

How the bean-counters took over the campaign

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There is an anomaly at the heart of this election campaign. Although Kevin Rudd's Labor continues to enjoy a strong lead in the polls, Labor scores poorly in response to the Newspoll question on which party would best handle the economy. On that dimension, Labor scores only 29 per cent against the Coalition's 53 per cent.

In light of the economic performance of the Howard Government, it is strange that anyone would give it a passing grade. While Australia has had a period of high growth, low inflation and falling unemployment during the Coalition's term, this good fortune can hardly be attributed to sound economic management. As the CPD paper *Reclaiming Our Common Wealth* argues, Australia's continued prosperity is not assured.

We are living off our assets and mortgaging our future. A resources boom and the delayed benefits of the economic reforms of the Hawke-Keating years have given Australia an easy ride over the last ten years. To borrow a line from Bill Hayden, even the "drover's dog" would have had difficulty in messing it up.

Unfortunately, only now are warning signs emerging. Our worsening inflation is due in large part to our failure to invest in skills and to replenish our tired physical and social infrastructure. Blaming inflation on the drought and high oil prices only reinforces the point of policy neglect, for we have had plenty of warning about the need to put our agriculture on a more sustainable basis and to reduce our dependence on fossil fuels.

An indicator our Government does not want to mention is our current account deficit. It is extraordinary that even at the peak of the commodity boom, we have to import more than we export. We cannot count on the rest of the world continuing to lend us money to finance our habit of consuming more than we are producing.

It's not as if people are unaware of these economic shortcomings. Long before the September quarter consumer price index (CPI) was released, many Australians have been feeling the pinch of inflation in life's necessities, like school fees, health care, electricity and other household essentials. Price rises in these items have been offset by falls in more discretionary types of consumption such as overseas travel, household appliances and electronic gizmos. In fact, inflation would be higher if it wasn't for the Chinese economy, which not only buys our coal and iron ore, but also returns some of it in low cost manufactures. The worst inflation is in housing, but for technical reasons this is barely registered in the CPI.

Besides inflation there are many other signs of poor economic performance. Evidence of infrastructure neglect surrounds us whenever we drive on a highway or catch a suburban train. Our public schools and hospitals are under stress. People feel insecure in their employment, and are wondering why, if we are so prosperous, we have to work such long hours. Anyone can see the distortions in our economic rewards: the share of GDP going to wages compared to profits is at a 35-year low, executive pay continues to blow out, and our tax system rewards speculators and rich retirees. At the same time, poverty is becoming more entrenched. And our most precious asset - our physical environment - is being sorely stretched.

Perhaps we have come to take a narrow view of what is meant by "managing the economy". In an extension of the economic management anomaly, Labor scores well ahead of the

Coalition in education (50 per cent to 30 percent), welfare and social issues (51 per cent to 28 per cent), industrial relations (47 per cent to 34 per cent), health and Medicare (47 per cent to 33 per cent) and the environment (39 per cent to 25 per cent). These are all important economic matters, involving the allocation and distribution of scarce resources, but they don't seem to register with the public as having an economic dimension.

The likely explanation is that for the mainstream media and government spin doctors, economic management has been confused with what economists call fiscal management - in other words, the balance-sheet of public revenues and expenditures. So long as expenditure does not exceed revenue, our Prime Minister and Opposition Leader can both boast of being "fiscal conservatives" and "responsible" economic managers.

This narrow view is dangerous, because it fails to consider the purpose of public expenditure. The philosophy of fiscal management is that nothing matters apart from the monetary aggregates; it's all just public expenditure. A million dollars spent on a dead-end "road to recovery" in a marginal electorate has no more value than a million dollars spent on a vital transport link. A handout of middle class welfare like Family Tax Benefit A has no more value than the same amount spent on childcare, health or public education. A budgetary saving achieved by cost shifting is "good", even if it simply shifts the burden from taxes to individuals, and even if it has no effect on resource allocation.

The present government, in its *Charter of Budget Honesty*, has encouraged this way of thinking. This pre-election exercise in costing of election commitments takes a purely fiscal view of election promises. It does no more than to analyse the effect of policy proposals on the budget bottom line. There is no wider economic assessment of election promises and no distinction made between capital and recurrent outlays. Nor is there any assessment of the costs and benefits of various proposals. It is a purely fiscal exercise.

It's as if the authors of the *Charter of Budget Honesty* consider all government expenditure to be wasteful anyway. Therefore, the less government spending, the better, and if governments must spend money, they should never spend more than they raise. Private debt is good, public debt is bad.

In essence, what "economic management" has come to mean is the government's ability to manage the equivalent of a domestic cheque account. That has been an easy task for the Howard Government, taking office as Australia was in the upswing of a business cycle, and, in all probability, leaving office just as the cycle starts to turn down. If Labor wins it may have a much more difficult fiscal task ahead of it, for it could be taking over a weakened economy just as the business cycle turns down.

Not only does this narrow fiscal construction trivialize the whole notion of economic management, it also constrains the options for prudent government policy making - as Fred Argy points out in his recent CPD paper *Australia's Fiscal Straightjacket*.

If the incoming government faces a period of sluggish growth or a recession, it would make good sense to run a temporary budget deficit and to borrow to finance productive infrastructure. Worryingly, there is a risk that a future Rudd or Costello Government - committed to the mantra that the budget must always be in a cash surplus - will decide it is not politically feasible to practice sound counter-cyclical economic management. As a result, if we do run into a recession, it could be much more costly and painful than necessary.

The economic debate we should be having is about the structure of the Australian economy. How can we ensure prosperity once the commodity boom is over? What do we need to spend on our collective assets - our physical infrastructure, our human capital, our environmental assets - to ensure our economic resilience and international competitiveness? How can we restore proper incentives into our taxation and welfare systems to distribute the benefits of economic growth and to preserve trust in our reward systems? How can we restore household balance sheets with real, liquid assets and reduce the insecurity of personal debt? How can we supply housing in places where people want to live? How can we bring the excluded and marginalized into the mainstream economy?

These are all difficult tasks - much more difficult than managing a cheque account.

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