

Budget Problems 2014-15

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Introduction 1

The Budget strategy is reflective of Reaganomics of the early 1980's. Reaganomics was popularly referred to as "trickle down" economics. In reality it was the first step in the US towards adopting supply side economics.

"Trickle down" economics sought to protect the wealthy in the expectation that in spending their wealth, the subsequent impact upon aggregate demand would create investment and employment. Supply side economics was a policy direction for a particular period in economic history. Reaganomics proved a dismal failure. Its legacy was unprecedented public sector debt and entrenched economic dislocation.

The Australian 2014-15 Budget seeks to protect the business sector and the wealthy in their retirement income programs. In this sense, the Budget strategy is "trickle down" economics. The inherent expectation is similar "trickle down" assumptions that under pinned Reaganomics.

Empirical analysis that follows suggests that the Budget targeting of debt is fundamentally flawed. Debt is a symptom of an underlying malaise of long term structural decline. Confused economic thinking has led to an austerity policy direction when economic decline requires support of an industry policy to achieve structural broadening and deepening of the economy. The policy strategy is therefore counterproductive

The changes to the labour force retirement age and social security entitlement for the unemployed suggests that by increasing the supply of labour, demand for labour will somehow follow. This is consistent with supply side economics return to the late eighteenth century / early nineteenth century Say's Law of Markets theory of supply and demand i.e supply creates demand.

The claim that an \$80 billion investment program in roads, rail and ports represents a second Snowy Mountains Scheme is political nonsense. In 1949 when the Snowy Mountain Scheme was legislated, the cost represented 18% of the 1949 GDP. The Snowy Scheme ran until 1972 providing 25 years of economic growth. Our \$80 billion represents 5% of the 2013-14 GDP; and, finishes in 10 years

To build the Snowy Mountains Scheme, migrant labour was brought in to provide both the manpower and skills base required. The Snowy Scheme is recognized as the major contributor to the Post War industrialization of south eastern Australia.

Our \$80 billion in roads, rail and ports pales into insignificance compared to the Snowy. We have the labour force, skills and industrial base to build the proposed infrastructure. Any short fall in equipment will be quickly imported. Most of the program will be farmed out to local governments and will enable retention of existing labour in face of the freezing of local government grants. Over the next ten years, there will be no broadening and deepening of the Australian industrial base commensurate to the Snowy Mountains Scheme

It is the underlying structural decline of the economy post 1983 structural reform identified in the empirical analysis that must be addressed. Until that realization penetrates the political and media world, the undeserving public will continue being bombarded with puerile political spin about who has told porky pies or said something nasty about the opposing political party.

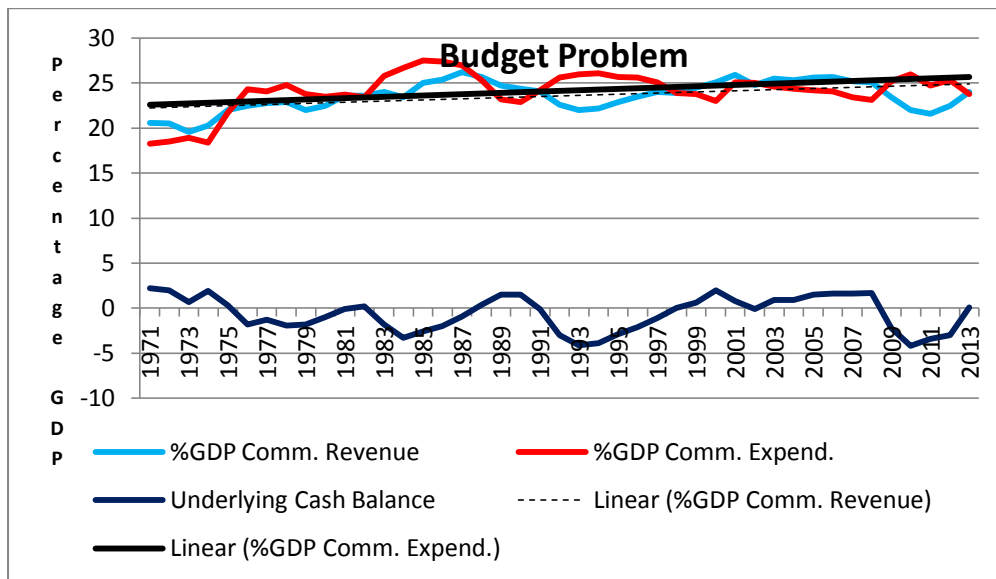
It is time serious economics discussion came back into fashion. The concern is that there has been a loss of economic knowledge post 1983 when supply side economics became fashionable. From the evidence in the graphs above, by 2013-14, there is nothing fashionable about market economics. Indeed that fetish lies at the heart of Australia's economic and political malaise.

2 Graphical Analysis of the Australian economy.

Budget Response

Chart 1

MYEFO : Budget 2012-13



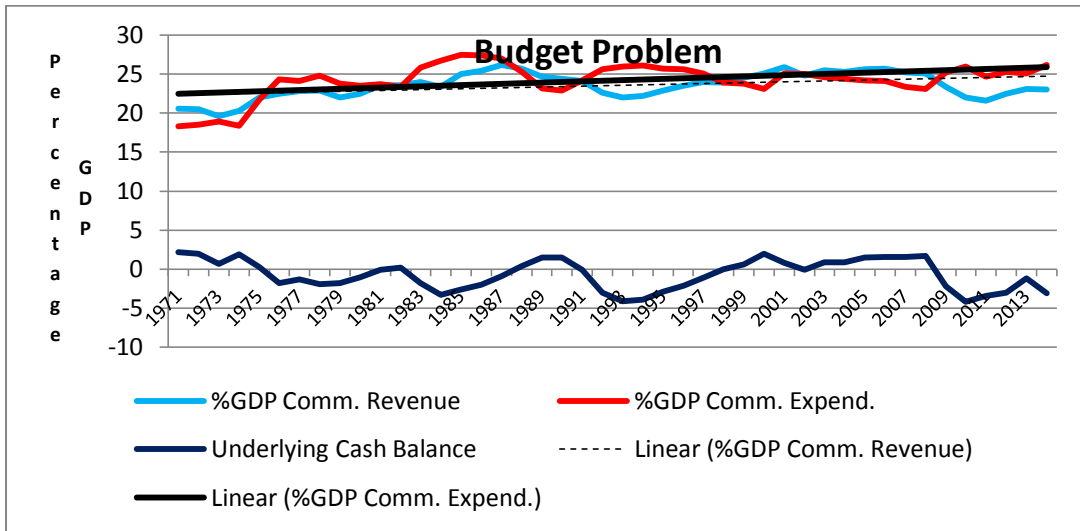
Compiled from: MYEFO 2012-2013- Appendix D ; Table D1

Underlying cash balance = (Revenue- Expenditure) + Futures Fund earnings

- The Budget problem is collapsing revenue which resulted from the GFC 2008-09
- At 21.6% of GDP in 2011, this was an historical low equalled in 1975
- A slow recovery began in 2011
- Expenditure rose from 2008-2011. From 2011, expenditure begins to slow.

Chart 2

Budget 2014-15



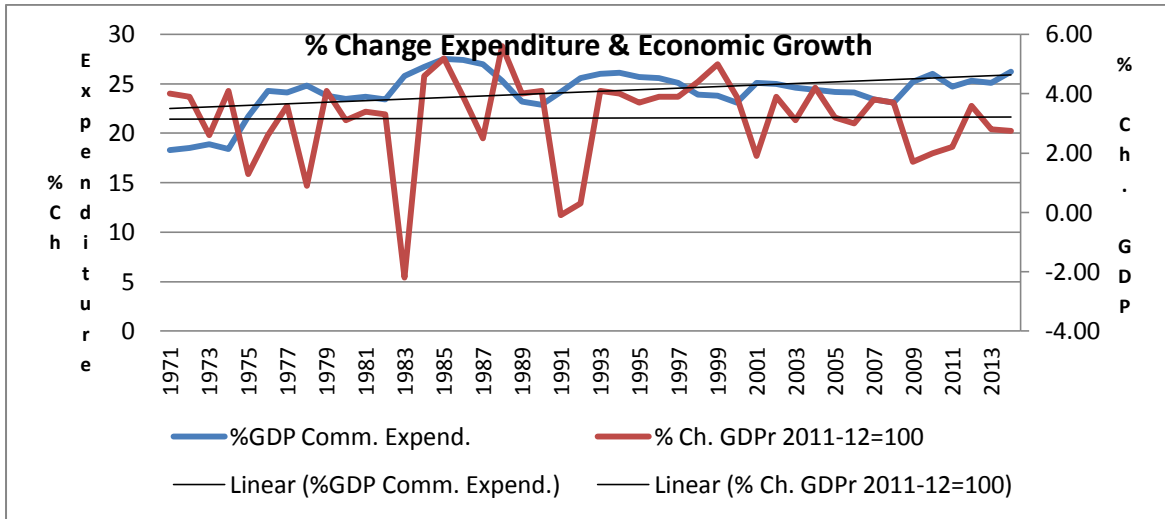
Compiled: (a) 1971- 2012, MYEFO 2012-2013- Appendix Table D1; and, Budget Strategy & Outlook Papers, 2014-15, Statement 2, Economic Outlook, Table 1,

- Revenue post 2011 recovery ceases in 2013 as the curve turns downward
- Budget problem continues as expenditure rises whilst revenue contracts.
- The Budget presents a different picture to the MYEFO document
- How reliable will be the Budget projections?

Economic Problem

Chart 3 examines the long term performance of the economy with reference to growth, expenditure and revenue. Whilst Chart 3 shows that the underlying economy has been in decline since 1985, the long term decline in growth gathers momentum from 1999. The rate of economic growth falls from 5% in 1999 to 2.75 in 2013-14. It is this collapse in underlying economic growth that should lie at the centre of economic policy. Austerity economics can only compound economic decline

Chart 3



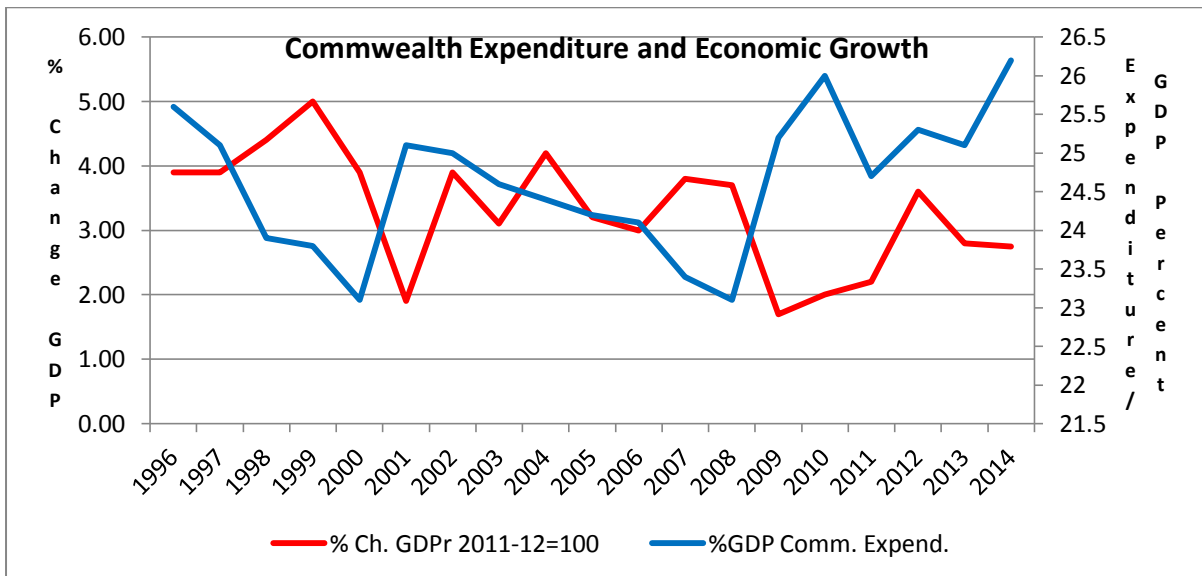
Compiled from :

(a)% Change GDP from ABARES commodity statistics, 2013, Table 6

(b) Expenditure from MYEFO , Appendix D, Table D1 and Budget Strategy and Outlook Papers Table 3

- The severe economic contractions of 1983 and 1991 show historically how expenditure increases in times of economic recession.
- The same patterns are there but in less dramatic impact in the shallow economic contractions of 2001 and 2008
- Economic growth post 2004 has been volatile and downward sloping
- It is the downturn in economic growth that is the most serious challenge for policy in curtailing expenditure blow out.
- An austerity budget does not address the problem of underlying growth decline

Chart 4



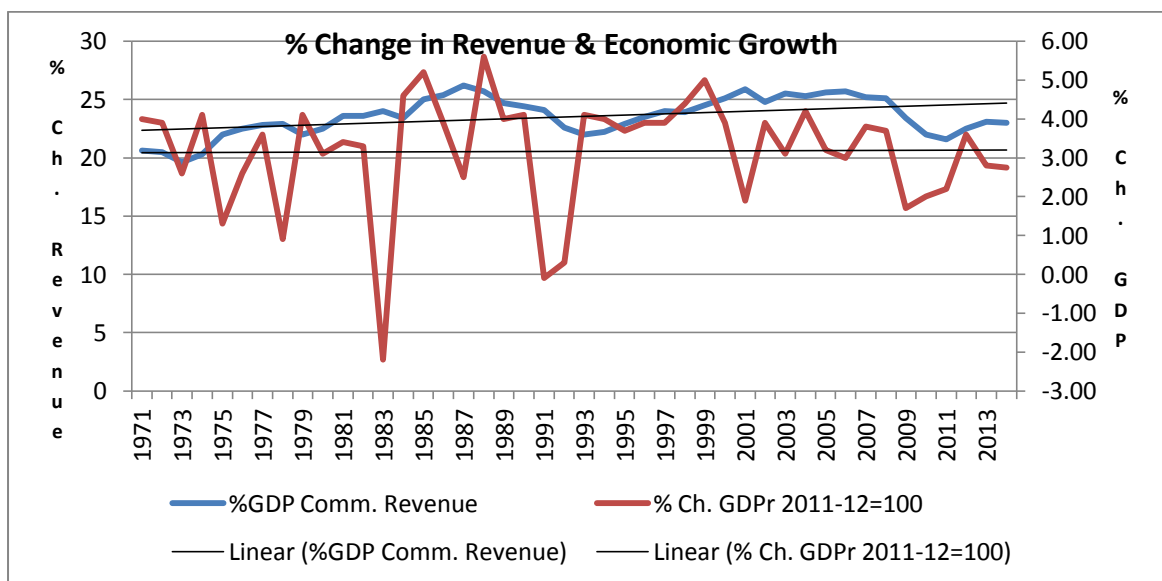
Compiled from :

(a)% Change GDP from ABARES commodity statistics, 2013, Table 6

(b) Expenditure from MYEFO , Appendix D, Table D1 and Budget Strategy and Outlook Papers Table 3

- Chart 4 illustrates the response of Commonwealth expenditure to changing levels of economic growth
- The response of expenditure to the GFC collapse in economic growth is clearly identifiable
- 2013-14 economic growth is 0.95% lower than 2008
- Persistent post GFC low economic growth underwrites the current pattern of expenditure
- Austerity policy directed to reducing expenditure can be expected to compound low economic growth.
- Policy direction to raise economic growth would be a preferred strategy

Chart 5



Compiled From :

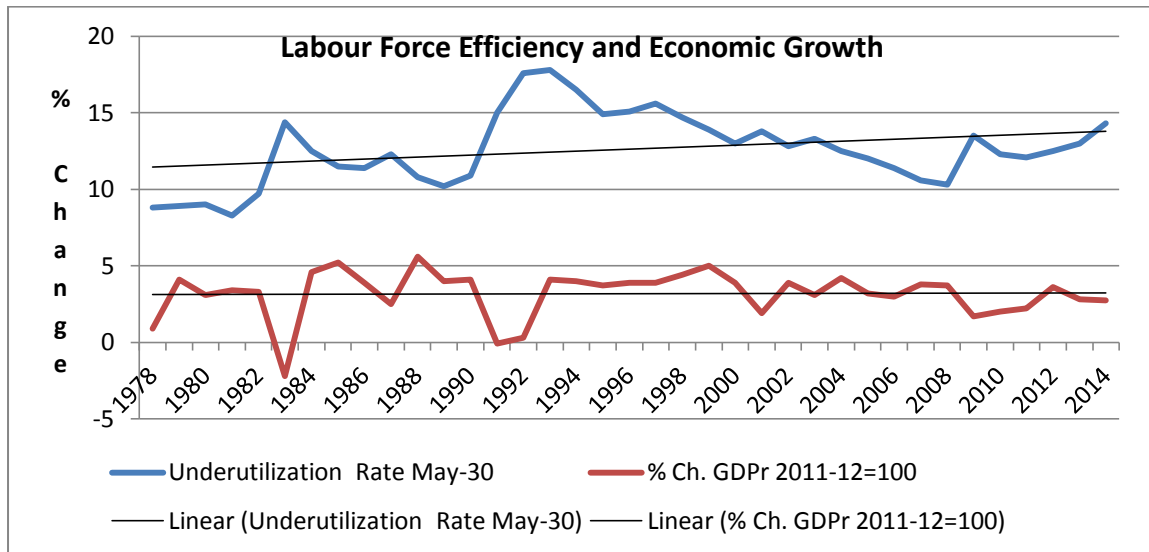
(a) % Change GDP from ABARES commodity statistics, 2013, Table 6; and, Budget Strategy and Outlook Papers, Statement 2, Table1

(b) Revenue from MYEFO, Appendix D, Table D1 and Budget Strategy and Outlook, Statement 5, Table 8

- Revenue decline begins in 2006
- Revenue collapse is triggered by the GFC 2008
- Post GFC revenue recovery in revenue stalls at 1978 levels
- The role of the GFC in revenue collapse is clearly identifiable
- Post GFC policy has failed to understand the correct nature of the revenue collapse and set macroeconomic policy accordingly

Labour Force Inefficiency

Chart 6



Compiled from:

(a) % Change GDP from ABARES commodity statistics 2013, Table 6; and
Budget Papers, Strategy and Outlook, Statement 5, Table 8

(b) ABS Labour Force Publication 6202 Series Spreadsheets, online, Feb
2014-05-17

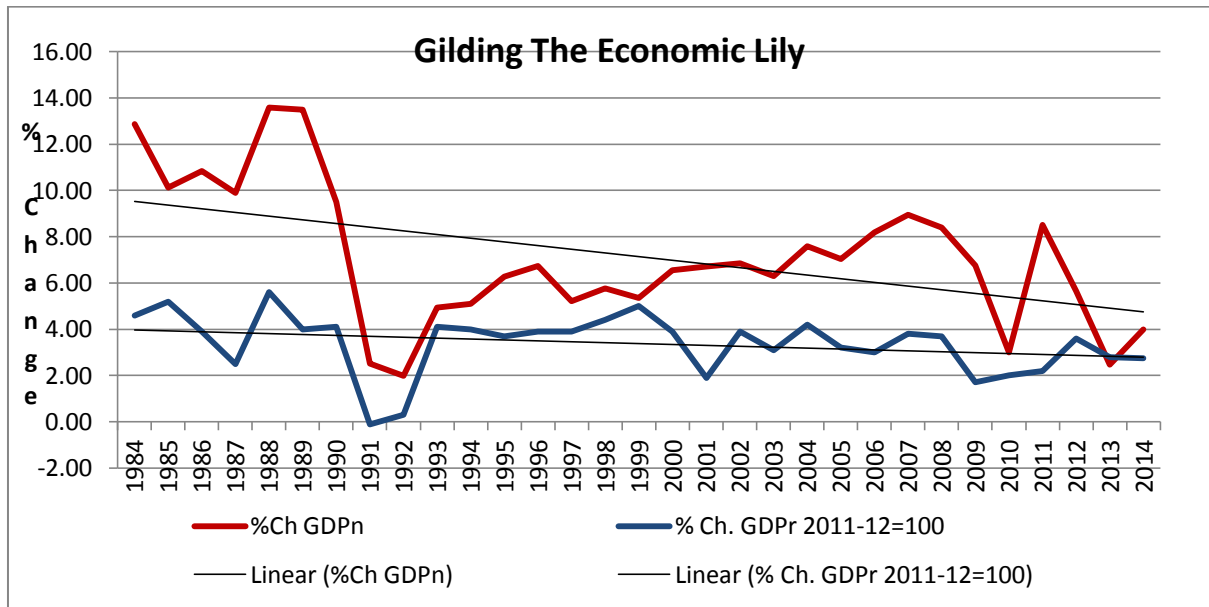
Note: The underutilization rate is published quarterly. May 2014 data is not yet published. The 2014 underutilization statistic is February 2014

- Note the response of the underutilization rate to underlying economic growth
- The underutilization rate consolidates unemployed and underemployed into one figure. It is the true measure of the inefficient use of the Australian labour force.
- February 2014 is one basis point below the level of 1983. The 1983 recession has proven to be the worst economic contraction since World War II

3 Gilding the Economic Lily

Structural reform of the Australian economy began on the election of the Hawke government in March 1983. At that time, the Australian economy was entering what proved to be and remains the worst economic contraction since World War II. Chart 6 excludes 1983 for the statistical reason of being an extreme sample that will distort analysis of post 1983 structural reform.

Chart 6



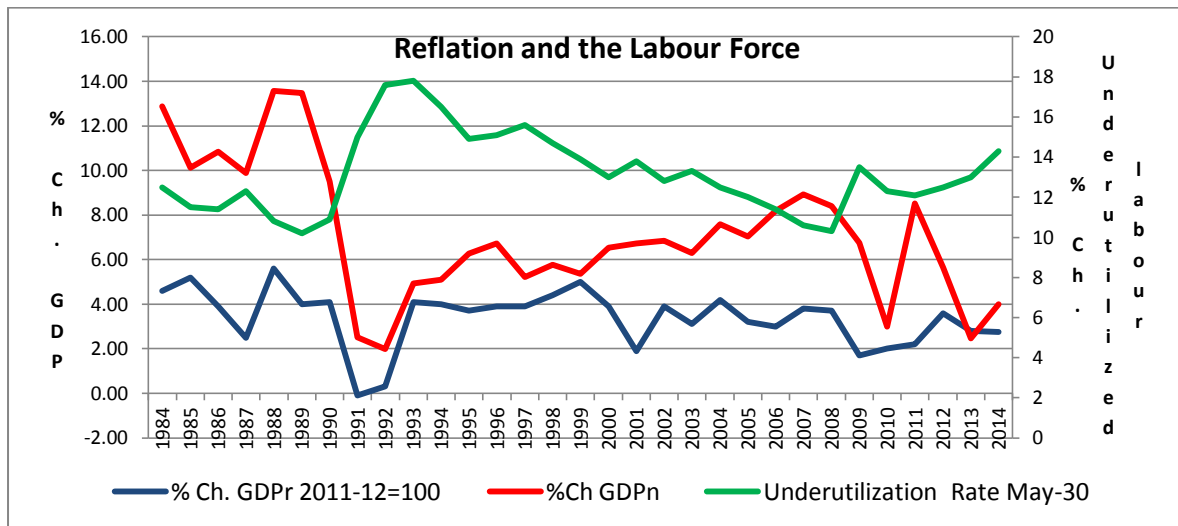
Compiled from:

(a) % Change GDP compiled from ABARES commodity statistics, Tables 1, & Table 6

(b) 2013-2014 data from Budget Outlook and Strategy, Statement 2, Table 1

- Inflation as a policy direction to recover from recession is a legitimate policy strategy.
- The distance between the rate of change in nominal GDP and rate of change in real GDP is monetary phenomena and confirms a predilection of Australian economic policy to reflate out of economic contraction
- The slope of the downward trend lines suggest that whilst reflating an economy in the short term will work, persistent reflation over the long term generates underlying economic decline in the real sector.
- The downward slope of the trend lines strongly question the populist claims that economic reforms post 1983 have produced a sound flexible , dynamic economy
- Graphical evidence suggests that the economic problem confronting Australia is entrenched long term structural decline in the economic base
- Structural reforms post 1983 must be considered as strong contributing factors to underlying economic decline.
- The “resources boom “ post 2004 does not express as a significant impact in underlying economic growth
- The 2007 peak in nominal GDP is attributable to monetization of the economy not the underlying performance of real growth.
- The sharp peak in nominal GDP in 2011 is again monetary phenomena not real growth.
- A 5.5 % increase in monetization of the economy between 2010 and 2011bought a 0.2% improvement in underlying real growth does not demonstrate policy success.
- The 2010-11 monetization of the economy raises underlying growth from 2%to in 2010 to 3.6% in 20112.

- As monetization fell from 8.51 % in 2011 to 2.8% in 2012, underlying real growth contracted from 3.6% to 2.75% in 2013-14.



(a) ABS Labour Force Table 6202, Time Series Spread Sheet, February 2014

(b) (a) % Change GDP compiled from ABARES commodity statistics, Tables 1, & Table 6 ;and, Budget Outlook and Strategy, Statement 2, Table 1

- Reflation of the economy demonstrates a more substantive impact upon labour force underutilization than underlying economic growth
- From 1984 onwards there appears an empirical relationship between reflation and the labour force than the underlying structure of the economy.

4 Conclusions

Graphical analysis of empirical economic data demonstrates that Australia does not have a debt crisis. The political concern over government rising expenditure and low revenue shows a poor grasp of economics. The real problem is the post 1983 structural decline in the underlying base of the economy. This is shown in Chart 6 *Gilding the Economic Lily*. The problem the underlying economic malaise was rudely exposed with the GFC.

Post GFC reflation of the Australian economy shows distinct characteristics of policy failure. Economic growth post GFC has been dismal. Consequently revenue has declined whilst expenditure has blown out. The policy problem then is inadequate economic growth which requires an expansionary industry policy that will broaden and widen the underlying production base. In other words structural reform through a planned discretionary industry policy not reliant upon market signals.

Chart 6 demonstrates that progressively over almost three decades of structural reform, the real economy has developed underlying economic malaise. The GFC has rudely exposed almost three decades of gradual decline for everyone to see. The long term malaise then is directly related to the structural reforms post 1983. There needs to be a sensible debate amongst the community now over a new policy direction that will rebuild the production base of this nation

