Why Are We Living Beyond Our Means?

8 October 2012

Big hitters are sounding off about the economy. Let's not forget the Howard government put the country on the road to private debt - and Tony Abbott's ideas for fixing it are nonsense, writes Ian McAuley.

Last Wednesday night on the ABC's 7.30 Report, David Murray, former Chair of the Future Fund and former CEO of the Commonwealth Bank, delivered some uncomfortable insights on the Australian economy.

In a bizarre twist Tony Abbott, helped by a journalist's leading question, represented Murray's comments as a warning that the current government "with its endless taxes", was "putting the economic future of our country at risk".

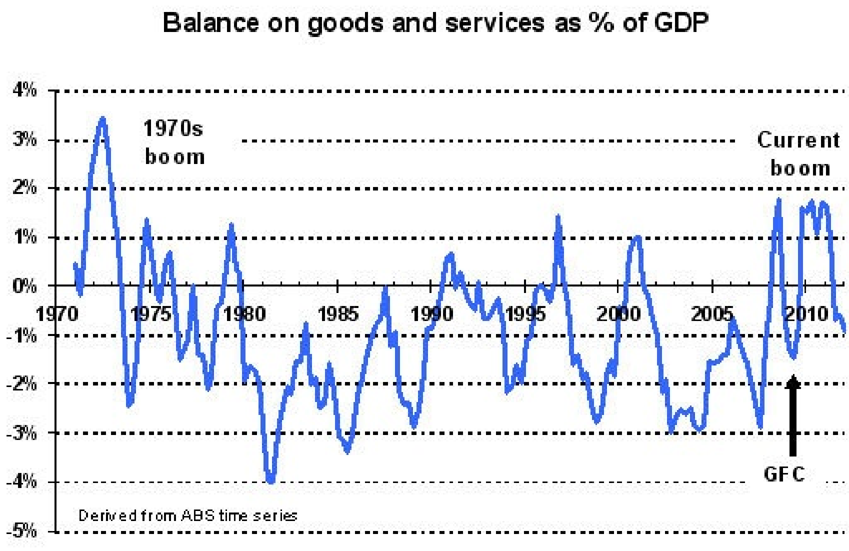
By Thursday the media interpretation was that Murray had been warning of "a Greek-style downturn" in Australia.

Leigh Sales' interview with David Murray is worth consideration, even if he does not communicate clearly to a non-expert audience: on Wednesday night he spoke as if he were with a class of postgraduate economics students. Also he is reluctant to acknowledge the responsibility of the finance sector in causing the economic problems of the last four years. After all, he was a banker.

He made three main points on the Australian economy, which can be summarised as a message that we are living beyond our means. To that extent comparisons with Europe are valid, because that is the basic problem in the Mediterranean countries. But that is where any comparison with Europe should end, because the circumstances between Australia and Europe are very different.

His first point was that Australia has a debt problem, a problem illustrated once again last Wednesday when the Australian Bureau of Statistics (ABS) released its figures on international trade.

Those figures show that we are importing more than we are exporting, as we have been for a long time. (The graph below is drawn from ABS time series and incorporates the figures released on Wednesday.) The conventional wisdom on the Australian economy is that we can run a trade deficit, balanced by inward investment and borrowing which will all be paid off by our mineral exports.



Unfortunately that rationalisation has not stood the test. If we were to enjoy an export boost we should be enjoying it now, but, after a couple of years of a positive trade balance, we have slipped back into the red once again over 2012, and the situation is getting worse. As can be seen in the graph and as pointed out by Ross Garnaut last Monday, the mineral booms which give us a positive trade balance are short-lived.

From a national perspective we have been supporting our lifestyle with debt, hoping that income from mining would pay it off. This debt is almost all private debt, rather than public debt, a distinction which is rarely made in the din of partisan politics and sloppy reporting. People have been borrowing from banks, and in turn banks have been borrowing from overseas.

A major factor has been household debt, which from 1990 to 2007 rose from 50 per cent to 140 per cent of household income. Over that period house price inflation allowed people to borrow against the apparent increasing equity in their houses. (In fact they were borrowing against inflation.) I recall the night of John Howard's 2004 election victory when a roving TV reporter picked up a young man who said "Of course I voted for Howard: three years ago my house was worth only $300,000; now it's worth $500,000. I'm $200,000 wealthier thanks to the Government."

It's hardly surprising that Murray didn't go on to explain how this private debt had grown, because the banks were complicit in this illusion. Tony Abbott isn't going to point out that this orgy of borrowing was encouraged by the Howard government, and politically he benefits from a confusion of private and public debt.

Murray's second point was that "welfare costs ... now take up to 100 per cent of the personal tax take". The casual listener or reader may see this as yet another right wing attack on "big government", but his words were carefully chosen. This year we are paying $151 billion in personal income tax, and the "social security and welfare" component of the Budget is $132 billion. Add in a few tax concessions, such as superannuation concessions, and Murray's equation is confirmed. In fact he was probably erring on the low side.

With distributive welfare taking all of our PAYG payments and a bit more, this means that funds for schools, roads, public transport, health care and other important government services have to be funded from other taxation sources, or not funded at all.

If anything, Murray was pointing out how the Howard government squandered tax revenues on middle-class welfare. The Howard government enjoyed high tax revenue — 25 per cent of GDP in its final year. Because of a collapse in GST, corporate taxes and capital gains tax, taxation receipts fell to 21 per cent of GDP in 2011, and are only slowly recovering. At the same time, however, these welfare payments continue to constrain the Government's capacity to fund necessary economic services.

The Government had a huge struggle in withdrawing just one of these pieces of welfare, the private health insurance rebate for high income earners, a reform that was blocked while the Coalition had control of the Senate.

The Coalition still cannot bring itself to accept that the Howard government was taking the country on the path to poverty, because it was using welfare payments to compensate for the inequalities it had allowed to open up in the economy. Rather than investing in infrastructure and human capital which would have reduced the need for welfare payments, it was using welfare payments to compensate for our declining productivity. That's pretty much what has been going on in the Mediterranean countries.

Murray's third point, indeed, was about productivity. We do have a productivity problem, but every time commentators raise the issue there is released a torrent of right-wing drivel about the supposed need to de-regulate the labour market, water down employment conditions, institute a one-sided version of "flexibility", and to bring back "Workchoices" or some similar individual bargaining system.

Our productivity problem is long-standing, and has many causes, including skills mismatches, poor people management, short-term incentives, shortages of finance to invest in capital equipment, and poor infrastructure. (On this last point, think of the thousands of people in Melbourne who lost a day's work sitting in a traffic jam last Wednesday.) If business lobbies could join the productivity debate in a mature way, and if Coalition politicians could admit that the Howard government got it wrong and develop some constructive ideas to deal with these complex problems, we may make some progress on productivity.

Tony Abbott's misinterpretation of Murray's comments was contemptible because he tried to distract us from Murray's warnings, presumably because any serious consideration of them reflect poorly on the previous Coalition Government.

Even worse, however, is his prescription to cut taxes and to increase welfare — a return to the Howard policy but without the tax base to support it. The Howard government had us on the path to a Spanish-style problem, where accumulating private debt would eventually lead to the need for government debt. An Abbott Government would take us down the more precipitous Greek path, with a yawning gap between revenue and expenditure, and nothing to show for it but the illusory prosperity of living beyond our means.