A Budget Built on a Bed of Sand

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Tuesday's budget was like one of those glitzy beachfront hotels in a country with slack building standards – not too bad until you realise that it's floating on beach sand.

Ben Eltham has given a great analysis of the budget, and a neat summary of its main measures.

I thought I'd go digging to see what it was built on.

It is based on three economic ideas: that we will go out and find employment, thus boosting the supply side of the economy; that we will spend our way to economic bliss; and that we will do all of this in the private sector, the source of all that is good and worthy.

The first idea concerns labour force participation: we should all be working or looking for work. Tony Abbott left us in no doubt that the child care measures are designed "to change the economics of going to work". That is, the needs of children and their carers are secondary. The child care and family tax policies are about increasing our labour force participation.

Just why we people should go out and try to find a job isn't really explained. The government talks about "productivity", but you're not productive until you've actually found useful employment, and there is no sign of a general improvement in employment opportunities. In our shopping malls and high streets there seem to be more signs advertising shops "to rent" rather than "help wanted".

The unemployment rate, having come down in the post Global Financial Crisis stimulus, is back on an upward trend, touching levels last seen back in 2002, and the Economic Outlook in the budget papers forecasts that unemployment will stay above six per cent in the next couple of years.

Perhaps the government's real agenda is to give such a supply-side boost to the labour market that there will be downward pressure on wages. But that wouldn't go down well – their experience with last year's budget has taught them that it's unwise to be too upfront about unfair economic policies.

The second idea is that we will spend our way to economic recovery.

There is a strong case for a fiscal boost, but the surest way this can be achieved is through public investment, as suggested by Ben Jarman, senior Economist at JP Morgan. The Australian government is carrying a low level of debt, has a sound credit rating, and with long-term bond rates at a record low can easily borrow to fund productive infrastructure.

As any business person knows, borrowing is fine if it's for useful assets and if the business can service the resulting debt. If we look at our public sector in a business-like way we would be thinking about the public balance sheet – not only our debt, but also the state of our assets on the other side of the ledger.

But, as Ben points out, there is no infrastructure boost in this budget. The budget papers suggest that the government's Asset Recycling Fund, which was supposed to fund new infrastructure from the proceeds of privatised assets, is actually accumulating unspent funds. Net capital investment this year is forecast to be just $3.9 billion, about half the (inflation-adjusted) amount it was in 2009-10.

The small business concessions will provide some boost, but for all the hoopla, it's not much. The budget papers forecast that they will cost $500 million in the coming year and $1700 million in 2016-17, and of course in outer years small business will be paying more tax, because you cannot depreciate an asset twice. Any leveraged boost from those concessions is hardly going to replace the tens of billions the mining sector was spending on plant and equipment.

Businesses, big or small, aren't going to invest or take on more staff just because there's a tax break. They need to see a market for their products. The signs from the business sector, however, are that firms are being cautious. Just last week, for example, the National Australia Bank announced that it's raising $5.5 billion to strengthen its equity-to debt ratio – taking precautions against hard times.

That's $5.5 billion or 16 per cent of the government's modest $35 million fiscal boost taken out of circulation, just from one company. And a budget figure that seems to have been missed in the Murdoch press is a forecast that business investment in the coming year will fall by seven per cent.

But the government is hoping that consumers will come to the rescue, spurred on by the low interest rates, and we will do this by going into debt. They don't say as much of course, but the inference involves an easy bit of arithmetic.

Their Economic Outlook forecasts that next year, for example, household consumption will rise by 2.75 per cent while wages will rise by 2.50 per cent. The difference almost certainly has to come from running down savings or increasing debt – either way increasing our already high level of household debt.

And that's based on optimism about economic growth: the Reserve Bank is estimating growth this year to be 2.25 per cent, while budget papers are estimating it to be 2.50 per cent.

The third and most fundamental idea was in Hockey's budget speech, when he said "we are reducing the size of government as a share of the economy". No justification, no argument. It is an article of faith for the Coalition front bench that government is some big unproductive overhead on the Australian economy, that all those teachers, nurses, scientists and police officers do nothing of any value, that our roads, parks and other public assets (that haven't yet been sold) are worthless. It's a deeply-held idea that goes against evidence and logic, and one my colleague Miriam Lyons and I have confronted in our recently-published book Governomics: can we afford small government?'

Our conclusion is that we are paying a high price for the economic dogmatism of this, and of previous governments, that have devalued our common wealth – a dogmatism in full display on Tuesday night.