

## THE AUSTRALIAN

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HENRY ERGAS THE AUSTRALIAN MAY 12, 2014 12:00AM

**“IT was not intended to make anyone giggle,” treasurer Arthur Fadden said of his “horror budget” of September 1951. The wool boom unleashed by the Korean War had nearly trebled the terms of trade, adding a massive 7 per cent to real gross domestic income. With unemployment falling below 1 per cent of the labour force, the inflation rate had risen to an all-time high of 25.6 per cent and seemed likely to increase further. Yet by 1953 inflation had plummeted to less than 2 per cent, setting the scene for two decades of solid economic growth.**

Slashing spending and increasing taxes, Fadden’s budget had shocked the economy back on track. Even by today’s standards, the fiscal turnaround was immense, all the more so as some 60 per cent of the change came from expenditure reductions; a spending cut affecting the same share of government outlays now would eliminate Labor’s deficit at a stroke. The 1951 budget required extraordinary political courage, but Fadden’s Australia was a different country. Post-war prosperity had neither healed the scars nor eliminated the culture of sacrifice forged by years of depression and war. And with communism in Europe and Asia threatening a global conflagration, Australians were prepared for hardship.

Today’s voters, in contrast, have been shaped by 23 years of continuous growth. And with class and religion ever less significant in determining political allegiance, electorates are far more volatile and far quicker to punish what they perceive as mistakes. Governments therefore have less room for manoeuvre, and there are many respects in which the political constraints on Tony Abbott are especially severe.

After all, according to the Australian Election Study, Abbott’s approval ratings at the 2013 election were the lowest the poll has ever recorded for the winner of a federal election. If Australians chose Abbott, it was at least partly because Kevin Rudd’s approval ratings had reached historic lows for a Labor leader during an election campaign.

And despite the Coalition’s victory, voters were no further to the Right on major issues, with the proportion supporting higher spending on social services nearly twice that when John Howard came to office in 1996. However dire the fiscal outlook, a buoyant economy kept expectations high, in contrast to the sense of crisis that facilitated the fiscal consolidations of 1987-89 and 1996-99.

Little wonder the Coalition felt obliged to endorse so many of Labor’s major spending programs, while adding promises of its own. And little wonder, too, that calls for a fiscal bloodbath tomorrow bring to mind Robert Lowell’s great hymn to Calvinist despair *After the Surprising Conversions*: “Cut your own throat. Cut your own throat. Now! Now!”

Not that the risk of political suicide will placate those commentators who would be happy to see the Coalition pay the price of correcting Labor’s mistakes, or silence the purists who contemplate losing power with the relish of an anchorite hankering for the solitude of his cell. But the essential pragmatism of the Australian liberal tradition means Abbott and Joe Hockey can and should brush those calls aside. And it also means fiscal machismo cannot be the measure of tomorrow’s budget; rather, it must be the credibility of its strategy for achieving fiscal repair.

Crucial will be whether expenditure cuts involve mere slicing, which is likely to be reversed as the political cycle unfolds, or start refashioning major spending programs on to a sustainable footing; and crucial, too, will be the balance between spending reductions and revenue increases.

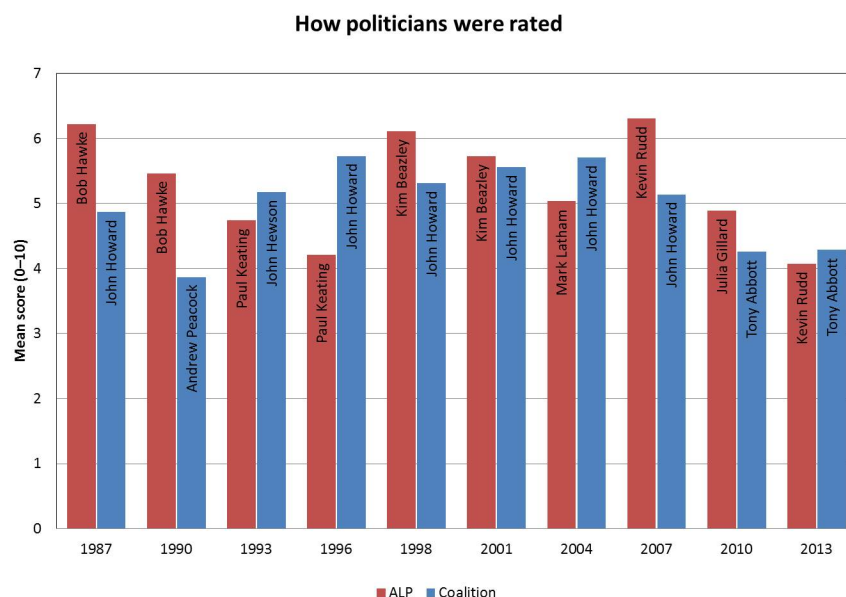
To say that is not to endorse tax slugs, but successful fiscal consolidations always involve action on the revenue side, with policy changes that increased revenues accounting for about a quarter of the budget turnaround the Howard government achieved in its first three years in office. However, the quality of those increases matters every bit as much as their magnitude.

The proposed “debt levy” on the highest income earners is a case in point. Here, too, international experience has its lessons, with several European countries imposing surcharges on top incomes in the wake of the GFC. But as taxpayers altered their behaviour, the revenues raised were invariably well below initial projections.

A simple calculation is telling. Assuming no behavioural change, raising the top marginal rate from 46.5 per cent to 49 per cent for those earning above \$180,000 would increase annual income tax collections by about \$1.2 billion. However, if the response in Australia parallels that in Britain, instead of rising, taxes collected from top-income earners could actually fall by up to that amount. Nor is it difficult to see why: 30 per cent of the top taxpayers in Australia are 55 or over, so are making choices about how long to continue working; nearly a third are in occupations which have substantial discretion over the timing and form of income; and a majority have sources of non-taxable income which offer opportunities for rearranging tax liabilities. But while reducing the tax take, all those adjustments impose steep economic costs, with each dollar raised shrinking national income by at least 50c.

It would therefore be more sensible to reduce the tax-free threshold instead, ultimately ensuring all Australians made some contribution, however small, for the government services they receive. And lowering the threshold would be far more effective than a levy in raising revenue from higher income earners as well.

But like the audit commission’s myriad proposals, that requires a public understanding that is still to be built. It is whether their budgets help form that understanding that will be Abbott’s and Hockey’s real test. For leadership in a democracy is the art of making the necessary possible. Until they rise to that challenge, durable fiscal consolidation will be elusive, and the politics of budgets will remain mired in the choice between the merely unpalatable and the truly disastrous.



Source: Trends in Australian Political Opinion, ANU College of Arts and Social Sciences, 2013