'Long-haul' Costello shortens government's horizon

'The imminent prospect of hanging concentrates the mind wonderfully' — Samuel Johnson

When Mark Latham became leader of the Australian Labour Party six short months ago, Australia's political landscape changed overnight. A government cruising comfortably to an inevitable fourth term suddenly found itself with a real fight on its hands. The polls have had Labor in a winning position ever since.

So nobody should be surprised that Peter Costello's near-record ninth budget is the most election-focussed in living memory. The treasurer may be *'there for the long haul'* — as he insisted this week — but his budget is all about the next six months. Ironically, while he is clearly keen to see the prime minister go, Mr Costello has now made a Herculean effort to delay Mr Howard's departure, at least until 2005. Opposition is not the legacy he wants to receive. He has worked hard and skillfully to cut down the Opposition's options for plausible, costed alternative policies.

The centrepiece of the treasurer's re-election bid is a bold attempt to show that — contrary to accepted wisdom — you *can* make a silk purse out of a sow's ear. Approaching the election, the government's only obvious economic Achilles heel was current taxation levels. Average earnings now attract an alarming effective tax rate of 43.5 per cent. Australians on just 1.3 times the average found themselves pushed up to the top rate of 48.5 per cent. In the process, for most people the much-heralded GST tax cuts have already been devoured by the monster that is bracket creep. Community resentment over rising tax and diminished services has been palpable.

So, awash with funds from the surging tax take, what better way to neutralise rising criticism than to give some back — but only to a carefully-targeted group. Tax benefits go primarily to higher-income earners. Those at the bottom — especially those without children — get very little. And there is no indexation of tax rates. So wage increases will once again quickly reduce the benefits announced, just as they did with GST tax cuts. Despite these shortcomings, middle-income families will certainly see plenty of attractions in the package, however.

In case the electorate really does prefer more services to tax cuts, as polls suggest, the government has also gone to some lengths to change course dramatically in this area to steal some of the Opposition leader's social policy clothes. Just a year ago, the eighth Costello budget was utterly silent on measures to help Australians balance work and family, despite immense community debate and the prime minister's own 'barbecue stopper' comments of two years earlier. Maternity leave lobbying was similarly ignored. But nothing drives policy flexibility like the possibility of defeat. So this budget is positively overflowing with new family policies. New maternity benefits, increased family tax payments, additional child-care places — they are all there.

If all this good news material sounds just too good to be true, the risk may lie in that old bogey — policy contradiction — which seems to bedevil all governments, especially those in heavy electioneering mode. The levers of Australian economic policy are operated by two drivers: the federal Treasury and the Reserve Bank of Australia. For two years now, the Reserve has tried delicately to stop the economy overheating by damping down a rampant housing market, without creating too sudden a slowdown. To that end, interest rates were increased four times by small increments totalling one per cent. In its last statement just days before the budget, the Reserve explained why it had decided not to lift rates again. *'The amount of monetary stimulus to the economy'* was now *'significantly reduced'*, it said. In that context, what then will the Reserve make of the treasurer's decision to take the economy in a diametrically opposite direction with the most expansionary budget in memory? A fiscal stimulus of this magnitude must surely make higher interest rates more likely.

Moreover, on a longer view, Mr Costello's choice to spend the bulk of his surplus on election sweeteners right at the peak of the economic cycle risks difficult times when the inevitable downturn — already long overdue by historical standards — finally arrives. At a time when things are likely to be as good as they get, a projected $2.4 billion surplus is not a particularly strong position to be in, especially given the near-certainty of additional outlays in the government's election campaign. The volatility of projected budget outcomes can be easily seen from the experience of the past twelve months. Just a year ago, Mr Costello predicted a surplus of $2.2 billion for this financial year. The actual result appears to have been almost five times that amount. Volatility of this kind can operate just as easily in the opposite direction. As the *Australian Financial Review* has recently demonstrated, Australia's long-run budget position still looks unhealthy and vulnerable to renewed debt build-up when a slowdown occurs. At that point, Australia may regret the absence of a solid rainy-day 'nest egg', which could have been secured from the current surplus.

The government, however, will be happy to leave such considerations for another day — after it has been re-elected. As for the treasurer, he will be banking on most voters not seeing his budget gifts as merely partial return of their own surging tax payments. He seems willing to risk the resentment of seventy per cent of taxpayers who receive no relief. Looking further ahead, he will hope a prime minister Costello does not have to explain why the budgetary cupboard is bare when hard times come.

Full-text of the ALIA budget anaylsis can be found at: http://alia.org.au/publishing/budget.analysis/2004.html.■

In a nutshell

Tax cuts: $14.7bn
Family assistance: $19.2bn
Super: $2.1bn
Security: $0.755bn
Science: $5.3bn
Land transport: $5.3bn
Growth: 3.5%
Inflation: 2.0%
Unemployment: 5.75%
Household consumption: 4.25%
Investment: 7.0%
Exports: 8.0%
Imports: 9.0%
Current account deficit:
5.0% of GDP, down from 5.25%
Cash surplus: $2.4bn
Fiscal balance: $0.7bn
Revenue: $194.0bn
Expenses: $191.0bn
Net debt: $24.5bn