A Mostly Harmless Budget

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After all those warnings about a tough budget, Wayne Swan presented a document that breaks a little with economic policy of recent years but not enough to ring alarm bells, writes Ian McAuley.

Conservatism is an easy path, for we are more apt to criticise a government for what it does rather than for what it fails to do — that's why conservative parties get such an easy run in the media, and it's why, since its near-death experience in last year's election, conservatism has been a mark of the present government.

Yet the Treasurer did give some hints of a return to traditional Labor principles in Tuesday's budget. In making some cuts to "middle class welfare", it is mildly redistributive, and it takes a few steps toward economic reform in terms of getting more people into the workforce. It breaks a little from economic policy of recent years.

One of the developments of the last 30 years, as the Australian economy has opened up to competition, has been for disparities between rich and poor to widen. The dominant policy approach, seldom articulated, has been to use government transfer payments (social security) and tax concessions to overcome some of these disparities, and to keep the middle class committed to economic reform. Contrary to popular views, governments of neoliberal persuasion have tended to be more committed to welfare payments than left-leaning governments, not because they are more compassionate, but rather because they have to maintain some minimal degree of social cohesion. That is why around 15 per cent of household income is now in the form of welfare payments from government, and a third of the population receives some form of Centrelink payment. In times past, social security was much more directed, because those who had work had relatively well-paid work.

The tradition of the Labor Party and of similar parties in other democracies has been to strive for an ideal in which everyone who is capable of work is able to do so, and can attract a reasonable income without the need for welfare assistance.

Redistribution is achieved through progressive taxation and through universal provision of public services, particularly health care and education. Historically in Australia these ends were served with measures such as tariff protection and highly regulated labour markets. As these measures have reached their use-by dates, it makes sense for our Labor party to follow the lead of Labour and Social Democrat parties in mainland Europe in making the turn to developing and sustaining human capital.

In line with this tradition we see in this budget some winding back of middle class welfare. Eligibility for family benefits is to be tightened, mainly through a means test ceiling which is to be frozen in nominal terms. The absurd tax concessions for company cars are to be scaled back. Diverting income to children through family trusts is to become less attractive. And the Government will once again present to the Senate its proposal to apply a means test to the private health insurance rebate. On the human capital side there is progress, particularly in upgrading skills and in increasing workforce participation — although there is much more that can be done.

These modest cuts in middle class welfare are changes which all but those with a superhuman capacity for rationalising unearned privilege would support. Shadow Treasurer Hockey, obviously with a brief to criticise the Government for becoming dangerously redistributive, has been struggling to defend family tax benefits for households with $150,000 incomes.

But there remain untouched some very large and inequitable benefits for the well off. Generous tax provisions for superannuation contributions remain, and they are particularly attractive to some well off people, such as those who can live off an inheritance while using salary sacrificing to reduce their effective tax rate to 15 per cent. When superannuation funds become pension funds, on retirement, they are entirely tax-free. There remains a capital gains tax system which, with its 50 per cent discount, rewards short-term financial speculation, while, because of its lack of indexation, it penalises long-term productive investment. "Negative gearing" for property investment remains, with its allowance for double-counting depreciation and interest payments as tax deductions. These and other concessions do not show up in budgetary papers as welfare. Some show up as "tax expenditures", while others do not show up at all in budget documents.

When governments are gripped by political caution, however, governments will do no more than make marginal adjustments. In framing this budget the Government seems to have worked within three constraints, the first two of which are self-imposed.

The first constraint is an obsession with bringing the cash balance back to balance by 2012-13. It's an imperative without any economic basis, particularly in a country without significant debt. Public debt is expected to peak next year at 7.2 per cent of GDP and should be eliminated entirely in a few years.

At first sight that seems to be sensible counter-cyclical management; governments should retreat when the economy is in a strong growth phase. But it has become a monomaniacal obsession, fuelled by the hysteria of Opposition politicians and talk-back radio hosts, who give the impression that our public debt situation is about to send us into ruin, and who perpetrate stories about our public debt being the largest in history.

The truth is that our public debt peaked at 120 per cent of GDP just after the Pacific War, and the years in which we paid it off were ones of strong growth and prosperity. And by international comparison our public debt is minuscule: in the USA, for example, it's 60 per cent of GDP and growing.

What counts is not the level of public debt, but rather the use to which it is put. When a government tries to use debt as a means to finance consumption (other than as a temporary Keynesian stimulus), or, as in the case of Greece, as a substitute for collecting taxes, that is indeed irresponsible. As a contrast it is instructive to consider Germany, which is bearing public debt at around 50 per cent of GDP. But no one is criticising Germany for profligacy, for that debt is balanced by excellent public infrastructure.

In Australia's case our debt obsession has meant that we have avoided investing in productive assets, particularly surface transport and environmental restoration. We are too concerned with fiscal deficits and too unconcerned with our infrastructure deficits, as if our national balance sheet has only one side, the debt side. In this regard we are fortunate that the National Broadband Network can be funded as a specific capital item, but, for reasons to do with accounting conventions and ownership in a federation, we do not keep adequate accounts of public capital.

The second constraint is to "keep taxation as a share of GDP, on average, below the level for 2007-08 (23.5 per cent)". Why 23.5 per cent? It's not explained. Actually Australia is one of the lowest-taxed countries out of the 32 countries in the OECD; only Mexico, Turkey and the USA have lower rates, and even the USA doesn't provide a reasonable comparison, for American companies bear many imposts, such as private health insurance, which are covered by taxes in other countries, and with its debt projected to reach 100 per cent of GDP it will have to raise taxes before long.

The third constraint is the ongoing demand for social security and welfare payments, which take about 40 per cent of the budget, leaving any economies to be achieved in the other 60 per cent of the budget. Even within this 60 per cent almost a third is accounted for by health care, which inevitably keeps growing with an ageing population. (Shifting health financing off-budget is not an economically responsible option, as American experience shows.) Therefore savings, if they are to be found, are focussed on that remaining 40 per cent of the budget which covers services such as transport, education, defence and a range of other services. That's why this budget has so many nitpicking cuts and deferrals in program expenditures, and why investments in human capital, while welcome, are still modest.

So, with those constraints, the 2011-12 budget hardly comes as a surprise. If the Government could get over its debt constraint it could be much more relaxed about funding recovery from natural disasters, and would not be forever deferring investment in infrastructure. On the revenue side it could raise taxation revenue significantly by addressing some of the most generous tax concessions, particularly those relating to unearned income, all without raising tax rates.

It has been a budget on the right track, but it hasn't gone very far down that track. The Government seems to have been held back by its own failure to articulate its principles — how these relate to its own partisan traditions and how they differ from alternatives on offer.