Is Hockey taking his cues from Ronald Reagan?

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> We don't need a debt ceiling to keep governments in check, and the current Senate standoff is pointless. But at least it might finally flush out Joe Hockey's economic policy, writes Ian McAuley

The Federal Government should not be shackled by a debt ceiling. Economists on both the left and right say that it is just as likely to hinder sound fiscal management as it is to keep a spendthrift government in check.

When expressed in nominal dollars – $300 billion as is presently imposed or $500 billion as the Government is seeking – inflation and economic growth will eventually cause even the most fiscally conservative governments to bump up against any dollar denominated ceiling, possibly at the most inconvenient time.

Some economists suggest the ceiling should be linked to GDP, but what is a reasonable benchmark? Germany's 80 per cent of GDP? America's 100 per cent? And how, in a federation, should central government debt relate to debt incurred by other tiers of government and by government business enterprises?

An even more basic problem is that a ceiling imposes a limit on gross debt, not net debt. The difference is that net debt is the residual after the value of government assets is taken into account, and if those assets are of sufficient value they will easily balance or exceed the value of gross debt. No one would evaluate the financial health of a business by looking only at debt, without looking also at the asset side of its balance sheet.

Then there is the further complication of accounting in a federation. When the Commonwealth makes a capital grants to a state, for a road for example, that outlay is recorded as an expense, with no offsetting asset. Nationally it's similar to the situation where parent may buy a car for a child – the parent's balance sheet takes a hit, but the family's balance sheet is unaltered.

We don't need to impose a debt ceiling on our governments, but we do want them to manage our assets responsibly and to be accountable, not just in terms of making the books balance and meeting arbitrary fiscal targets, but more basically in explaining their economic policies. Those explanations should include details of the purpose of their borrowing, as suggested by Ross Garnaut in his contribution to the debate

If the Senate standoff on the debt ceiling can flush out a statement of economic policy from our secretive Government, the standoff will have been worthwhile.

This Government has had an easy run into office, helped by Labor's internal conflicts and a partisan Murdoch media. It has also been helped by the perception, consistently found in polling, that the Coalition is better able to manage the economy. The Coalition therefore feels it doesn't have to justify or even to explain its economic policy because we all know we're in better hands.

The closest the election campaign came to discussing economics was a set of exchanges on short-term fiscal targets. The din around these issues crowded out discussion of more basic economic issues. We should have been arguing about how we cope when the terms of trade turn against us, how we raise the public revenue to finance our infrastructure deficits, how we raise our productivity to support our legitimate expectation of decent minimum wages, and so on – all questions of economic policy.

Sound fiscal management is but one of many aspects of economic policy. Successive governments, Coalition and Labor, have allowed their obsession with election fiscal costings to substitute for debates on economic policy, and in the media there are few political journalists who understand the distinction between fiscal and economic policy.

Labor in office didn't articulate its economic policy clearly, but when we put the bits together some coherence emerges. In its aggressive dealing with the GFC it prioritised sustaining economic activity over fiscal stringency.

It tried (with limited success) to turn some of the revenue from mining activity to other businesses in the form of generous depreciation and loss carry-back provisions. Its clean energy package was about helping industry adjust to a world where, sooner or later, a carbon-intensive economy will be at a competitive disadvantage.

In realising the importance of human capital as a source of competitive advantage it made significant investments in education at all levels and was committed to a further significant increase in school education funding.

All sound policies, poorly communicated.

Labor's problem was more than one of technical communication. Over its six years in office it avoided confronting the hard reality that we have been living beyond our means. It did little to repair our public revenue base, so badly damaged by the profligacy of the previous Coalition administration — who squandered the taxation revenue from the mining boom — and by boom-time asset price inflation.

Instead of investing in infrastructure, education and other means to strengthen our economic resilience, the Howard-Costello Government gave income tax cuts and generous concessions for superannuation, private health insurance and other forms of welfare for the comparatively well-off. When it came to the need to restore our revenue base, Labor squibbed on most of the hard recommendations of the Henry Review into taxation.

In office the Coalition has been even less forthcoming about economic policy. We can infer, however, from its proposals to repeal carbon pricing and the minerals tax, and to repeal the industry adjustment measures that were to be funded by these taxes, that it is abandoning Labor's policy of helping industry to modernise.

It has no intention of doing anything of significance to raise the low tax base it inherited from the outgoing government. In fact, in its decisions on fringe benefits tax, self-education expenses and superannuation, it is giving extraordinarily generous tax breaks to the well-off.

It seems to be counting on a budget deficit – a Keynesian stimulus funded by low taxes rather than spending – to sustain material living standards for a few years, and there is the hope that with confidence now restored, because we have a "business-friendly" (read "rent-seeker-friendly") government in office, economic activity will increase.

Investors will invest, consumers will consume, and eventually tax revenues will pick up. A crucial requirement for this strategy to work is that interest rates should stay low, even though the Government would be pursuing an expansionary fiscal policy.

Abbott's policy has echoes of Ronald Reagan's policies of the 1980s. When elected with a budget already in deficit he cut taxes, particularly for the well-off, on the basis that they would turn their tax breaks to investment and that the benefits would "trickle down" to others.

He had no understanding of the need for an economy to have a balance between public goods and private markets. In fact he was contemptuous of the idea that public services and public infrastructure are important parts of an economy. To him all government expenditure was intrinsically wasteful.

Reaganomics didn't close the budget deficit, which worsened during his term. Nor did benefits trickle down; rather economic inequality started to widen and has done so to this day. Reaganomics did achieve a boost to recorded economic growth – as indeed any Keynesian stimulus might be expected to do. But that growth was in a US context. There are three important differences between the US in 1980 and Australia in 2013.

First, America is more economically self-sufficient than Australia. Therefore more of the stimulus stayed in the USA. America's rich in the 1980s bought American-made Cadillacs and Lincolns, while our rich in the 2010s buy German-made Audis and BMWs.

Second, to cope with falling real incomes, the American middle classes sustained material living standards by borrowing, and their domestic borrowing translated into foreign borrowing. America, like Australia, has consistently been running a trade deficit (the deficit no politicians are game to talk about).

The world, for now, tolerates a US trade deficit, because of the global reserve status of the US dollar. The Chinese in particular don't want to see their holdings of US denominated debt written down. There is no such global stake in sustaining the value of the Australian dollar, and while most economists want to see a fall in our exchange rate, a precipitous collapse associated with a current account crisis would plunge us into recession.

Third, while America's economy had and still has structural problems, it is much more diversified than ours. With coal and iron ore dominating our export base we are vulnerable to the commodity cycle. Some pin their hopes on gas as a new export base, but once past the investment phase its linkages back into the rest of the economy are even weaker than those of mining, and many of the profits will go to overseas investors.

If Abbott is taking us down the Reaganomics path, we need to be told. While the debt ceiling is not a good instrument, it doesn't matter if the wrong tool is used to produce a good result – a clarification of this Government's economic policy in this case.

Abbott and Hockey may complain, but let's remember that it was Abbott and his supporters in the Murdoch media who dumbed down our understanding of debt. Exposure of his hypocrisy may force him to abandon the patronising drivel he has been using over the last four years and to deal honestly with those who elected him.