

You can't run a nation on tricks and groupthink

18 December 2013

Rather than cutting waste, the Coalition is planning a massive fiscal stimulus for the well off - but a re-run of Howard era economic policy will be a disaster for Liberal voters too, writes Ian McAuley

Ben Eltham on Tuesday gave an assessment of Abbott's first 100 days in office. I want to end my contributions for the year by trying work out where this government might be going in the next 995 days. While the Coalition's microeconomic policies are all over the place, a macroeconomic policy does seem to be emerging: a return to the profligacy and indolence of the Howard years.

There is no economic logic in the Government's microeconomic decisions. It's OK to let Holden go to the wall — in fact, to encourage its demise — but it's important to support a chocolate factory with a \$16 million grant, to sustain a tax rort supporting the German luxury car industry, and to keep on spending \$4 billion a year subsidising private health insurers.

Graincorp must be protected from foreigners, but Qantas, even though it is in intense competition with subsidised airlines, needs no help. States should be free to allocate their education funding as they wish, but the Commonwealth will make sure it gets its way in road funding.

A guiding rule seems to be to undo, wherever possible, the reforms of the previous Labor government, as if the 2007 to 2013 period was one in which the Australian electorate had made a terrible mistake. As one Coalition supporter said to me, "that was when the opposition was in government". The Howard years were good years of growing prosperity while the last six years have been years of anxiety and uncertainty. All we need to do is to get back to the policies of the Howard era.

Supporting this view is a culture of groupthink so spiteful that those on Abbott's frontbench seem to believe their own propaganda about Labor's incompetence. It's a belief reinforced by the general community impression that the Coalition is better able to handle the economy than Labor, and by an uncritical faith among many small-business people and the self-employed that a Coalition Government will look after them — as if support for the Liberal Party goes along with having an Australian Business Number.

The Coalition has purged sources of economic advice not to its liking. Its appointments to advisory bodies and to statutory corporations, even if not explicitly partisan, have been of people prepared to ignore evidence and argument, and to hold to an unshakeable belief in the superior performance of the private sector, without regard to the economics of market failure.

One may argue that a newly elected government has every right to seek advice from wherever it wants, and indeed that is so, but as Machiavelli pointed out it is unwise to ignore your critics, and your critics are not necessarily your enemies.

Most of the Coalition's criticisms of the former Labor Government are way off the mark. In fact Labor managed the economy reasonably well and many of its policies were taking us along a path of economic adjustment. It made the right call in responding to the GFC, avoiding the waste of unemployment and closed industrial capacity. The Gillard government was dragged reluctantly to carbon pricing, but it put together a package to help the economy make a transition to a world where carbon dependence is becoming a liability.

Labor's main shortcoming was a lack of political courage, starting when Rudd ditched emissions trading. Its response to the Henry Taxation Review was insipid. It watered down Henry's minerals resource rent tax and ignored almost all his other recommendations. As a consequence the Government struggled with an inadequate taxation base, which had been weakened over the years of the Howard government.

Howard's much celebrated budget "surplus" was an accounting artefact, achieved with windfall tax revenues and neglect of capital replenishment. The consensus among economists is that it was running a structural deficit of around 2 per cent of GDP.

Labor did no more than to tinker with the irresponsible policies it inherited from the Howard government. While it reduced some inequities in superannuation it left in place the absurdly generous tax-free provisions for "self-funded" retirees and the capital-gains tax provisions which encourage speculation at the expense of long-term investment. Labor did nothing to halt the growth of private health insurance — a hugely wasteful

means of funding health care — and only in its final months did it address the problems of misallocated school education spending under the Howard Government's "SES" formula.

Labor excuses itself on the basis of its weak hold on parliamentary power, but this was of its own making. Labor disempowered itself with leadership infighting and with its inability to convey a coherent economic message — another reason the Coalition has found it easy to discredit its achievements.

An economically responsible government, rather than peddling lies about its predecessor's economic management and using its election victory to inflict revenge, would be looking dispassionately at both Coalition and Labor shortcomings. It would implement an economic reform agenda and attend to important economic problems — adjusting to a low carbon economy, reducing inequality, re-establishing a connection between contribution and reward, suppressing the power of rent-seekers and, above all, improving our tax base to pay for the public services we legitimately need.

But the Abbott Government seems to be so convinced by its own propaganda, and so blind to the shortcomings of the Howard government, that it is trying to replicate the Howard-Costello macroeconomic strategy. Its rhetoric is about Labor's deficits (modest deficits quite fitting for a cyclical downturn which we are now meant to believe were a "disaster") but this Government is deliberately forgoing opportunities to close the fiscal gap and to attend to our long-standing structural deficit.

In fact, the only interpretation one can make from the Treasurer's MYEFO statement this week is that it is planning a massive fiscal stimulus. It is scrapping two major taxes, is reversing the previous government's tax decisions on superannuation and fringe benefits, and is showing no inclination to wind back middle-class welfare — rather, it is deliberately tipping economic policy to favour the already well-off.

It is trying to give the impression that it is reducing the deficit, but this is an accounting deception achieved by pulling forward a \$9 billion contribution to the Reserve Bank, so that this year's deficit looks like "Labor's" deficit, and provides a high base for future deficit reductions. The Coalition's fiscal stimulus will be reinforced by low interest rates which are already re-kindling housing price inflation. As we know from the Howard years, the illusion of rising wealth stimulates borrowing.

That combination of loose fiscal and monetary policy will support material living standards for a while, as it did for the Howard government and as it did for Spain and Greece before the GFC, but it cannot last long. The Howard Government managed because it held office during a mining and stock market boom, and before the world's financiers appreciated the fragility of a housing boom. The Abbott Government is facing economic headwinds. In particular the mining industry is now in its production phase, with much less stimulation of local activity.

At some stage the rest of the world will realise that our trade deficit (the deficit the Coalition never talks about) is unsustainable and that it's supporting a speculative housing boom. When it does our exchange rate could drop precipitously and we will almost certainly lose our hard-won strong credit rating. The costs, in terms of inflation and higher interest rates, will be incurred well before our industries can take advantage of a lower dollar.

All that seems to matter to Abbott, however, is celebrating his victory and going on to win the next election. If the way to gain voter support is to create an illusion of prosperity through mounting public and private debt, that's OK, just so long as the day of reckoning is somewhere over the horizon. If it looms too soon there's the option of an early election.

From the day he pushed out Turnbull, Abbott's aim has been to win office, and he has done this through discrediting Labor, which he sees not as a political rival but as a deadly enemy. As David Marr points out, he's a fighter, and a fighter's only objective is to win. To the Liberal Party faithful, a weakened economy is not too high a price to pay for Abbott's victories.