Can Government quit spending?

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August 22, 2011

[First published on *Quadrant Online*, 22 August 2011]

Cuts to Government spending – tilting at windmills?

Shadow Treasurer Hockey was reported last week as identifying possible cuts in Federal government spending of $50-70 billion over the next four years. Apparently using forward budget estimates, he pointed out that "the Government –Liberal or Labor – would spend $1500 billion over the next four years. It is a massive amount of money. Therefore finding $50, $60 or $70 billion is about identifying waste and identifying areas where you do not need to proceed with programs". Is this a practical possibility or a Don Quixote tilting at windmills?

The Government is ridiculing the idea but seems also to have introduced the Don's heroine, Dulcina. Julia has taken on the role of challenging the gallant Joe to show how in practice he actually will cut down the windmills, line by line - or is it blade by blade? But surprisingly she hasn't so far taken it much further. Perhaps because she has also acknowledged government windmills contain excessive spending that need slimming if she is to realise her "complete confidence" of achieving a budget surplus in2012-13. Her establishment of a razor gang certainly suggests she is determined not to be given the Don Quixote blessing which Keating's speech writer, Don Watson, bestowed on him (after he left his office).

There is some confusion, possibly deliberately engendered, about the precise objectives of Hockey's cuts. Would they mainly be to pay for Opposition promises at the last election (and any costs from eliminating new spending based on the carbon and mineral resources taxes proposed by the government) or might they also allow new tax reductions? Either way the implication is that Joe proposes to attack windmills not previously on his list. Presumably no new or replacement windmills would be allowed but, instead, a government spending $70 billion less than otherwise at the end of four years.

It is of some interest to consider what such a task could involve. Rough calculations based on forward budget estimates, and assuming no global recession, suggest that $70 billion of cuts over the four years would lop off about 20 per cent of the windmill – that is, reduce the size of the Federal Government from about 24.5 per cent of GDP in the current financial year to about 19.5 per cent of GDP in 2015-16; cuts of $50 billion would imply total spending in that year of about 20.6 per cent.

Is such a cutting of windmill blades achievable? Well, Joe could legitimately claim that he would at least leave a smaller windmill than an earlier Don Quixote by the name of Gough. In 1974-75, after allowing Jim to sign the cheques, Gough left a windmill of 21.5 per cent of GDP before the Governor of La Mancha sent him back to his castle. Even so, Joe could run a "back to Whitlam" program.

Of course, that would be a mammoth task and many lances would be thrown at Joe by Julia: indeed she has already sent some. Given that, any serious attempt would seem to require the assembly of much armour well before the final charge to the windmill(s). A detailed rationale of the cuts before that charge would require much more than the old hardy of eliminating waste, which Julia is also promising.

But the Opposition would start from the position that Labor has already undertaken to reduce spending by about two percentage points of GDP from the 2009-10 stimulus peak of over 26 per cent of GDP. And with Julia's latest reaffirmation of the commitment to a small budget surplus for 2012-13, even more slimming is to come. Spending reductions would also be consistent with what is happening overseas, where a number of major countries have started programs to slim their spending and deficits. Fiscal "consolidation", also recently publicly endorsed by Swan along with other members of the G20, is in vogue.

True, the immediate motivating force overseas is the concern that government debt levels have reached unsustainable levels. But the increase in Julia's net debt levels (from *minus* $44 billion in 2007-08 to an estimated $105 billion in 2012-13) and the surge in minerals exports suggests the time is right to join the vogue. The decision of overseas governments to adopt fiscal consolidation policies reflects the increasing recognition that, whether through budgets or central banks, attempts to stimulate economic growth after the global financial crisis have generally failed.

Treasurer Swan has claimed that the spending shovel used here in 2008-09 – a real increase of 12.7 per cent, the largest since Whitlam times - has succeeded and that the government's economic management is widely admired overseas. But this claim conveniently overlooks the favourable effects of Reserve Bank interest rate reductions and continued strong export demand. Even then real GDP per head increased by only a miniscule 0.5 per cent between the June quarter of 2009 and the March quarter of this year. True, there were adverse effects from floods in the March quarter, but that outcome would scarcely justify a return to stimulation.

The adoption of fiscal consolidation policies also reflects the realisation that there has been a loss of confidence in the capacity of governments to manage economies and to achieve specific interventionist objectives. In Australia there has been a sharp drop in consumer sentiment and a marked slowing in retail sales and this is reflected in the continued increase in the household savings rate as households repay debts.

Against this background Joe has a potentially sympathetic audience to a program involving major reductions in government spending and interventions - that is, actually knocking down a few windmills. Such a program could also include some reductions in taxation without running a deficit. That could be used to help compensate those who might lose from any tightening of eligibility for social benefits, which has the potential to provide considerable savings and which Julia has publicly recognised would help add to the supply of labour. Relevant here is the fact that households with incomes in the two top quintiles receive about 30 per cent of social security and certain education and health benefits and many could surely be persuaded by friendly Joe to accept cuts in circumstances where taxes were also cut.

The avowed policy of the Opposition is to support small government and an increased role for the individual. There is a strong economic and social case for reducing the availability of government benefits, not by reducing benefit rates but by tightening eligibilities. Welfare dependency would be reduced as an increased proportion of individuals and families would assume more responsibility for their own welfare. A win-win situation for those prepared to seriously fight the windmills.

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