The Three Goals Hockey's Budget Must Strive for

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When Treasurer Hockey brings down the budget there will be the time-honoured process of lobby groups preparing "what's in it for us" responses for their members, and "what's in it for you" pieces in the newspapers, analysing the immediate financial effects on the typical pensioner, single parent or "working family" with two kids, a mortgage and private health insurance.

The more serious question is whether it will address three basic fiscal and economic needs: to ensure that any costs of economic adjustment are fairly shared, to provide a fiscal stimulus for an economy facing a possible recession, and to develop a credible plan to bring public finances back towards a structural balance.

At first sight these objectives seem to be contradictory, but a competent government should be able to achieve them.

1) Fairness

The government has recognised the political disaster of last year's budget, and must be secretly thankful to those Senators who blocked its worst proposals. Had they passed not only would the government be even further behind in the polls, but also the country would be reeling from the effects of severe austerity. The government, blinded by its faith in the mining sector, missed the signs the boom was over.

It seems that the government won't repeat last year's mistake of bringing down a blatantly unfair budget. It has already announced a reduction in the asset threshold for a part pension from $1.15 to $0.83 million and a change the taper rate, reversing the unjustified generosity of the Howard Government. That is certainly preferable to the original proposal to freeze the real level of the age pension.

But, as Alan Kohler points out, its greatest effect will be on moderately well-off retirees, with assets between $600,000 and $800,000. It will leave untouched those wealthy retirees outside the pension system who can therefore go on enjoying unlimited tax-free income from their superannuation accounts.

Those asset test changes are only a token nod to fairness.

A budget that shares sacrifice fairly would see attention to the top end of town, starting with corporate tax avoidance and evasion. It would address personal concessions, including not only superannuation, but also favoured taxation of family trusts, tax treatment for highly geared investments ("negative gearing"), capital gains discounts for short-term investments, exemption of high-income earners with private health insurance from the Medicare Levy Surcharge, and fringe benefit tax concessions for employer-provided private cars.

Only if some of these tax dodges are closed will one be able to say the budget is fair.

2) Stimulus

At first sight it may seem reasonable to go easy on tax concessions because our economy clearly needs a fiscal stimulus.

But what counts is the form a stimulus will take.

Preserving privileges for the rich will not provide any domestic stimulus if their spending goes on German cars, French wine and first class foreign travel. Even if the rich invest there is no guarantee that their investments will be productive.

In a period of poor consumer and business confidence people's savings may go into bank capitalisation or back into government bonds and out of circulation. In any event there is no evidence that trickle-down economics has ever worked.

Even more ridiculous, however, is Hockey's exhortation, in light of the latest interest rate cut, to go out and spend. That's idiotic and irresponsible.

A bout of consumer spending may stimulate the flagging retail sector, but discretionary spending is likely to be heavily directed to imports – cars, appliances, clothes, foreign travel – which would be fine if we were paying our way with the rest of the world, but we have a chronic deficit on current account – in fact just this Tuesday we got another disappointing figure on our trade deficit.

And, of course, we already have high household debt (the debt the government ignores) and inflated housing prices.

If people are to "go out and spend" it's likely that they will "go out and borrow", and some of that borrowing will be from mortgage-redraw based on unrealistic and unsustainable high house prices.

The soundest advice in response to the interest rate cut is that people should consolidate – take the opportunity to pay off mortgages a little faster, pay off credit card debts, get another 20,000km out of their cars before buying a new one. If we all do that, of course, there will be a downturn, but if we don't exercise a little frugality now the pain further down the track will be much worse.

3) A public investment path

There is a way to reconcile the need for personal frugality with fiscal stimulus, and that's through debt-financed public investment. We have huge backlogs in rail, roads, urban public transport, environmental repair, broadband, and infrastructure support for renewable energy. (Public sector construction work has fallen 37 per cent from its peak in 2010.)

We have needs in research and education at all levels, which, although not counted as "capital" are in effect investment for our long-term competitiveness.

So long as the government can put up a credible plan to finance that debt, and as long as it is used to fund productive assets, the government's hard-won AAA credit rating can be sustained.

A locked-in set of tax increases, starting easy but building over time, would serve that purpose. In that regard, fuel tax indexation is the ideal model, as would be phased-in taxes on superannuation and the curtailment of other tax breaks favouring the well-off, as mentioned above.

Until those higher taxes start to take effect, the well-off would have investable funds, and government infrastructure bonds would provide the perfect opportunity for risk-averse investors.

Being tied to domestic activity they would get funds circulating and take up post-boom capacity in the engineering and construction sectors.

A responsible stimulus package, in other words.

Will we see such a considered approach on Tuesday, or will the government be so ideologically opposed to pubic investment and raising taxes that it misses this opportunity for a fair and economically responsible budget?