it would be far better to start on fiscal repair while the task is still manageable. The question is how.

Unfortunately, history shows that fiscal consolidation (the economist's term for balancing getting and spending) is anything but easy. All too often, the pain it causes is visible, immediate and concentrated, while the gains from bringing the public finances under control are difficult to grasp, long term and diffuse. Concerns about depressing economic activity then add to governments' reluctance to act.

Sudden changes in circumstances - unexpected upswings that ease fiscal pressures, or severe downturns that make the costs of consolidation difficult to bear - can and frequently do throw even well-designed fiscal reforms into disarray.

Little wonder consolidation has generally required multiple attempts. Even Margaret Thatcher's first effort in 1980 came badly unstuck, and it took until the 1984 budget for her government to make significant headway. Equally, Canada's efforts in 1985-91 failed, with fiscal consolidation occurring only as of 1994-95. And Bill Clinton's relative success in 1993 followed debacles in 1985 and 1990.

Moreover, even when progress is made, governments readily slip back into profligacy. Malcolm Fraser, for example, did little to improve the structural fiscal position, but what little he did was more than undone in his final budget, of 1982-83, which took public spending as a share of GDP to record levels.

The Hawke government performed better, its landmark 1986 budget achieving a real fall in expenditure; but that proved fleeting, as subsequent surpluses came from previous savings and rapid economic growth, before Labor's return to persistent deficits.

As for the Howard government, its efforts were heroic and enduring, but also ebbed as its life came to an end, with the Rudd government then frittering away the inheritance.

That reversing a fiscal course is so difficult only underscores the long-run costs of fiscal profligacy. But four important lessons can be drawn about the factors that make for success.

The first is to tell the truth - not merely about the mess the preceding government left but also about one's own decisions and their likely effects. The Thatcher government's early shift to a multi-year fiscal framework, which the Hawke government imitated by publishing forward estimates of outlays in 1983, made fiscal policy far more accountable.

The move in Hawke's 1987-88 budget to separately identify the impact of policy changes on spending took that forward a step, as did improvements in the Howard years, including the intergenerational reports. And the use of fiscal rules, beginning with the Hawke trilogy in 1984, provided a standard, however imperfect, for judging outcomes.

Since then, however, we have gone sharply backwards in the budget's quality and credibility. Combining short-sightedness with a lethal dose of ignorance, Labor has time and again ignored its own fiscal rules, bringing the whole concept into disrepute. And while all governments play budget tricks, few, if any, have gone as far as this one in presenting estimates so implausible that they can only be designed to mislead, with last week's statement plumbing new depths.

But as Peter Walsh, Hawke's outstanding finance minister, said: "Whatever one believes about the morality of telling lies, it is just not sensible to use dodgy figures, for a government which lies to delude the public ends up deluding itself."

A second lesson is that it isn't enough to trim the sails; one must redesign the boat. Obviously, that principle shouldn't lead us to ignore immediate savings: the fact the commonwealth's salary bill, after falling in real terms from 2002 to 2007, has risen by $1.6bn each year under Labor suggests there is plenty to be done.

But the greater the extent to which fiscal consolidation changes the shape of government, dropping areas of spending that cannot be justified, the more long-lasting its effects. And where expenditure areas remain, it is crucial they be subject to spending caps aligning their growth with that of long-term revenues. That can be achieved only if automatic adjustment mechanisms are built into major entitlement programs.

Labor's decision to gradually increase the pension age was sensible. Extending that decision, we should follow the Nordic countries in providing a gradual, automatic link between pension age and life expectancy, and between the pension's growth across time, national income and the tax base.

Equally, efficiency and equity in health spending would be enhanced by moving from our present mess of user charges to predictable, consistently set co-payments that increased automatically as incomes rose and could be covered by insurance - with an expanded role for insurance giving a means of placing downward pressure on costs, as recommended by the Rudd government's National Health and Hospitals Reform Commission.

A third lesson is that growing the economy is one of the most effective ways of achieving fiscal sustainability. Indeed, taking the major fiscal consolidation efforts in the advanced economies since the 1980s, each one percentage point of higher growth has improved their eventual fiscal outcome by 0.5 per cent of GDP.

As Germany found with its 2003 "Agenda 2010" structural reforms, which tackled rigidities in the labour market, removing unnecessary regulations can yield fiscal dividends t not only as large as those from tax hikes but more enduring, as they are less likely to be dissipated in costly compensation packages and in other pressures for increased spending.

Fourth, but perhaps most important, fiscal consolidation is an exercise in politics, purpose and persuasion. The great economic reformers of the 80s - Paul Keating in Australia, Roger Douglas in New Zealand, Miguel Boyer Salvador in Spain, Kjell-Olof Feldt in Sweden and Britain's Nigel Lawson - were all seasoned politicians, capable of rescuing from the debilitating squabbles of everyday democracy a politics of courage and imagination. They used that ability to confront decisions it would have been all too tempting to continue postponing.

But a return to fiscal sustainability is not a matter of leadership alone. It requires an informed debate. Instead, we are treated to the shrill silliness of Kevin Rudd's scare campaign about the GST.

There is no known vaccine against the risks posed by a man as consumed by means as he is barren of ends; and Rudd has repeatedly shown he has no interest whatsoever in fiscal sustainability. But Rudd's failings should not blind us to the role that could be played by institutions that help build a base for sensible fiscal policy. Britain's recently established Office of Budget Responsibility could provide a useful template for expanding the Parliamentary Budget Office. And there is also a great deal to learn from the Swedes, whose fiscal sustainability commission includes former senior economic ministers from both sides of politics.

Few things in life are certain; but one certainty is that what cannot last, will not last. Were our present fiscal settings to persist, the only question would be how painful the end proved to be.

The key question in this election must therefore be whether our public finances are placed on a basis that enriches, rather than impoverishes, the Australians of the future. Unless that happens, only more broken promises and dashed hopes lie ahead.

Empty words

On November 23, 2007, Kevin Rudd told The Australian he would take a tough line on border security and turn boats back. "You cannot have anything that is orderly if you allow people who do not have a lawful visa in this country to roam free."

Status: Failure.

The May 2010 budget forecast a surplus of $1 billion in 2012-13. This date was brought forward from an initial return to surplus timeline of 2015-16. "We now expect a surplus in three years," said Wayne Swan.

Status: Failure.

In August 2007 Rudd said he was prepared for the commonwealth to launch a takeover of the nations' public hospitals to eliminate duplication and buck-passing: "I believe the mood of the nation is that we need to ask the Australian people for a mandate to take commonwealth responsibility for full funding for public hospitals."

Status: Failure.

Rudd pledged to introduce an emissions trading scheme and claimed climate change was the greatest moral challenge of the era. In April 2010 Rudd opted to delay the ETS because of Coalition opposition, breaking his biggest election promise.

Status: Failure.

In his first term, Rudd committed to a $1.2bn strategy to halve the rate of homelessness by 2020. He has since pledged to revive this 2008 promise.

Status: Tough ask.

Rudd promised to "fix the federation" through a new co-operative federalism. But the COAG process has been bogged down for several years and the former chairman of the COAG reform council has said the commonwealth government must share responsibility for the dysfunctional "failure" that COAG has become.

Status: Some progress made.

Rudd promised to increase competition power for consumers via GroceryChoice and bring greater competition pressure on to petrol retailers via FuelWatch. GroceryChoice website was ditched in 2009 and the government walked away from FuelWatch after it was defeated in the Senate at the end of 2008.

Status: Failure.

Rudd campaigned hard on a pledge to build 260 childcare centres on school grounds at the 2007 election. The pledge was quietly dropped in April 2010.

Status: Failure.

Rudd signed off on a $2.45bn scheme for home insulation to help stimulate the economy following the global financial crisis. The scheme was shelved in April 2010 after it was linked to four deaths, 224 house fires and up to 1000 electrified roofs.

Status: Failure.

Labor said there would be full consultation with the mining industry before the implementation of the resources super-profits tax. The announcement of the scheme in 2010 caught the industry by surprise and triggered a major advertising campaign that helped sink Rudd's political fortunes.

Status: Failure.