Forget talk of clouds and cuckoos, Australia is in strife

By Maurice Newman, The Australian, 25 April 2017

There's a clever American cartoon doing the rounds depicting two pop-up stalls. One is selling "comforting lies", the other, "unpleasant truths".

One has a long line of customers. The other, not one. No prize for guessing which stall that is.

This is the state of politics today. It's a game played by voters and politicians alike, especially at budget time. Better to deal in falsehoods than face reality. Tony Abbott is the last prime minister to sell unpleasant truths, and look where that got him.

Yet, after decades of Robin Hood-style social democratic policies, Australia is confronting its greatest wealth inequality ever. Though 40 per cent of all working households receive more in government benefits than they pay in taxes, one-third have less than one month's mortgage payments in reserve.

Even in a pretend world, where unaffordable promises of equality are regularly made, politicians still pay lip service to balanced budgets. The problem is with 84 per cent of personal income taxes coming from a shrinking 20 per cent of constantly-redefined-lower "wealthy" taxpayers, they're getting harder to achieve.

Raiding superannuation savings shows nothing is sacred. What's next, means testing the family home, estate duties, higher capital gains taxes, removal of dividend imputation, repeal of negative gearing, and GST increases? When all else fails, there's still the printing press.

Scott Morrison believes "we actually have an earnings problem in this country". What the Treasurer should have said is "we actually have a spending problem in this country". But revenue is politically the softer option.

Forget that raising taxes and increasing debt ultimately become brakes on activity and that declining growth adds to state dependency. In a post-truth world, there will be no day of reckoning. Like cheap renewable energy, balanced budgets become an ever receding mirage that continues to fade from view.

The Treasurer concedes there is more work to be done on the budget and says he won't repeat Labor's mistakes of promising surpluses and not achieving them. Best not to nail your flag to the mast. All he will say is that "on the best information we have available to us, the government's plan to return the budget to balance is projected to be in 2021".

But what is "the best information available to us"? Does it factor in the possibility of a recession or another global financial crisis? If so, what weighting is given? Economic downturns have obvious budget implications. With such orders of magnitude, even small changes in assumptions can have a huge impact on outcomes. In a downturn, automatic stabilisers, designed to dampen fluctuations in real GDP, add substantially to debt and deficits.

No doubt the government will cite the International Monetary Fund's latest forecast of a sharply increased annual growth rate of 3.4 per cent, compared with the 2 per cent forecast by Treasury and the Reserve Bank. However, before we get too excited, we should be aware that according to The Economist, the IMF "never once foresaw a contraction looming in the next year". Worse, a senior economist who resigned from the IMF, blaming bias and suppression of staff warnings, lamented: "The failure of the fund to issue (warnings) is a failing of the first order. After 20 years of service, I am ashamed to have had any association with the fund at all." We can only hope IMF forecasts are not taken too seriously in Canberra.

Regrettably, there are too many Keynesians at the IMF and treasuries around the world who are quick to recommend fiscal stimulus, including infrastructure spending, as "temporary" when the empirical evidence shows it hardly ever is.

Since the 2008 "great recession", global debt has increased by $73 trillion. Yet, other than the central banks' watchdog, the Bank for International Settlements, few audible alarm bells are sounding, even at this late stage of an extremely extended business cycle.

The BIS warns of a probable "full-blown" Chinese banking crisis, saying this is in a different league from the 1997 East Asia speculative boom or the US subprime bubble before the Lehman Brothers crisis. It further cautions "the latest turbulence has hammered home the message that central banks have been overburdened for far too long post-crisis, even as fiscal space has been dwindling and structural measures lacking".

Australia's Reserve Bank may well echo these sentiments and certainly will be closely watching budget measures intended to improve housing affordability. Government interference in markets usually marks the end of the cycle and, with Moody's calling Australian housing a bubble and with one-third of households having less than a month's mortgage payment as a buffer, any intervention that adds to supply at this time could exaggerate what already has the potential to be a severe market correction. Mortgages represent 60 per cent of Australian banks' loan portfolios (Norway is next with 40 per cent) and, with 80 per cent loan-value ratios and increased global uncertainties, budget interventionists should be careful what they wish for.

It's not only Australian households running on empty. More than 29 per cent of Europeans have no savings at all, while 47 per cent of Americans say they cannot afford an emergency expense of $400. With a global savings deficit and an enormous debt overhang, it is time for urgent budget repair, but so far Malcolm Turnbull has demonstrated little appetite. Even Abbott's "repeal days", designed to remove unnecessary and costly legislation, seem to have been abandoned.

It's too easy to dismiss calls to rein in the $250 billion we spend annually on health, education and welfare as yesterday's, hard-right, ideology. But from Europe to Venezuela, impoverished victims of the welfare state can attest that sooner or later comforting lies lead to unpleasant truths. Even in a post-truth world, the laws of economics catch up with you.

Let's hope this reality finally dawns in the upcoming budget.