THE AUSTRALIAN

Apocalyptic claims need to be put into perspective

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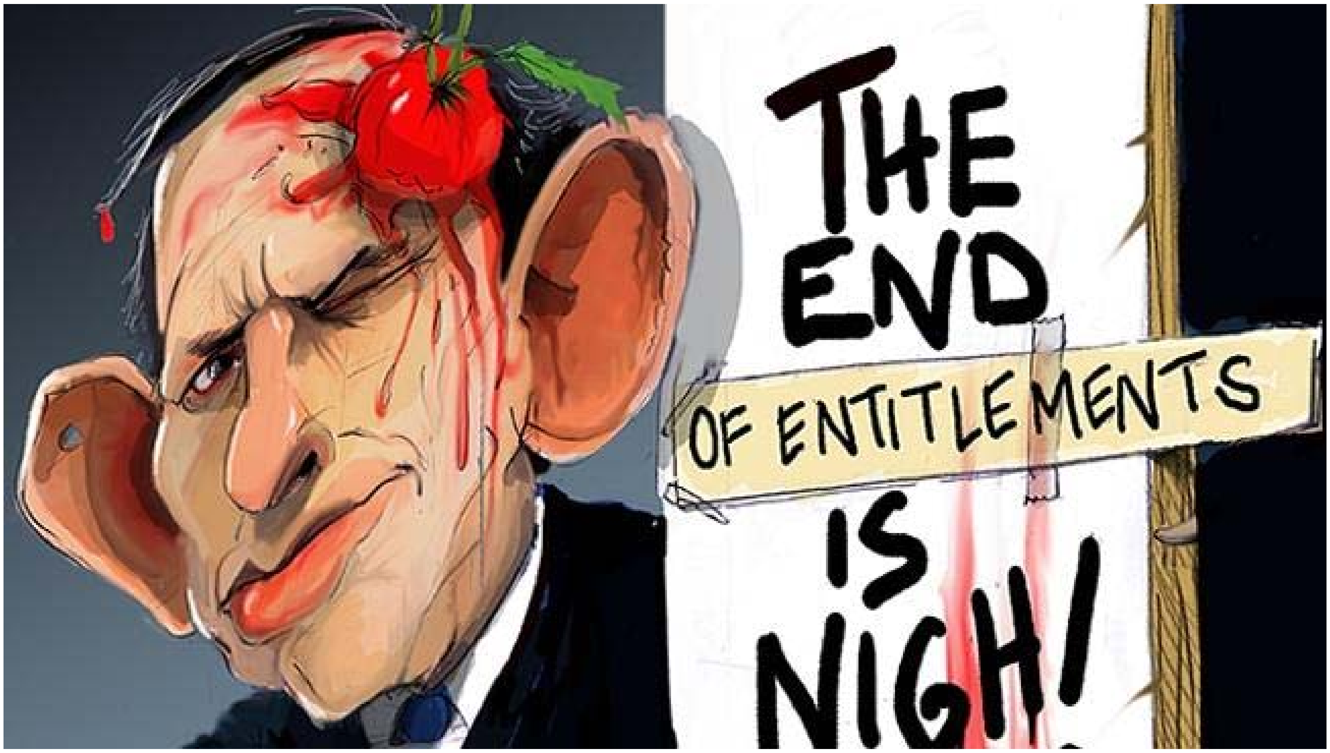

Illustration: Eric Lobbecke Source: Supplied

TOUGH but measured. So far, however, only the toughness has registered with voters. That the budget is measured has been drowned out by the shouting.

And there is no shortage of material fanning the hysteria. As the headlines proclaimed this week, an analysis by the National Centre for Social and Economic Modelling (NATSEM) finds a raft of changes to welfare payments will cost the poorest 20 per cent of families $2.9 billion over the four years to 2017-18, with lone parents especially hard-hit. In contrast, in 2017-18, the year the levy will expire, the richest quintile of households will be better off.

Those numbers, which were commissioned by the ALP, are iffy: that explains why Labor, though feeding the report to the ever-sympathetic Fairfax press, has covered up the problems by refusing its release, just as it did with the similarly apocalyptic report it had NATSEM produce in 2007.

But even putting aside those problems (which are discussed below), the apocalyptic claims need to be put into perspective. To begin with, instead of being slashed to the bone, welfare spending continues to rise by 2.5 per cent annually in real terms until 2017-18, while total real public spending increases by 3.6 per cent a year. Spending therefore grows at rates well above those in Labor's own fiscal consolidation in 1987-89 and in that the Coalition undertook from 1996 to 1999.

No wonder Treasury secretary Martin Parkinson has described the 2014-15 budget as imposing only a "modest" consolidation over the next three years. Instead, the vast bulk of the turnaround occurs in

2017-18, with the savings measures in that year accounting for nearly 60 per cent of the tightening over the four-year period.

The bottom line tells the tale: both the Hawke and Howard consolidations returned the budget to surplus in two years; this budget does not achieve a significant cash surplus before 2019-20, by which time Australia will have had an unprecedented 10-year run of fiscal red ink.

Even taking full account of the savings in 2017-18, the reductions in individual programs could hardly be described as ferocious. Far from the “brutal and cruel cuts to schools” Bill Shorten has denounced, commonwealth funding of government schools in 2018 will be 36 per cent higher in real terms than this year and more than double its level in 2003.

As for health, rather than “ripping billions and billions out of hospitals”, as Penny Wong has claimed, real commonwealth spending on hospitals in 2018-19 will be 40 per cent to 50 per cent higher than it was in 2002-03, and 15 per cent to 20 per cent higher than in Labor’s last year in office.

Despite what Chris Bowen has colourfully described as “the destruction of Medicare”, the “savage cuts” leave the growth rate of spending on medicines unchanged while actually increasing the nominal annual growth rate of spending on medical benefits to 2023-24 from 5.8 per cent to 6 per cent. Of course, none of that takes away from the nasties, but their impacts are mostly small.

Indexing the fuel excise, for example, is likely to increase the average motorist’s petrol outlays by 50c a week in the next two years: an amount equivalent to 0.03 per cent of average weekly earnings. The changes to welfare benefits for young people are more substantial, but they are intended to be as their aim is to encourage recipients to get a job.

Even NATSEM’s much-quoted estimates rise to heights worthy of A Nightmare on Elm Street only by multiplying relatively small numbers (the effects on individual families) by a very large number (the number of families) and then cumulating the impacts over four years.

Unpicking that tangle is impossible without access to NATSEM’s analysis but the press report implies an average annual income loss per family in the bottom quintile is $290 a year — an amount that could be replaced by working two days at the minimum wage. But NATSEM, despite plenty of evidence to the contrary, seems to assume there will be no such response.

Nor does it pay any attention to the counterfactual: what would happen were fiscal repair postponed into the never-never. After all, that is what Labor, which commissioned NATSEM’s work, appears to have in mind, given that it has proposed no policies for returning to surplus.

As a result, NATSEM’s study should have compared the outcomes under Joe Hockey’s budget with those under the drastic fiscal consolidation Labor’s approach would ultimately require.

As it happens, fiscal crises have been so common in recent years that NATSEM would have had no trouble showing that the costs of delay would be extremely high, and especially so for the poorest and most vulnerable.

For example, the drastic consolidations accompanying fiscal crises since the GFC have typically involved increases in unemployment of at least four percentage points for five years or more.

But a mere rise in unemployment of 40,000 people for four years, which is one-tenth the rise likely to occur in a severe fiscal crisis, would inflict costs of about $3.2 billion on some of the most disadvantaged: a loss one-third greater than the $2.4bn NATSEM's analysis laments.

And as Wong used to say, albeit in a different context, the longer we delay, the higher the costs will be.

But why then is the backlash so pronounced, even compared to that which accompanied the harsher cuts of 1996?

In part, that reflects the Abbott government's weaker initial position.

When John Howard was elected in 1996, the Australian Election Study found his approval rating was one-third higher than Paul Keating's; in contrast, at last year's election, Tony Abbott's approval rating was barely 5 per cent above Kevin Rudd's.

With a weaker base of support to build on, Abbott has been forced to spend political capital he doesn't have.

Moreover, public opinion has moved in a direction that makes selling fiscal repair much harder. When Howard came to office, 17 per cent of the electorate favoured spending more on social services, while 57 per cent wanted to see taxes cut; so for every voter preferring an increase in social spending, three voters gave greater weight to tax reductions. But by the time Abbott was elected, that three to one ratio had fallen to 1.2 to one.

The "spirit of expenditure", as William Gladstone famously called the tendency of rising spending to "insensibly and unconsciously" become entrenched in the public's expectations, has well and truly seized the nation. No doubt, the prosperity of the resource boom has helped that occur; but so has a longer-term shift in the composition of the electorate.

The number of recipients of age and disability pensions has increased by slightly more than one million since 1996; and two in three Australians now obtain some social benefit payment, with healthcare then bringing the share to virtually 100 per cent. At the same time, the expansion in public spending has been accompanied by a five percentage point rise in the share of the labour force whose employment depends on government, with 1.4 million more Australians in those jobs than in 1996.

For both those groups — the recipients of benefits and the employees reliant on taxpayer funded jobs — reductions in public spending are a natural source of anxiety, which the phasing of the cuts does little to assuage.

Together, those groups constitute a formidable, readily mobilised, lobby against reductions in outlays; and with real wage growth slowing and unemployment trending up, it is not surprising their outrage has resonated more broadly.

That the cuts can so readily be portrayed as unfair then greatly aids the opponents' cause. And the reality is that spending cuts will almost inevitably focus on low-income earners: not because the Coalition is uncaring but because they receive the bulk of public spending.

The facts are clear: despite the incessant bleating about middle- class welfare, strict means-testing of welfare payments ensures the poorest 20 per cent of Australians get more than 40 per cent of income transfers; the richest 20 per cent receive less than 3 per cent.

The poorest fifth therefore receive 12 times as much in cash benefits as the richest fifth, by far the highest ratio in the advanced economies.

When spending is allowed to get out of control, it is consequently on the relatively poor, who are the main recipients of public expenditure, that the burden falls.

Sure, the budget tries to be faithful to Dion Chrysotom's exhortation that "when all pay their share, the burden to each is light"; but in spreading the pain widely across programs and beneficiaries the government may simply have multiplied the number of voters it has antagonised.

To all that, the critics' answer is simple: instead of cutting spending, tax the rich. But income taxation — our largest revenue source — already bears almost entirely on middle and upper-income earners.

And it is complete nonsense to claim the wealthiest get off lightly.

On the contrary, the effective average tax rate on Australian top income earners is three percentage points higher than that in Canada, five percentage points higher than that in Sweden and 10 percentage points higher than that in the US.

With the top 1 per cent of taxpayers collectively paying 40 per cent more tax than the bottom 50 per cent, those the Left wants to soak are well drenched.

In turn, the steep effective tax rates on high incomes impose substantial economic costs in lost jobs and deterred investment; raising them further, as the debt levy will, is likely to yield little revenue while materially increasing the damage.

Nor are there any especially attractive options for expanding the revenue base.

It is easy to say superannuation concessions for high-income earners should be reduced, but our effective tax rates on long-term retirement savings are already high.

As for scrapping negative gearing, it would inefficiently impose double taxation on property investment, further distorting housing markets.

And yes, there are issues associated with the taxation of trusts, but they are mired in practical difficulties it would take years to resolve.

Like the GST, these are areas that cry out for well-designed tax reform, not unlocked doors ripe for the fiscal burglar's midnight grab.

The Coalition has therefore faced a dilemma. Fiscal repair requires spending reductions, but those involve political costs that are even greater today than they were in the past.

Its response has been to emit a bark much worse than its bite, yet the price it is paying suggests the bark has proved every bit as fearsome as a far more savage bite would have been.

Doubtless, hindsight will reveal many flaws in the government's tactics.

The government's tradecraft has at times looked artless: it is, for example, disconcerting that Labor's claims have gone so largely uncontested; and perhaps more should have been done to prepare the Coalition premiers for the shock that was coming.

But that is water under the bridge, and the real test is whether the government can ensure that "tomorrow is another day", as Scarlett O'Hara said, while nonetheless staying the course.

Morley, Gladstone's devoted colleague and biographer, considered the key to that great reformer's success “his signal distinction of creating the public opinion by which he worked, and forming the climate in which his projects throve”.

As the Prime Minister and Treasurer know all too well, that has proven much easier said than done; given the firestorm, they will now need to do it that much better.