

The Australian

Ending waste even more important than deficit

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THE trouble with the budget is not that it will be a curate's egg. It's that the government can take no responsibility for the parts that are good but is all too responsible for those that are rotten.

The good part, after next year, is on the revenue side of the ledger. But for that, thank China and Brazil: China, the hungry giant, for its insatiable demand for resources; Brazil and other Third World suppliers of resources, for rigidities that constrain production, helping to drive prices sky high.

With 20 years of economic reform making us somewhat better placed to respond, those high prices are manna from heaven.

So the budget revenues are Made in China. What the government does control, however, is spending. And here the record is clear. Until 2007, Australia's largest peacetime expansion in public spending occurred under Whitlam, who in three budgets increased per capita outlays by \$1780 in today's prices. Kevin Rudd took only two budgets to raise spending by \$1820 per man, woman and child.

Since then, spending has increased further, and even if real spending growth is limited to 2 per cent a year for the next three years, commonwealth outlays will be \$2200 higher a head than when "the real fiscal conservatives" were elected.

Public spending is hardly necessarily bad. But it's certainly bad when it's wasteful. Many Howard government programs were nothing to write home about. But Rudd, Gillard and Swan have given reckless spending a whole new meaning.

Nor does the much trumpeted fiscal stringency seem set to bring improvements.

Consider health. Here the government will curtail spending by not listing on the pharmaceuticals benefits scheme new medicines recommended by its expert advisory body. But new medicines are one of the few areas where tough cost-effectiveness tests are rigorously applied.

So those recommendations, which do meet stringent cost-benefit criteria, will be ignored so as to continue spending on favoured constituencies.

That the quality of public expenditure is so low is far more troubling than the deficit. Imagine you have \$100. To spend \$150 on an investment that, net of interest costs, yields \$200 you incur a deficit, and hence temporarily increase debt. But that investment increases wealth by \$50, so the debt is well worth incurring. Alternatively, take \$99 from the \$100 and burn it. No deficit, no debt: but you and future generations are plainly poorer.

Of course, this government has wasted resources and left future generations the bill. But it is the waste, not the mere fact

that some of it is debt-funded, that is deplorable. And that windfall revenues will help cut deficits is no achievement if the waste continues unabated.

That is not to say that debt and deficits are of no concern.

The reality is that the commodity boom makes our economy richer but riskier. And it does the same for the federal budget. Taxes on company profits account for more than 20 per cent of Australian tax revenues: more than twice the average for the advanced economies. And even before the new mining tax, a quarter of those taxes come from mining, though mining accounts for less than 8 per cent of value added.

Historically, company profits have fluctuated twice as much as consumption: so a tax system weighted towards company profits, rather than to consumption taxes, will be especially volatile. And for the economy to adjust to commodity price shocks, mining profits and related incomes must swing by more than the terms of trade, adding to volatility. Without the buffer of surpluses in good times, the bad times, when they come, will be that much tougher.

Good thing then that in the 2008-09 budget, Swan committed the government to "achieving surpluses, on average, over the medium term". But taking 2007-08 as the starting point, the government needs average surpluses of 3 per cent of gross domestic product in each of 2014-15, 2015-16 and 2016-17 to meet its promise.

However, the highest post-war surplus on record, in 1970-71, was of barely 2 per cent. And a string of massive surpluses would be unprecedented. It is all the less likely from a government that can't say boo without flinging billions to every squeaky wheel.

Medium term budget balance is therefore hardly assured. Yet even more worrying is the longer term. Since 1970-71, spending has grown at a trend annual rate of 4 per cent while revenues increased by only 3.3 per cent. And the Intergenerational Reports have shown that taking the tax share of national income as constant, population ageing will make current policy commitments increasingly unaffordable.

In the 2007 IGR, permanent deficits began in 2020; by assuming a "Big Australia", IGR 2010 postponed the crunch to 2029. But even using IGR 2010, the present value of the shortfall, from today to 2049, could be about \$350 billion.

That is the number a listed entity would have to disclose. But what we are likely to get in the budget is more accounting tricks.

This government is not the first to resort to such chicaneries. Rather, international studies confirm that the more stringent the fiscal rules, the greater are governments' efforts to massage the numbers. Effective oversight is therefore all the more important. Getting a properly resourced parliamentary budget office established, rather than just talking about it, could help.

But why not follow the Swedes, and now the British, in having an independent fiscal commission, reporting to parliament on the quality and sustainability of public expenditure? That the Swedish commission has former ministers from both main parties, and a deputy chair who is a leading foreign economist, has helped cement its reputation for dispassionate, rigorous analysis.

The secret of success in Hollywood, said Bertolt Brecht, is to promise a happy ending. So too with budgets, and this week's will be no exception. But fairy tales are not what this country needs. It needs a government with the courage to face facts, admit mistakes and genuinely lift its game.

Those are not qualities the government has shown to date. Let's hope tomorrow's budget brings better.

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