

## THE AUSTRALIAN

# Bitter medicine for starters: Hockey must now finish the job

HENRY ERGAS THE AUSTRALIAN MAY 17, 2014 12:00AM

### Promises and delivery – Swan's budget speeches v fiscal record

Swan's budget night speech promise	Actual outcome
<b>2010-11</b> "A strategy that will see the budget return to surplus three years ahead of schedule, and ahead of every major advanced economy."	Cumulative deficits totalling \$112 billion in 2010-11, 2011-12 and 2012-13.
<b>2011-12</b> "We are on track for a surplus in 2012-13, on time, as promised."	Actual outcome in 2012-13 was a deficit of \$18.8bn, or 1.2% of GDP.
<b>2012-13</b> "The four years of surpluses I announce tonight are a powerful endorsement of the strength of our economy, resilience of our people and success of our policies."	No actual or forecast surpluses across the four years, rather deficits totalling \$115 billion from 2012-13 to 2015-16.
<b>2013-14</b> "Speaker, tonight, we put in place the savings to fully fund these priority investments (Gonski, NDIS for 10 years and beyond, an achievement unprecedented in our nation's history."	"In this 'business as usual' scenario the commonwealth's budget remains in deficit out to 2023-24 and beyond." National Commission of Audit 2014.

### The Fiscal Consolidators, the best of the best

Government	Best 4-year fiscal consolidation	Average annual fiscal real spending consolidation growth (% GDP deflated)	Fiscal consolidation (% GDP)
Labor	1985-86 to 1988-89	-0.2	4.1
Coalition	1996-97 to 1999-00	1.6	4.1
Labor	2010-11 to 2013-14	3.0	1.1
Coalition (f)	2014-15 to 2017-18	2.0	2.9

Note: Fiscal Consolidation is defined as the turnaround in the deficit as a percentage of GDP

Source: Commonwealth Budget Papers

Promises and delivery. Source: TheAustralian

**HAVING failed at the art of fiscal management, Labor has now descended into its kitsch. Time and again, Labor heralded a return to surplus, only to leave the country drowning in red ink. Reduced to the last refuge of the profligate, Bill Shorten's budget reply speech ignores the problems altogether, offering yet more promises built on a marsh of unreality.**

But that is not to say Shorten's claims about the budget won't resonate. After all, Joe Hockey's budget contains plenty of bitter medicine, with the polls showing more than 80 per cent of Australians expect to take a hit.

Yet the fiscal turnaround the budget projects looks relatively small, achieving about two-thirds the deficit reduction the Hawke and Howard government consolidations secured over a four-year period. Expenditure growth also remains higher than in earlier consolidations, while the expected fall in the ratio of government spending to GDP ratio is about half that which occurred from 1996 to 1999.

In part, the relatively small budget turnaround is the result of not comparing like with like. Inflation tends to increase nominal GDP more rapidly than it increases government spending; to that extent, relatively high rates of nominal GDP growth in earlier years themselves tended to reduce the ratio of spending to GDP. Correcting for that factor brings the consolidation Hockey's budget undertakes much closer to that under Hawke and Howard. But there are also structural forces at work. The Rudd and

Gillard governments went to unprecedented lengths to lock-in rising spending, sharply reducing the new government's room for manoeuvre.

And they deferred the greatest increases to the years beyond their own budget projections, with real outlays due to rise by a near record 5.9 per cent in 2017-18 alone. With the Coalition's own election promises adding to the woes, the Abbott government faced a "counterfactual" (what would have happened without policy change) that was especially challenging.

At the same time, the politics of curtailing public spending have become ever more daunting as the growth of government ensures a steadily greater proportion of the population receive benefits in one form or the other. Each attempt at reining in spending consequently touches more and more of the electorate, making removing entitlements like peeling the bandage off a gaping wound.

The increasing reach of public spending is readily illustrated. In 1957, no public pension was paid to anyone with assets worth more than £1750 (\$50,000 at today's values); 10 years later, that had risen to \$5200 (some \$60,000 today). Although differences in eligibility tests make direct comparisons difficult, the current threshold is some 10 to 15 times greater. Nor has compulsory superannuation yet reversed the trend to broader eligibility, with the share of the population 65 and older currently receiving a public pension 10 percentage points higher than it was in 1989.

As other programs have also expanded, the result is that two in three Australians now obtain some social benefit payment, with healthcare then bringing the share to virtually 100 per cent. Quite regardless of its political consequences, that means every major change to social programs can disrupt the financial plans of vast swathes of the electorate, creating understandable anxieties and imposing adjustment burdens.

As those burdens are real costs, the desirable rate of consolidation may be slower than it once was, even though the overall consolidation required is large.

The budget's tough but measured approach consequently makes economic and social sense. But that won't stop Shorten's fear campaign, with its outlandish claims. It is, for example, simply incorrect to say the government has jettisoned the Gonski funding model; on the contrary, funding will be distributed among the states and territories on the basis of need, assessed using the equity metrics developed in the Gonski reforms. Rather, the change the government has made is to eliminate the anomalies that came from Julia Gillard's rush to cut a deal. That led to agreements that locked in permanently higher commonwealth funding to the jurisdictions that had previously spent relatively less on schools, while equally permanently penalising those that had spent more. Instead, from 2018, all jurisdictions will receive the same proportion of the Student Resource Standard, adjusted for factors such as socioeconomic disadvantage and disability.

What is true is that the aggregate amount of commonwealth spending on schools will not rise as rapidly as Labor's unfunded promises entailed. But by 2018, commonwealth funding of government schools will be 36 per cent higher in real terms than in 2014 and more than double its level in 2003. There is consequently every reason to bring growth back towards normal levels, while assessing the impacts the sustained funding increase has had.

Similar issues arise in health, where commonwealth spending has been rising by some 5 per cent a year in real terms. Moreover, while more than four-fifths of the net growth in health expenditure per capita over the period from 1995 to 2010 reflected growth in GDP, population ageing will increasingly drive spending going forward, increasing the strain financing health outlays imposes on the budget.

The moves the government has made to deal with all those pressures do not cut social spending in real terms, but they do dramatically slow its rate of growth. Under Labor, real per capita social spending was set to exceed \$11,000 by the end of this decade; under the budget's strategy, the annual growth rate of per capita social spending is reduced to barely 0.4 per cent, less than one-fourth the trend increase Labor had left behind and well below the historic average. Achieving such a slowing is a substantial achievement, all the more so given the momentum Labor cemented into public expenditure. It is therefore difficult to understand those commentators who criticise the budget as unduly soft on spending and unduly reliant on revenue increases. In fact, taking the forward estimates as a whole, the 70 plus per cent share of the fiscal effort accounted for by tougher spending policies (rather than higher taxes) is similar to that in previous consolidations and compares extremely favourably to successful fiscal consolidations overseas.

But it would be premature to give the government the good housekeeping seal of approval. Rather, it must now show it can hold the line, including in terms of how it copes with the blowback coming from the states. That requires it to accelerate the white papers it has promised on tax and federalism, which should at least set out a framework for placing taxing and spending on a more rational basis. Instead of heavy-handed expenditure controls, the government must progress fundamental reform of key spending areas, including health and retirement incomes, in ways that meet community expectations.

This is also the time to push forward with reforms that can increase our long run growth potential. Yes, infrastructure projects can contribute, so long as they are rigorously selected and properly implemented; but it will take much more than that to facilitate the economy's transition from the high investment phase of the resource boom. Rather, reviewing and reducing the regulatory burden is crucial, and nowhere more so than in the labour market.

Labour market reform is perhaps the most pressing issue Australia faces. It is not merely inefficient to push young people into a labour market that lacks the flexibility needed to absorb them: it is also inequitable. Having shown the courage to address the welfare system, the government must rise to tackling our dysfunctional industrial relations system.

What is now clear, and that was by no means obvious before the election, is that the Coalition has the ticker required. Not that the task will get any easier; and Labor will only get more obstructionist as the pressures build. But with Hockey having gotten the job well started, the government must marshal the persistence to get it done.

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