TRAILERS

BUDGET: LIGHT FROM THE BLACK HOLE

ECONOMIC RECOVERY RELIES ON DEVELOPING NEW TAX BASES. BUT, ARGUES WILLIAM MITCHELL, BOTH PARTIES HAVE MADE THIS A POLITICAL IMPOSSIBILITY.

As the rationalist agenda has become the dominant ideology the idea of the mixed economy is now a thing of the past. The concept of a vibrant public sector administering a broad welfare-oriented policy has given way to a more callous vision of the world, where a minimalist state serves to provide law and order and some welfare benefits. More importantly, the state is now an active agent for the private sector, privatising public assets and making laws which favour capital over labour.

This swing in sentiment is demonstrated by the renewed fetish for balanced budgets with on-going tax and spending cuts. The Hawke-Keating years gave the Coalition Government scope to further erode the public sector. The ALP pursued very narrow fiscal policy options. Essentially, taxation ceased to be an active fiscal policy partner with spending. It has become almost impossible at the Federal level to increase taxation.

Budget deficits have historically been used to stimulate the economy when the unemployment rate is high and activity levels low. Prudent fiscal management cuts spending and increases taxes when the economy approaches capacity and the labour market achieves full employment. With the unemployment rate still over eight per cent it would be particularly imprudent to cut back on government spending. While the current growth rate is good, the worry is that the long term unemployed are being left behind. The Government should maintain its commitment to the highly successful labour market programs rather than seeking large cutbacks in spending.

To complicate matters, the size of the budget deficit is misleading as a guide to the stance of fiscal policy (whether it is expansionary or contractionary) because government revenues and outlays vary with the level of economic activity. When the economy weakens (strengthens), tax revenues fall (rise) and outlays like unemployment benefits rise (fall), and so, with no changes to the policy position, the budget will worsen (improve). In other words, a rising budget deficit does not imply that the Government is conducting an expansionary policy. It may signal a weakening economy.

Some calculations of the extra tax revenue and reduced unemployment benefits outlays which would accompany higher employment show that the budget would improve by $4.6 billion if the unemployment rate fell to 6 per cent. The improvement would be $6.4 billion if the rate fell to 5 per cent, and over $8 billion if the unemployment rate was brought down to 4 per cent. Given that the unemployment rate is currently over 8 per cent, there is a significant portion of the current budget position that is cyclical.

It is worth recalling the 1980s experience. After a year of negative average growth in 1982/83 the budget deficit ballooned. The ALP inherited a high unemployment rate and a stagnant economy. They used spending stimulus over the next four years and achieved average per annum GDP growth rates of over 4.1 per cent. By 1987/88, the budget deficit was in surplus (over $2 billion).

The lesson is simple. If you want to reduce the budget deficit, then first you have to push the economy closer to full employment.

The Coalition does not seem to understand this logic. They have already prepared the public for large cutbacks by proposing the concept of the so-called $8 billion 'black hole'. My own calculations show that the budget deficit does not even approximate this figure. At worst, the budget deficit is around $5 billion with a large cyclical component.

A leaked Department of Social Security document whose details were published in the *Sydney Morning Herald* on June 26 gives a clue to the type of thinking that will drive the forthcoming budget. The so-called budget razor gang outlined $6.5 billion in welfare cuts up until the year 2000. It would be implausible to expect that the Government would try to extract the full $6.5 billion given the political costs and the now clear trend in the Senate for the ALP and minor parties to thwart as much key legislation as possible. However, even cuts of $2 billion would be harsh.

At the same time, the Government-appointed Commission of Audit released its report and declared the Government bankrupt. This report emphasised the lengths to which the Right will go to give their ideology legitimacy. While the Commission included all the future liabilities of the Government, it failed to include future tax revenue. It said it was too difficult. Obviously, a Government without tax revenue is insolvent. But the failure to include it renders the Audit meaningless.

The Audit Commission proposed a bevy of policy options which resembled the discredited Fightback.

The question now is how far the Coalition are going towards resurrecting Fightback.

Proponents of massive cuts argue that if the public is drawing on national savings to finance their budget deficits then less is available for private sector investment and interest rates are higher. The latter argument is largely spurious. First, any demand for capital, whether it be private or public, places pressure on the available capital. Public debt is also likely to be cheaper than private debt due to its lower associated risk. Second, a budget deficit is usually associated with a low level of private sector investment activity.

There is no evidence available which shows that higher budget deficits lead to higher interest rates. My own empirical research shows there is no discernible relationship between the two. Further, savings are higher when national income is higher. The surest way to increase national savings is to ensure that the level of activity is growing. Endangering the growth in national income by harsh budget cuts is likely to reduce national savings.

The Fightback-driven Coalition believes that if it cuts spending and taxation and deregulates the labour market, profit-seeking firms will ensure that the economy grows strongly. However, there is no evidence available which shows that lower wages stimulate employment. There is also vast experience which shows that the private sector cannot be relied upon to ensure the economy grows strongly and steadily for long periods.

The Audit Commission did argue that the Government faced a declining tax base and increased demand for health services and the like because of the ageing population. It wrongly concluded that the approach should be to cut back on services. The correct response is to innovate new tax bases. A sensible new strategy to shore up the declining tax revenue and to maintain a vigorous public sector would be to introduce a wealth tax. Evidence shows that the large proportion of wealth is held by a small number of persons and that small tax rates on wealth generate large amounts of revenue.

Unfortunately, the Coalition is intent on introducing Fightback and increasing advantages to the wealthy at the expense of those who need welfare support the most.

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CAROLYN DEERE

NAFTA: CASUALTY UPDATE

Seldom have so many people been so wrong about so much. As the North American Free Trade Agreement (NAFTA) enters its third year, the promises of its promoters are almost comical to reprint.

So begins a recent report by the leading left think-tank, the Washington DC-based Institute for Policy Studies (IPS). Entitled *NAFTA After Two Years: The Myths and the Realities* the report lays out the promises and myths of NAFTA and dismisses them with the hard, cold facts of recent history. It paints a picture of North American integration that has financially rewarded the few at the expense of the many. Moreover, it argues that the social, environmental and economic havoc wreaked over the last two years is not simply an indictment of NAFTA, but confirms the urgent need for us to condemn anew an economic model that 'glorifies the market, that demonises government, and that views human beings and civil society as little more than customers in a continental shopping mall'.

Already captured by the logic of the World Trade Organisation, Australia's politicians are unified in their merry journey along the path to further trade and investment liberalisation and deregulation through the Asia Pacific Economic Cooperation (APEC) Forum. For Australians, the NAFTA experience's blatant manipulation of democracy should provide a message. NAFTA's failures in terms of social justice, workers' rights and environmental protection must spur us to look more critically at so-called 'free trade' which so readily receives bipartisan support here.

During the campaign for NAFTA's approval, Presidents Clinton and Salinas (of Mexico) and Canadian Prime Minister Chretien promised that by lowering barriers to trade and investment, NAFTA would not only