# Trusting Treasury: When to Say Yes, When to Say No

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Whoever is prime minister next year – Malcolm Turnbull, Bill Shorten, Julie Bishop, Tanya Plibersek or some yet-to-be revealed candidate – he or she will depend on the Treasury Department for economic advice.

When the economy is buoyant, as in the boom times up to 2008, governments can (and do) override Treasury advice. But in tough times, Treasury carries much more authority. Unless there is some Lazarus-type economic recovery in the near future, our next government will have to pay much more attention to Treasury.

We have a glimpse of the Treasury's direction in a speech last week by its new secretary, John Fraser. It's a worthwhile read, because, unlike the puerile partisan drivel dished up by Joe Hockey and Mathias Cormann, it's reasonably dispassionate and objective in its analysis, although its prescriptions for the Australian economy have a definite neoliberal bias.

Unfortunately, apart from a selective interpretation in the Financial Review, Fraser's speech got little coverage in the mainstream media, who, true to form, were far more interested in Parliament House gossip about Abbott's demise than with public policy.

While Hockey, Cormann and many journalists would have us believe that managing deficits and debt are all there is to economic policy, Fraser's speech starts (and ends) with a discussion about structural issues – the challenge of economic adjustment as the mining boom fades, the need to lift our productivity, and the need to restore trust in the financial sector (as a reminder of the tough times that lie ahead, on the same day his speech was released the Bureau of Statistics published dismal figures on expected new non-mining capital expenditure).

While Fraser's emphasis is on economic management, a large part of his speech is devoted to fiscal management, and he does not refrain from criticising past or present governments, regardless of their party label. Of course he doesn't name names, but in his coverage of the boom years of 2002 to 2008 before the GFC, he points out that:

> "… a very substantial amount was spent, including on untargeted transfers (so called middle class welfare) without sufficient regard to the future prospects for servicing those ongoing transfers.
>
> Generous income testing arrangements for Family Tax Benefits in the early 2000s and access to million dollar contributions to tax-preferred superannuation through 2006-07 were notable examples of middle or higher income welfare that contributed to the problem."

That's hardly an endorsement of the Howard Government's fiscal management, or of the present government's stubbornness in failing to attend to the loss of revenue resulting from superannuation concessions.

He goes on to point out that "an important criterion for a well-functioning tax system is fairness", and in this context mentions the perverse distributive effect of superannuation concessions. There will be some interesting discussions between Treasury officials and whoever is treasurer as the 2015-16 budget is prepared – will they feel bound by Abbott's promise not to change superannuation arrangements?

Most of Fraser's discussion on fiscal matters is about the deficit and debt, pointing out that unless economic growth can be lifted to and sustained at 4 per cent a year, there is no way the budget can be brought back to a balance by 2017-18, and that therefore, with present policy settings, the level of government net debt will rise. There's no sign of such a lift in economic growth: we have to go back to last century to see a sustained period of growth above 4 per cent.

Fraser doesn't join with the government in panicking over debt, however, pointing out that at 12.8 per cent of GDP Commonwealth net debt is still substantially lower than it was when we dealt with the early 1990s recession. But he does state the economically responsible orthodoxy that "we cannot continue to finance recurrent expenditure by continuing to increase our debt".

It's an important statement – one we should hope to hear from a treasurer or prime minister with the nous to engage in a "grown up" discussion with the Australian people. It does not preclude the normal practice of counter-cyclical spending and accumulation of debt when recession threatens, as practised by the Rudd Government (and by governments of both persuasions in past years). Nor does it preclude accumulating debt for productive capital expenditure.

Fraser's keyword is "recurrent", and that's the problem confronting the present government: the debt we are now accumulating is funding current expenditure.

Although Fraser criticises past governments (of both persuasions) for failing to match revenue to expenditure, his preferred policy approach is definitely on the expenditure side, rather than on the revenue side. He does not acknowledge that by standards of comparable countries, Australia collects very little tax, and he uses a little statistical trickery to give the impression that past governments have been big-spending. For example, Fraser points out that from 2007 to 2013 government expenditure as a percentage of GDP rose by 2.5 percent, without pointing out that the base year he picked was an outlier, with the lowest expenditure since 1974. And it appears that he has used the Consumer Price Index rather than the more conventional GDP deflator to give an impression of high real growth in government spending.

Fraser states a clear preference for private funding for infrastructure, failing to acknowledge that for a country with a sound credit rating, government funding of infrastructure is much lower cost than private funding, and can avoid the economic distortions we are experiencing with toll roads (in an otherwise "free" road network) and privatised power utilities (which try to cover fixed costs on a declining revenue base).

When it comes to productivity Fraser makes guarded statements about "a more flexible workplace relations system", but he gives a strong hint of his preferences when he credits the "remarkable flexibility" of the US labour market for its recovery from the GFC. On other aspects of productivity Fraser stresses the need to ensure that the public sector, in big-spending areas such as health and education, needs to be efficient – in itself an uncontentious assertion – and there are undoubtedly areas where significant productivity gains can be made.

But Fraser's preferred solution to improve the efficiency of service delivery is to draw on competition – a re-statement of an obsession of Australian governments over the last 30 years, as if Adam Smith's "invisible hand" can cure all economic distortions.

It's a naive and simplistic philosophy, ignoring many aspects of market failure, and neglecting to acknowledge the costs of competition (discontinuities in services as firms win and lose tenders, tendering costs, duplication of bureaucracies, encouragement of short-term management and corresponding discouragement of long-term investment in skills-deepening, specialisation, research and innovation).

Fraser's is a bleak view of human nature, as if the only way to prevent public services from becoming bureaucratically stodgy or places of indolent featherbedding is to apply the blowtorch of competition, with all its attendant problems. There is no reason why, with good managers (rather than political appointees) and a sense of professional pride (rather than a message of worthlessness conveyed by governments) government agencies cannot be leaders in innovation and productivity.

Whoever is treasurer in coming years needs to listen to the advice of Treasury, but also needs to realize that, with its entrenched neoliberal or "dry" culture, it is not the sole source of economic wisdom.