

MANAGING THE BUDGET/DEFICIT CRISIS? OR AN OPPORTUNITY TO PRUNE PUBLIC SPENDING

PRESENTATION TO 'CRISIS MANAGEMENT:
THE HOWARD GOVERNMENT EXPERIENCE

THE JOHN HOWARD PRIME MINISTERIAL LIBRARY
ANNUAL CONFERENCE 2022

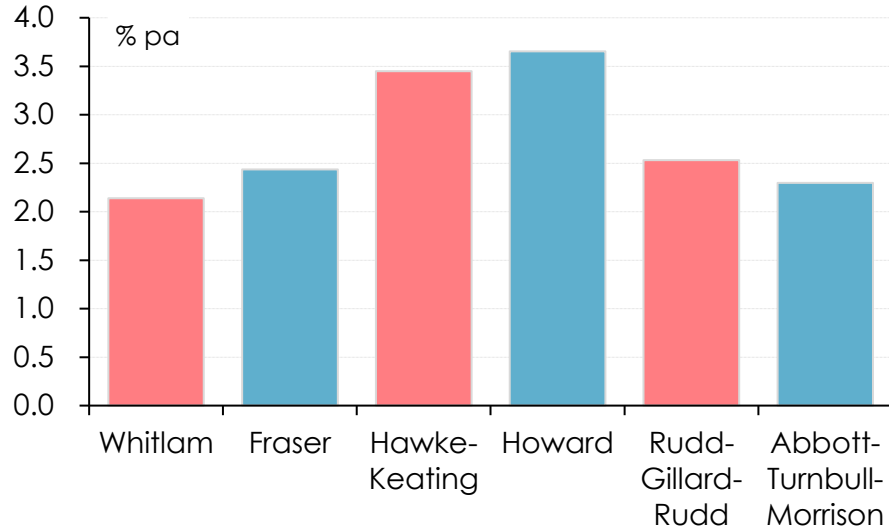
THE NATIONAL PRESS CLUB, CANBERRA
23RD JUNE 2022

SAUL ESLAKE

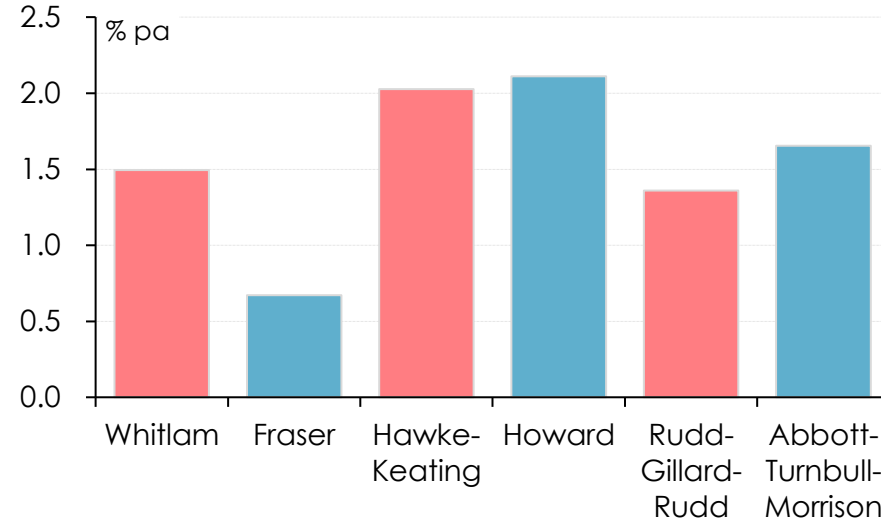
CORINNA ECONOMIC ADVISORY
INDEPENDENT ECONOMICS

The Howard Government's economic 'track record' is the best of any Australian government in the past fifty years

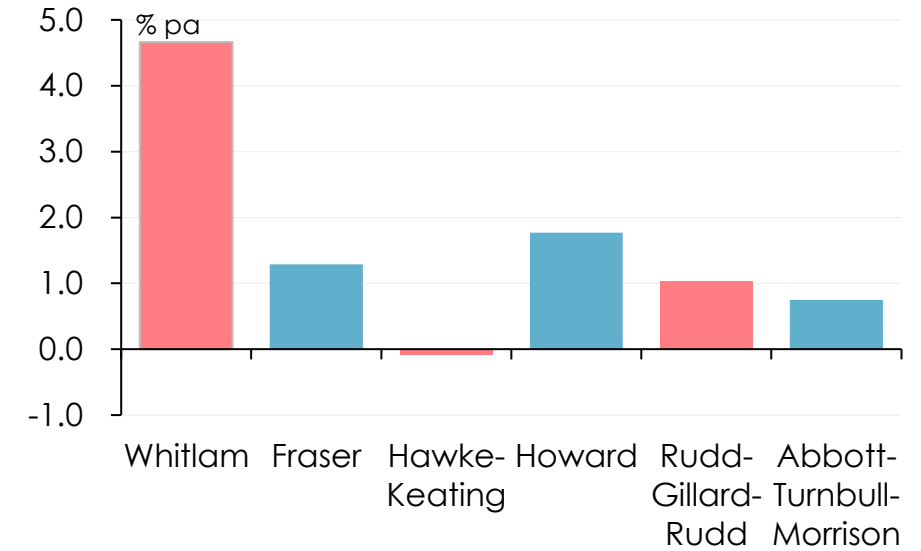
Real GDP growth



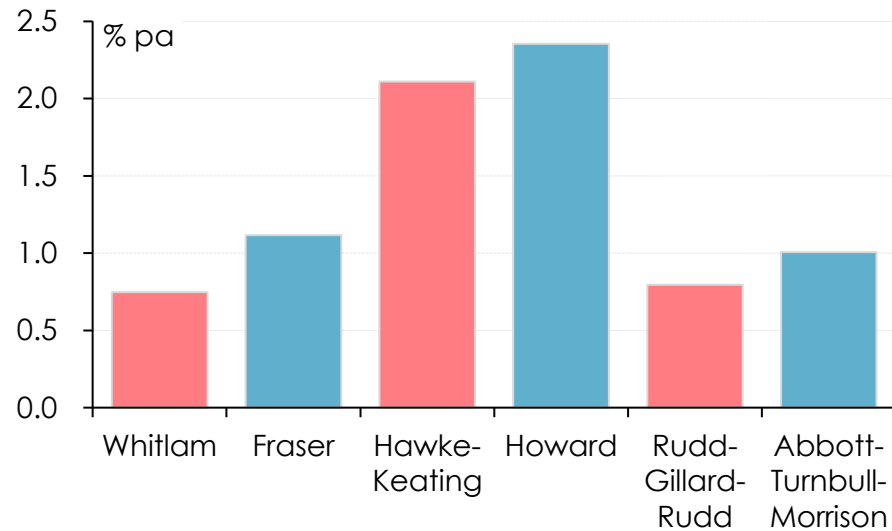
Employment growth



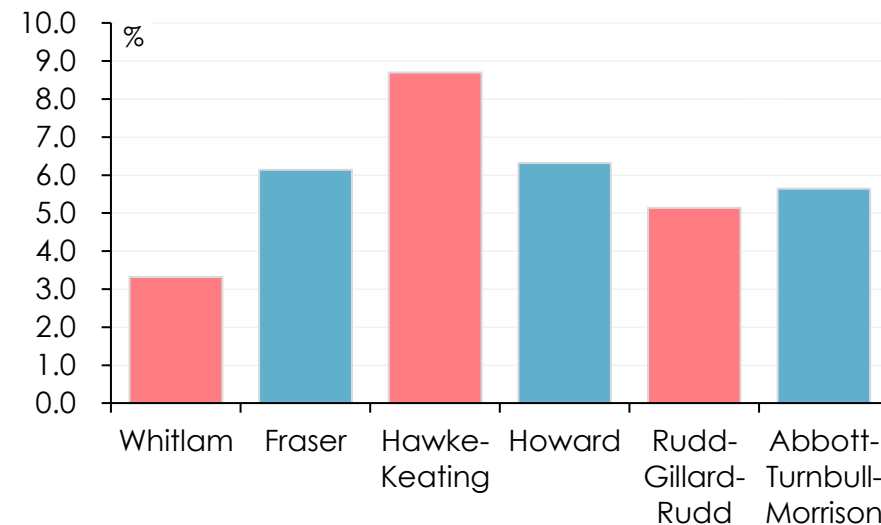
Real average earnings growth



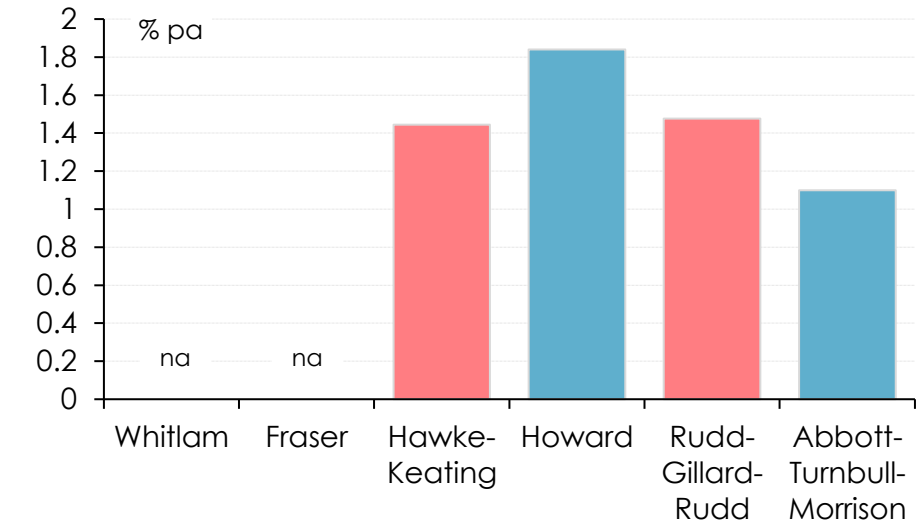
Real per capita GDP growth



Unemployment rate



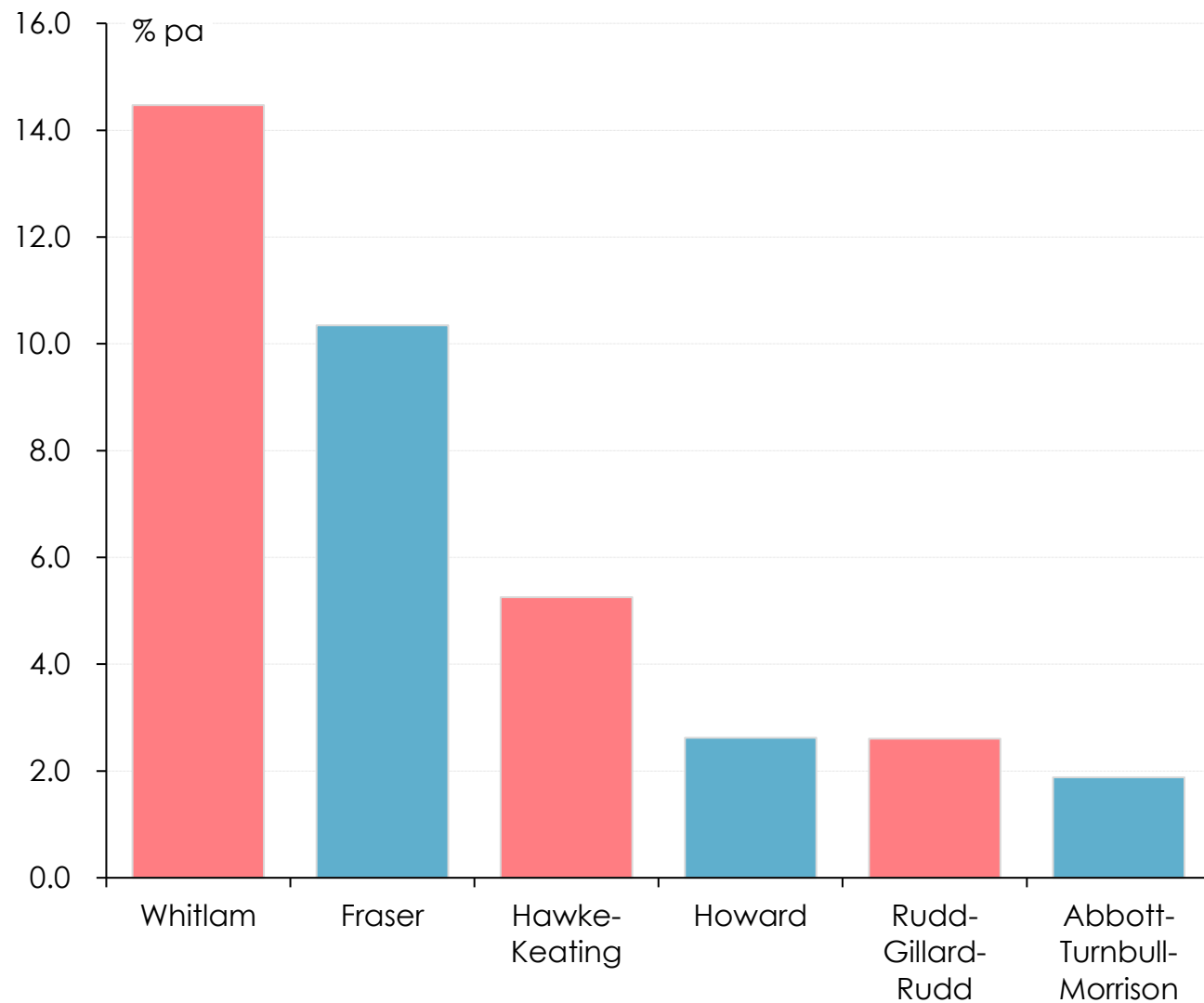
Labour productivity growth



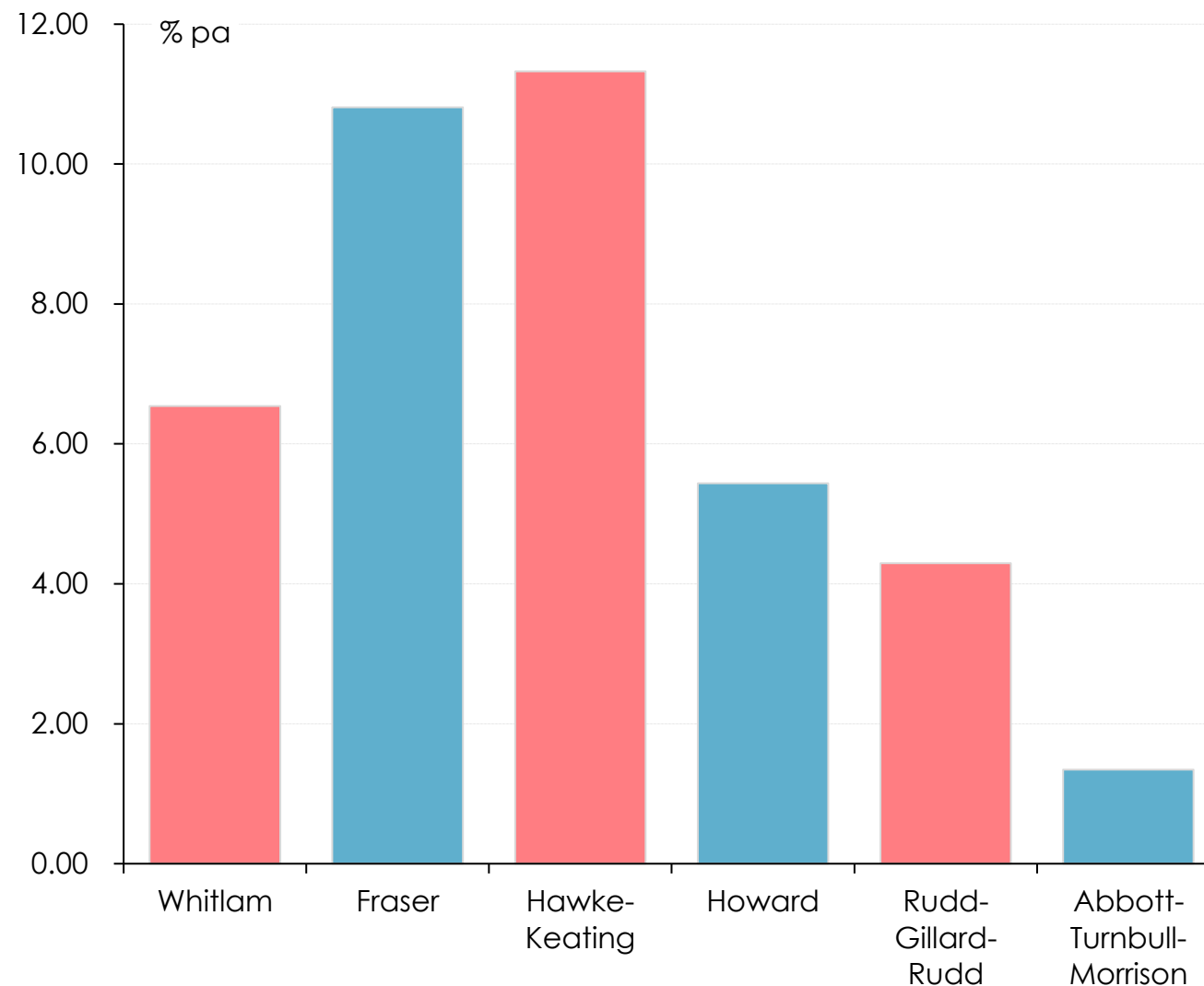
Note: growth and unemployment rates are calculated over the intervals between the quarters closest to the beginning and end of the term of each government shown.
Source: ABS.

The Howard Government presided over larger reductions in inflation and interest rates than any other in the past fifty years

Inflation



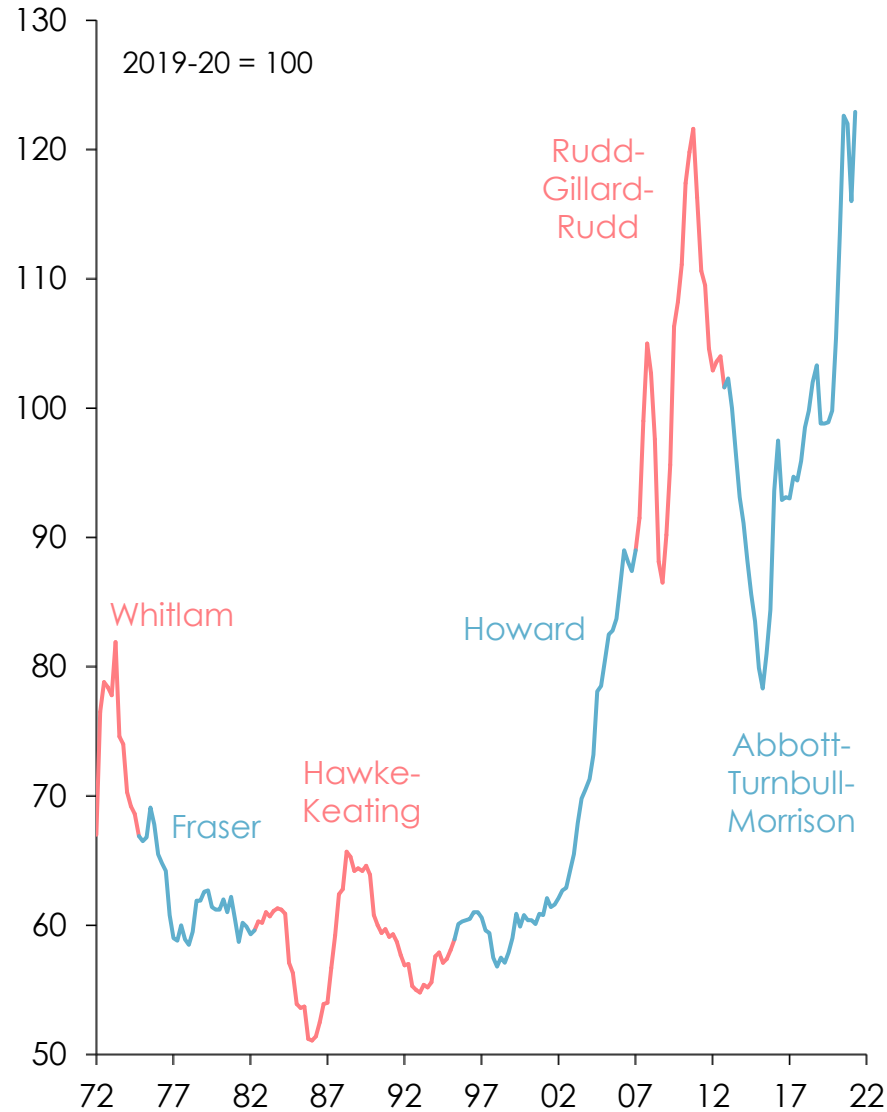
RBA cash rate



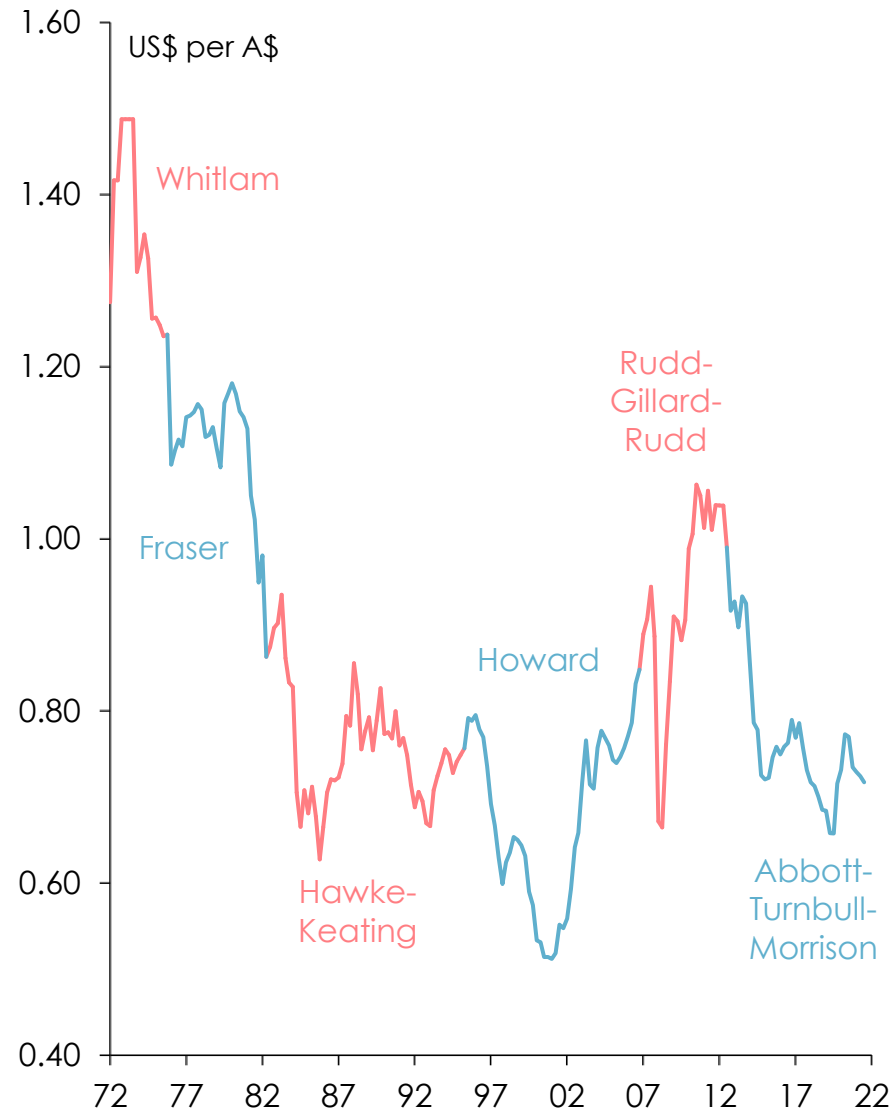
Note: Inflation and interest rates are calculated over the intervals between the quarters closest to the beginning and end of the term of each government shown.
Sources: ABS and RBA.

The Howard Government's economic 'track record' benefited from unusually favourable external circumstances

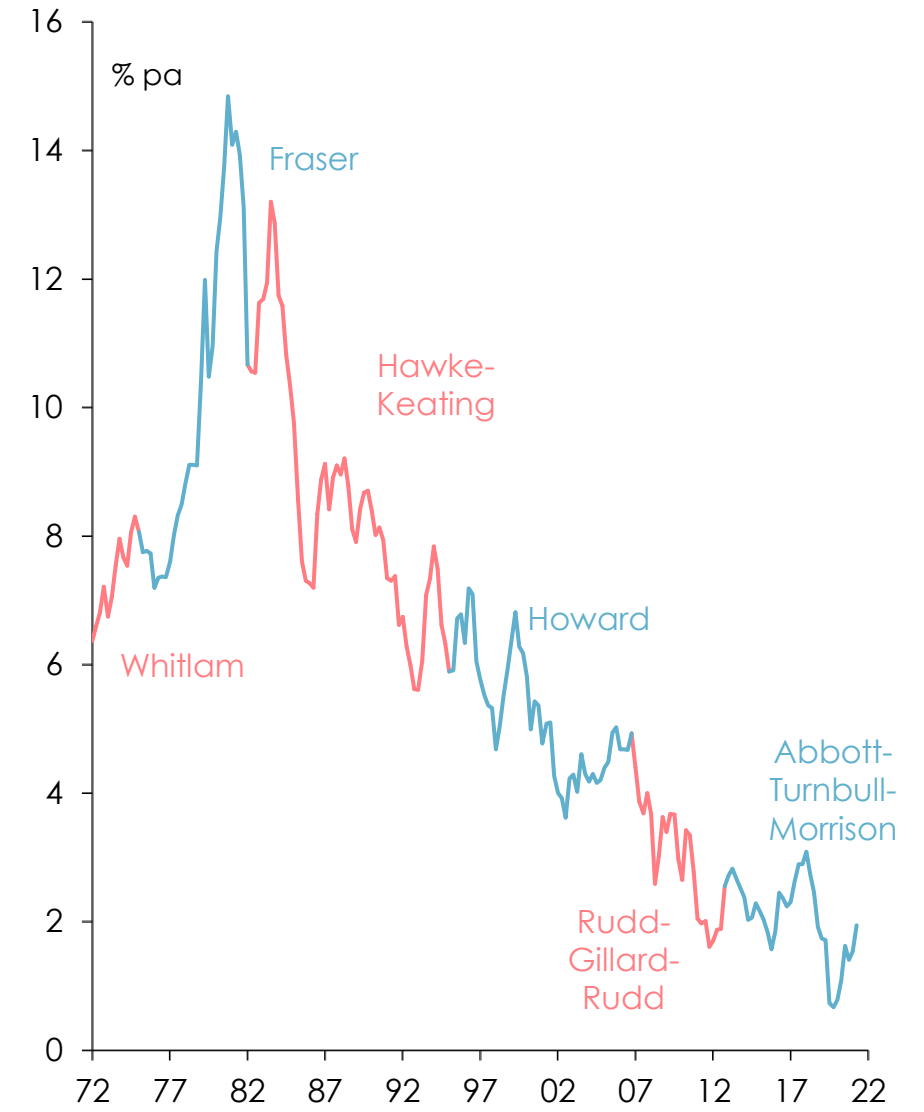
Australia's terms of trade



A\$-US\$ exchange rate



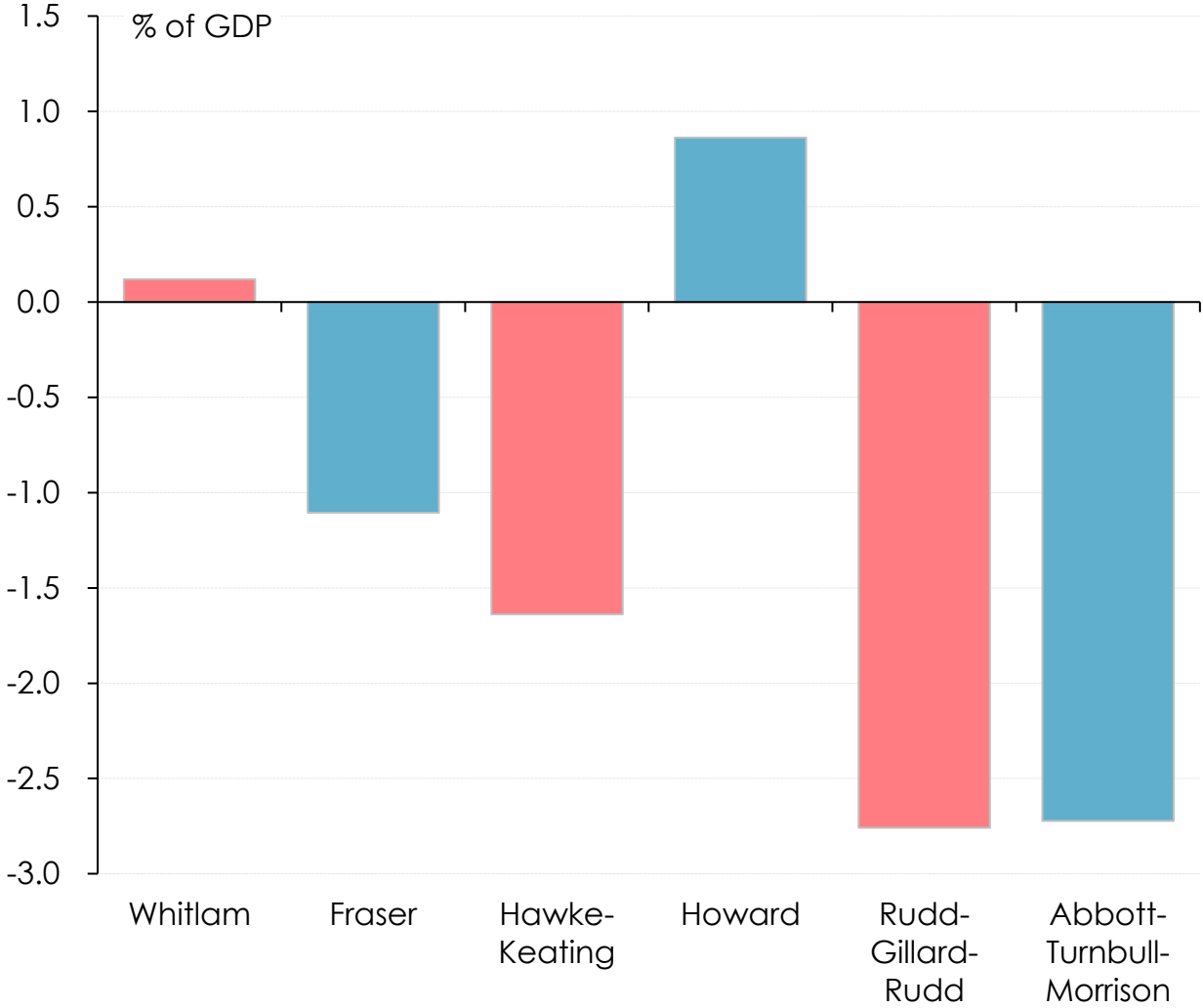
US 10-year bond yield



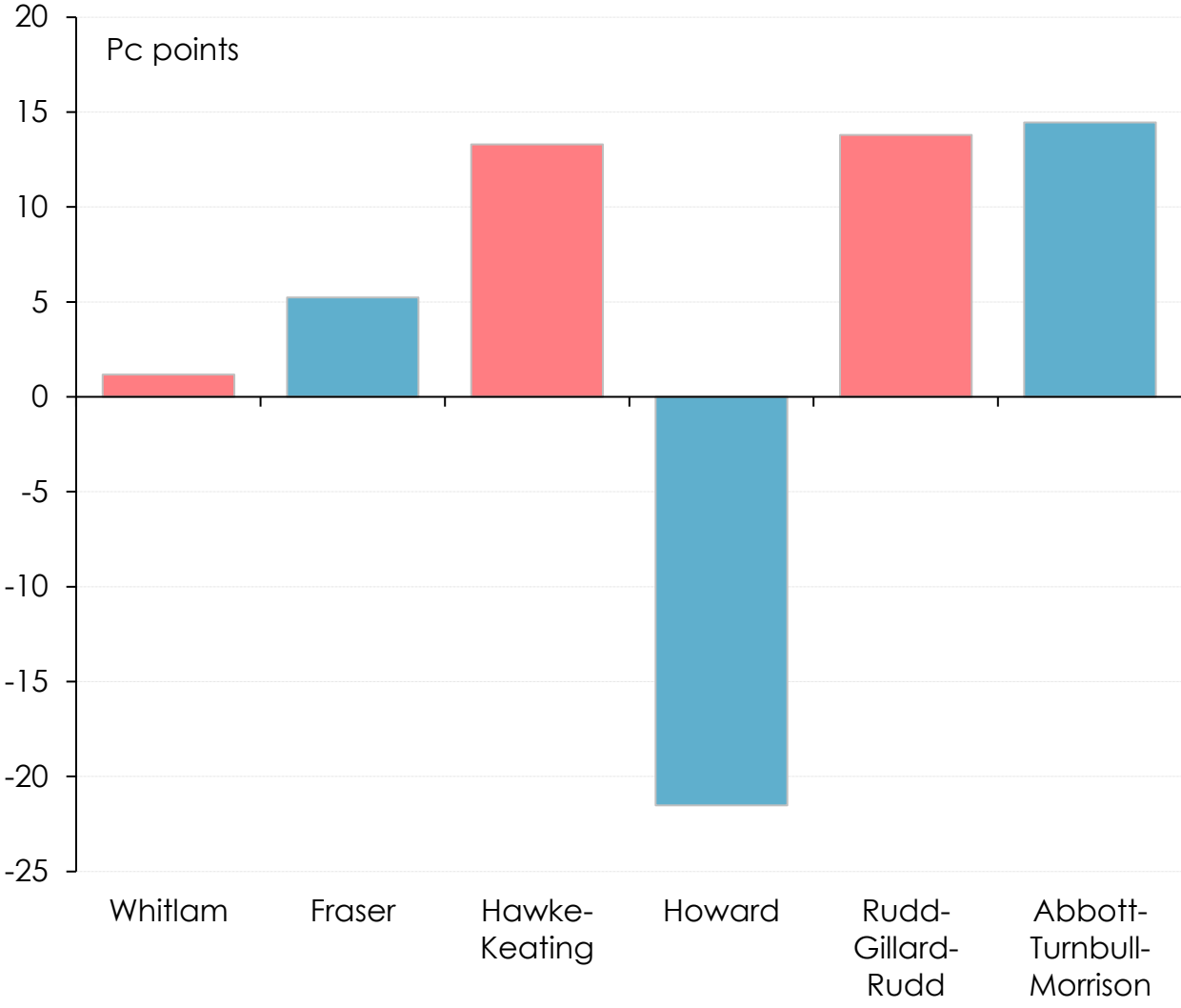
Sources: ABS; RBA; US Federal Reserve.

The Howard Government's record in managing Australia's public finances is without parallel

Commonwealth Government 'underlying' cash balance



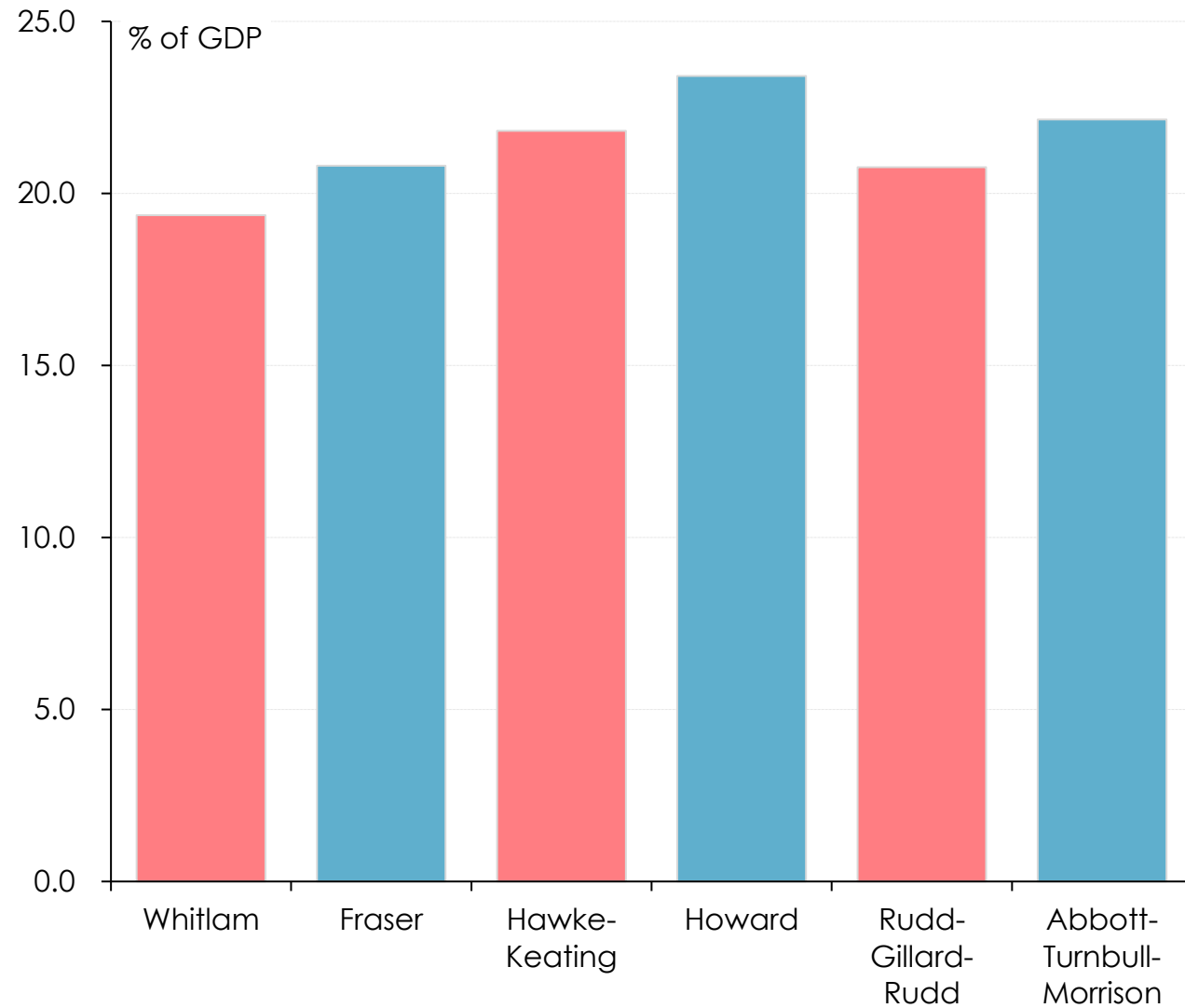
Change in Commonwealth Government net debt



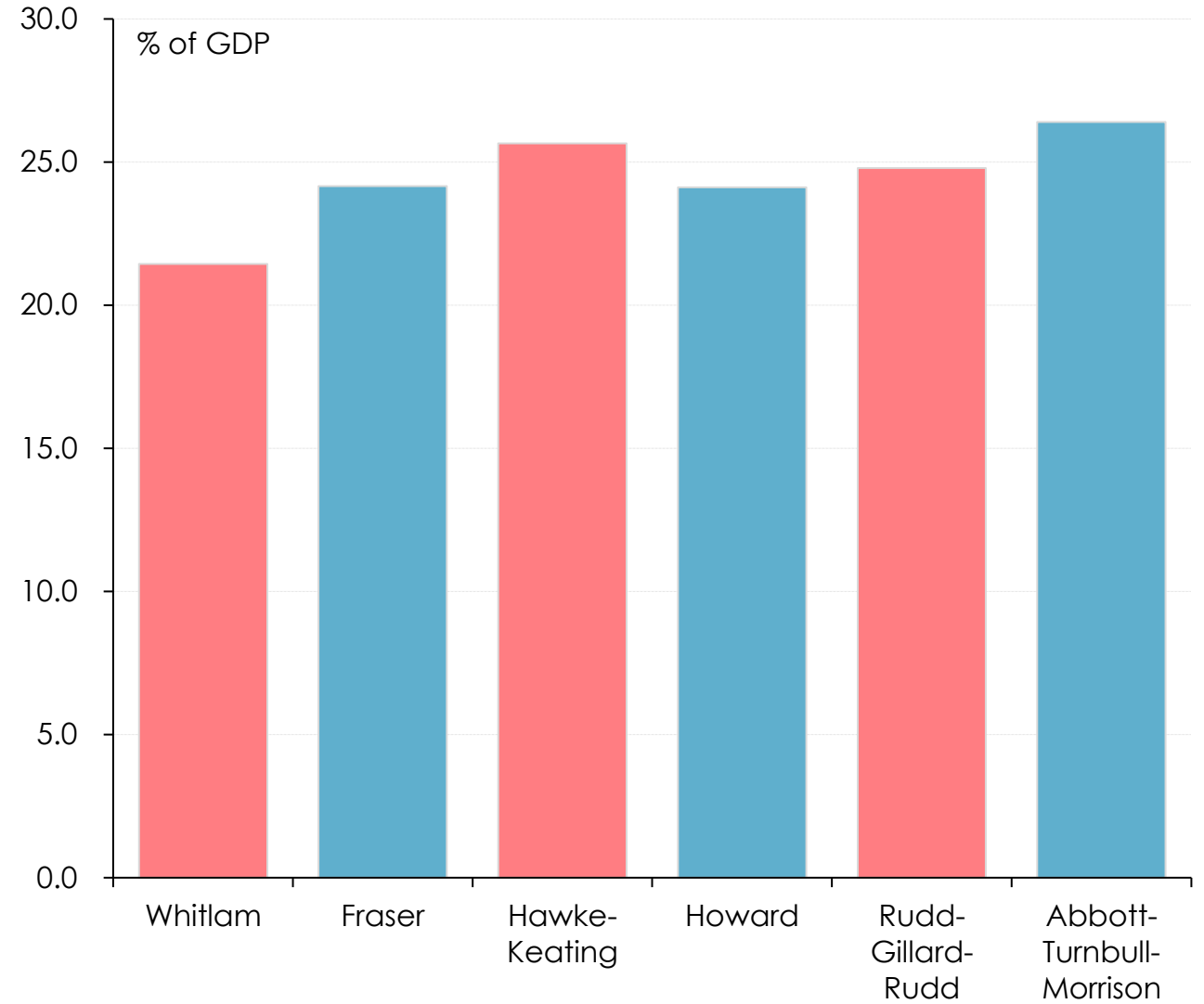
Note: The average 'underlying' cash balance and the change in net debt are calculated over the financial years for which the government shown produced the annual budget. Source: Australian Government, 2022-23 Budget Paper No. 1, Budget Strategy and Outlook, Statement 10.

But those outcomes owed more to the revenue side of the budget than the spending side

Taxation receipts as a percentage of GDP



'Underlying' cash payments as a percentage of GDP

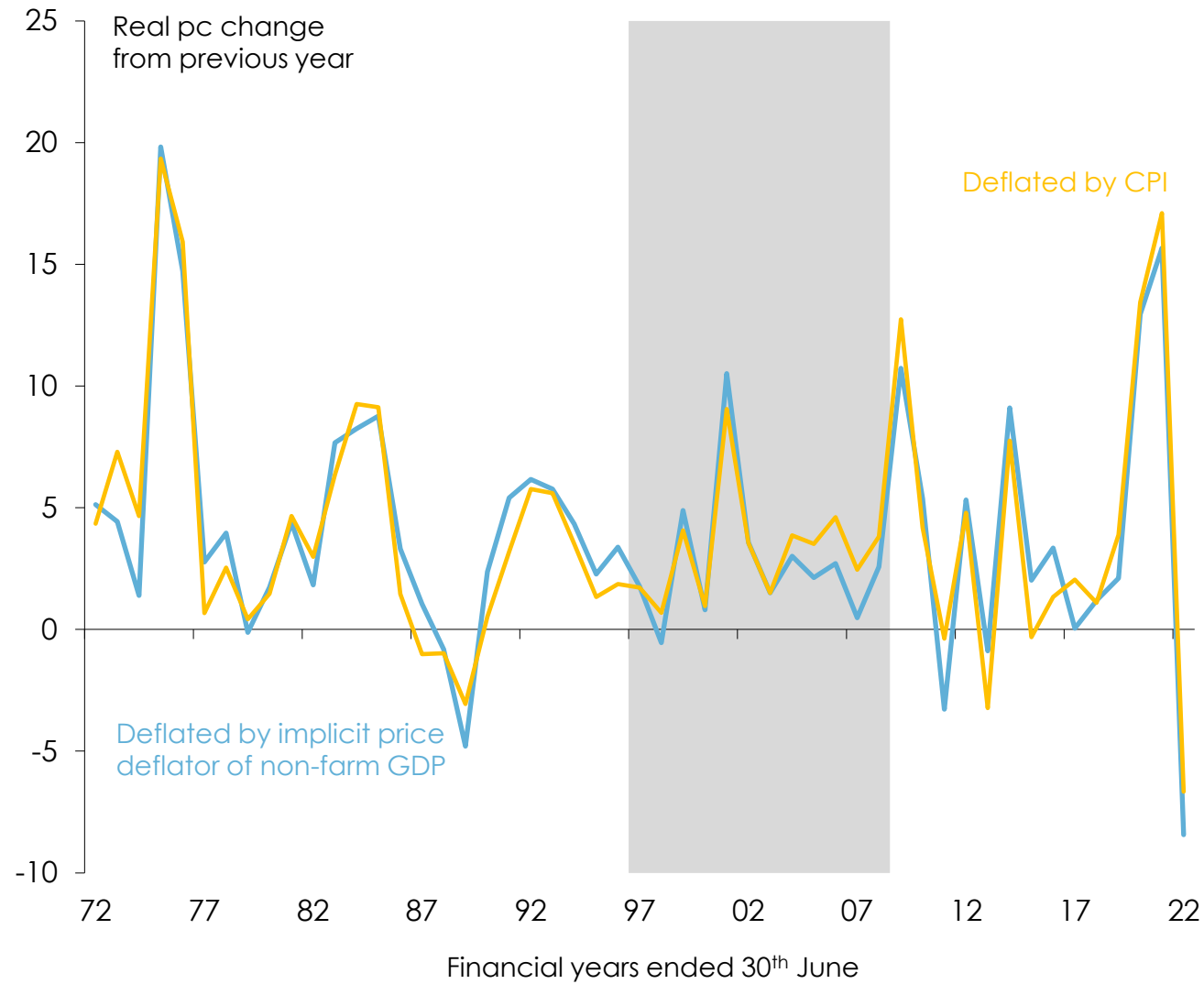


Note: Average tax receipts and cash payments are calculated over the financial years for which the government shown produced the annual budget.

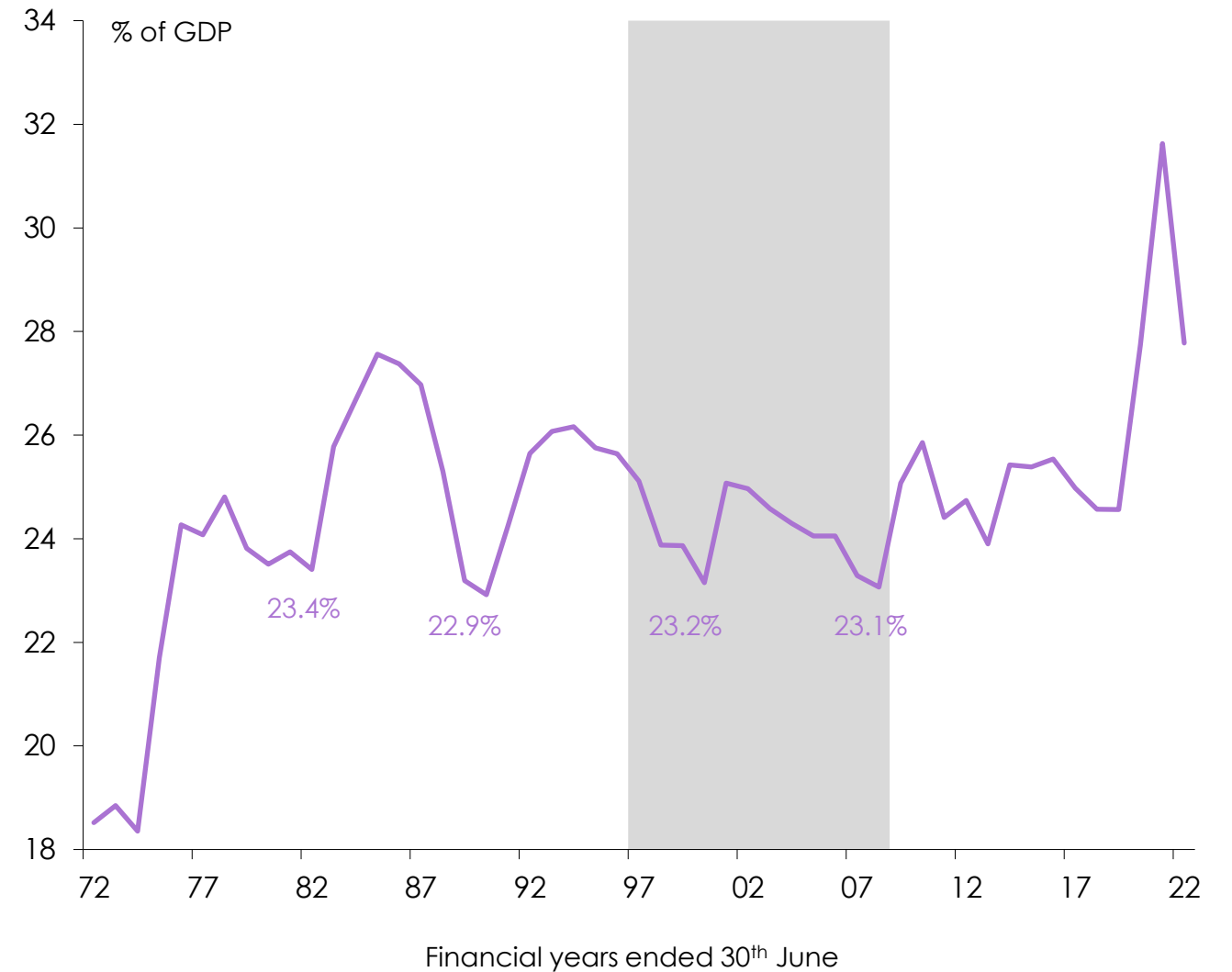
Source: Australian Government, 2022-23 Budget Paper No. 1, Budget Strategy and Outlook, Statement 10.

Government spending fell, in real terms, in only one year during the Howard Government's term (or not at all if the CPI is used as the deflator)

'Underlying' cash payments in real terms



'Underlying' cash payments as a percentage of GDP



Note: Shaded interval depicts the period covered by the budgets of the Howard Government.
 Source: Australian Government, 2022-23 Budget Paper No. 1, *Budget Strategy and Outlook*, Statement 10.

The Howard Government's first Budget did include significant cuts in government spending – but it was the only one which did

Spending cuts in the 1996-97 Budget

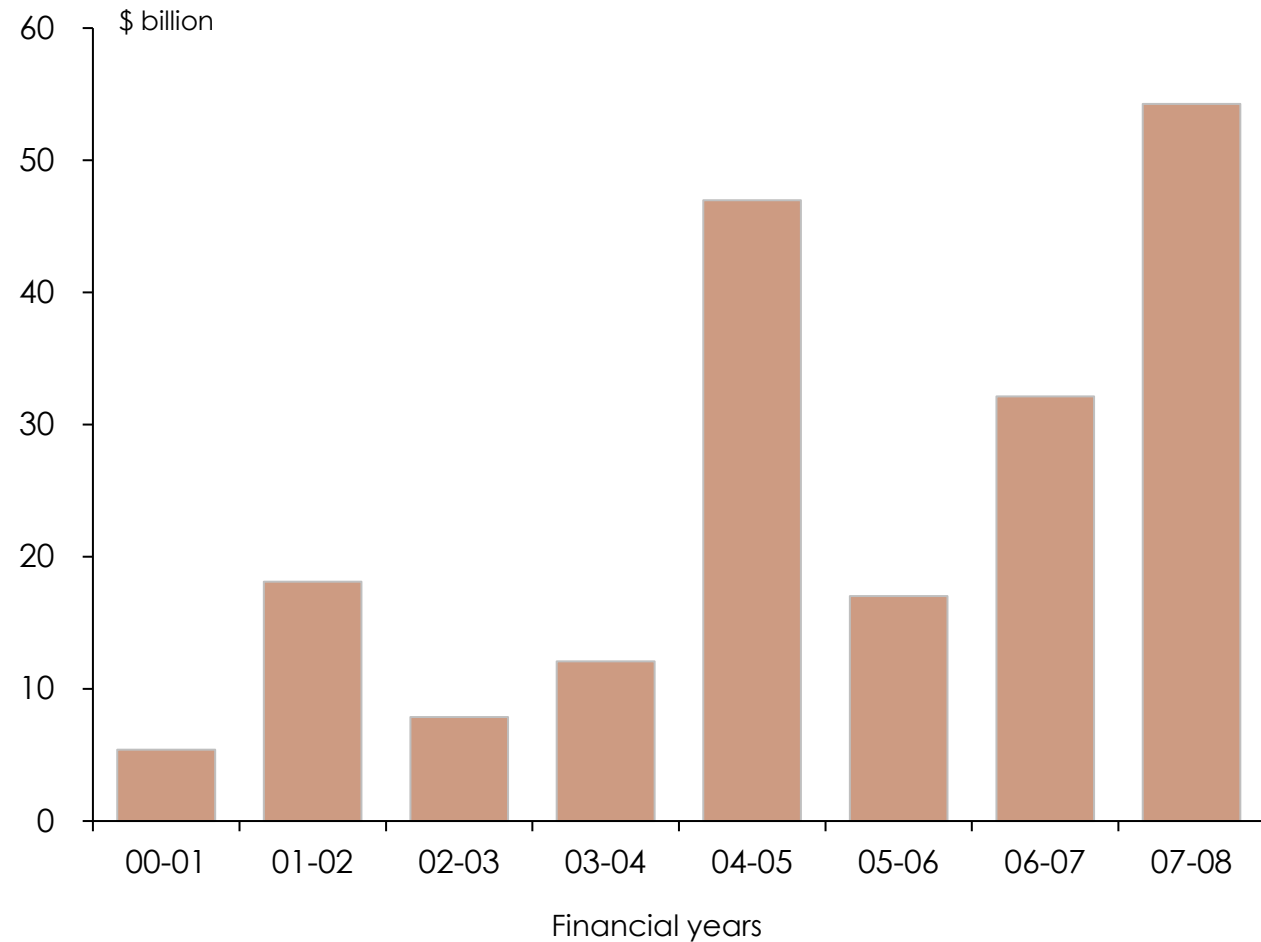
	Effect on outlays			
	1996-97 \$m	1997-98 \$m	1998-99 \$m	1999-00 \$m
SAVINGS MEASURES				
Reduction of 2 per cent in running costs	-187	-188	-190	-194
Migrant two year waiting period for Social Security payments	-28	-140	-188	-194
State fiscal contributions	-619	-640	-300	-
Amend AUSTUDY eligibility	-56	-123	-136	-143
Differential HECS: Course Cost	-133	-373	-569	-694
Labour Market Program Savings	-575	-956	-130	-175
Abolish Development Import Finance Facility	-94	-126	-130	-134
Capping the EMDG Scheme	-	-77	-122	-145
Reform of Aged and Community Care	-6	-141	-190	-231
Diagnostic Imaging and Pathology Reform Package	-62	-127	-174	-223
Tighter targeting of childcare	-17	-147	-170	-170
DFRS Efficiency Savings	-56	-113	-116	-120
Tighten JSA/NSA Activity Test Administration	-39	-105	-110	-115
Reduction in National Highway Funding	-113	-138	-157	-214
Other(a)	-2464	-3829	-4354	-5260
Total Saving Measures	-4449	-7223	-7036	-8012
SPENDING MEASURES				
<i>Election Commitments</i>	571	1392	1418	1287
<i>Other Spending Measures</i>	949	634	772	660
TOTAL IMPACT OF ALL MEASURES	-2929	-5197	-4847	-6065

- ❑ On taking office the Howard Government 'discovered' that the budget 'bottom line' for the four years 1995-96 through 1998-99 was \$28.4bn worse than had been forecast in the last Keating Government Budget
- ❑ The Government used this 'black hole' as a rationale for spending cuts in its first Budget totalling \$26.7bn (4½%) over the four years to 1999-00
 - although it 'gave back' \$7.7bn of that in new spending (much of it on election promises)
- ❑ The 1996-97 Budget also included revenue-raising measures totalling \$9.4bn over the four years to 1999-00 (including cuts to R&D tax concessions and the 'superannuation surcharge') partly offset by tax cuts (mainly the Family Tax Initiative) worth \$3.1bn
- ❑ The budget returned to cash surplus in 1997-98, a year earlier than predicted in the 1996-97 Budget
- ❑ This in turn paved the way for to start cutting interest rates, which helped the Australian economy through the 'Asian financial crisis'

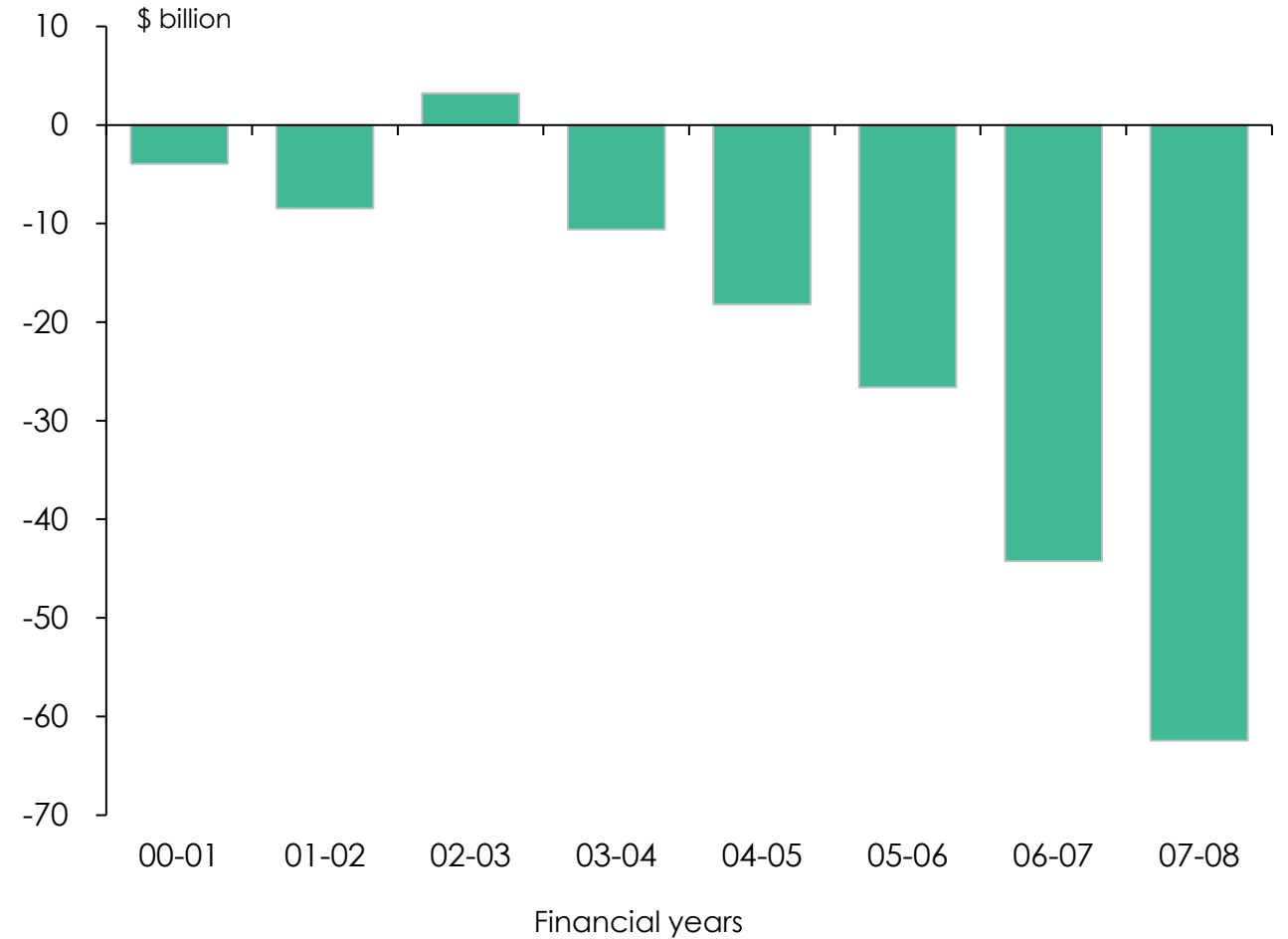
In its third and fourth terms, the Howard Government's budgets consciously increased spending – and cut taxes

Impact of 'policy decisions' on the fiscal balance measure of the budget 'bottom line', 2000-01 through 2007-08

Expenses



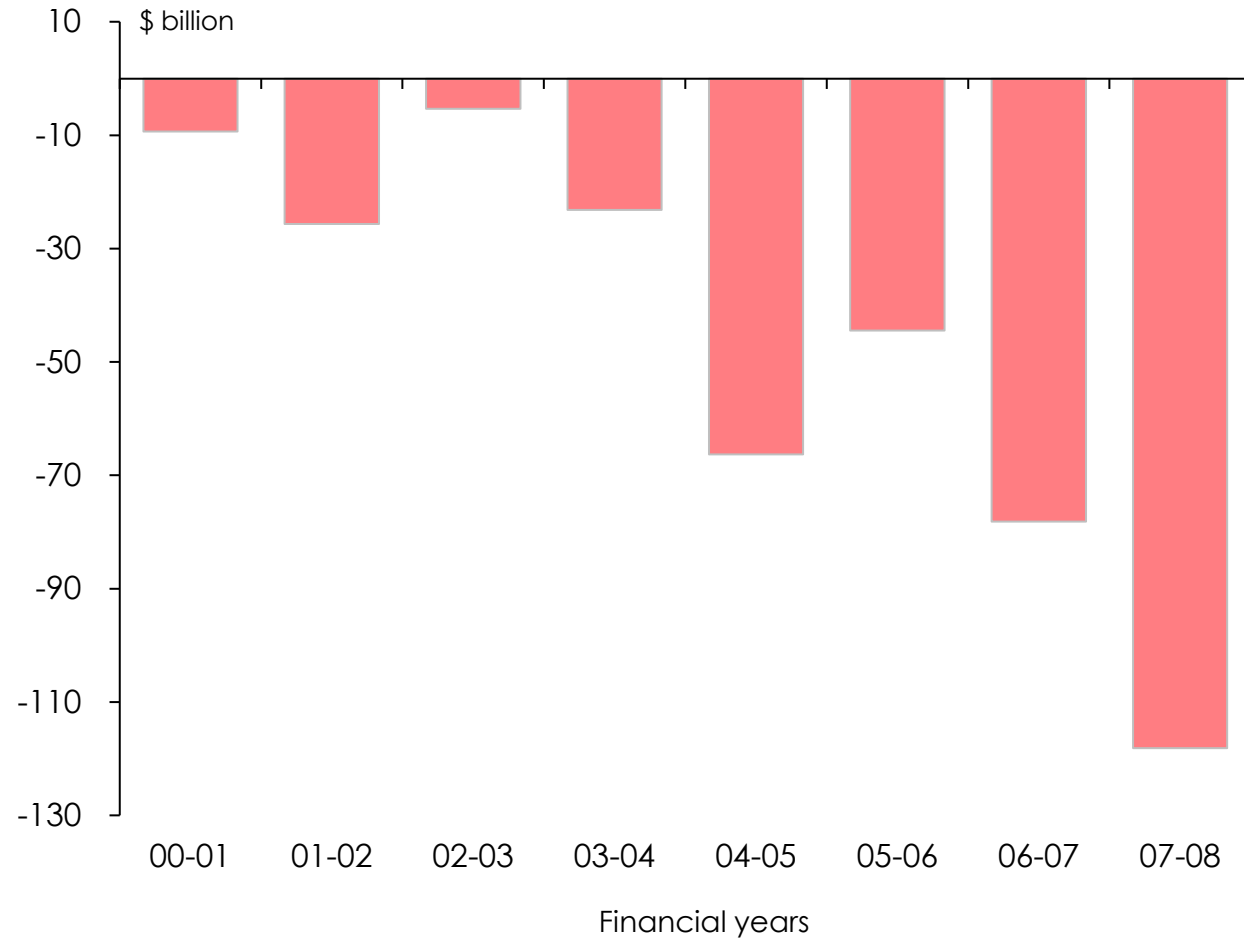
Receipts



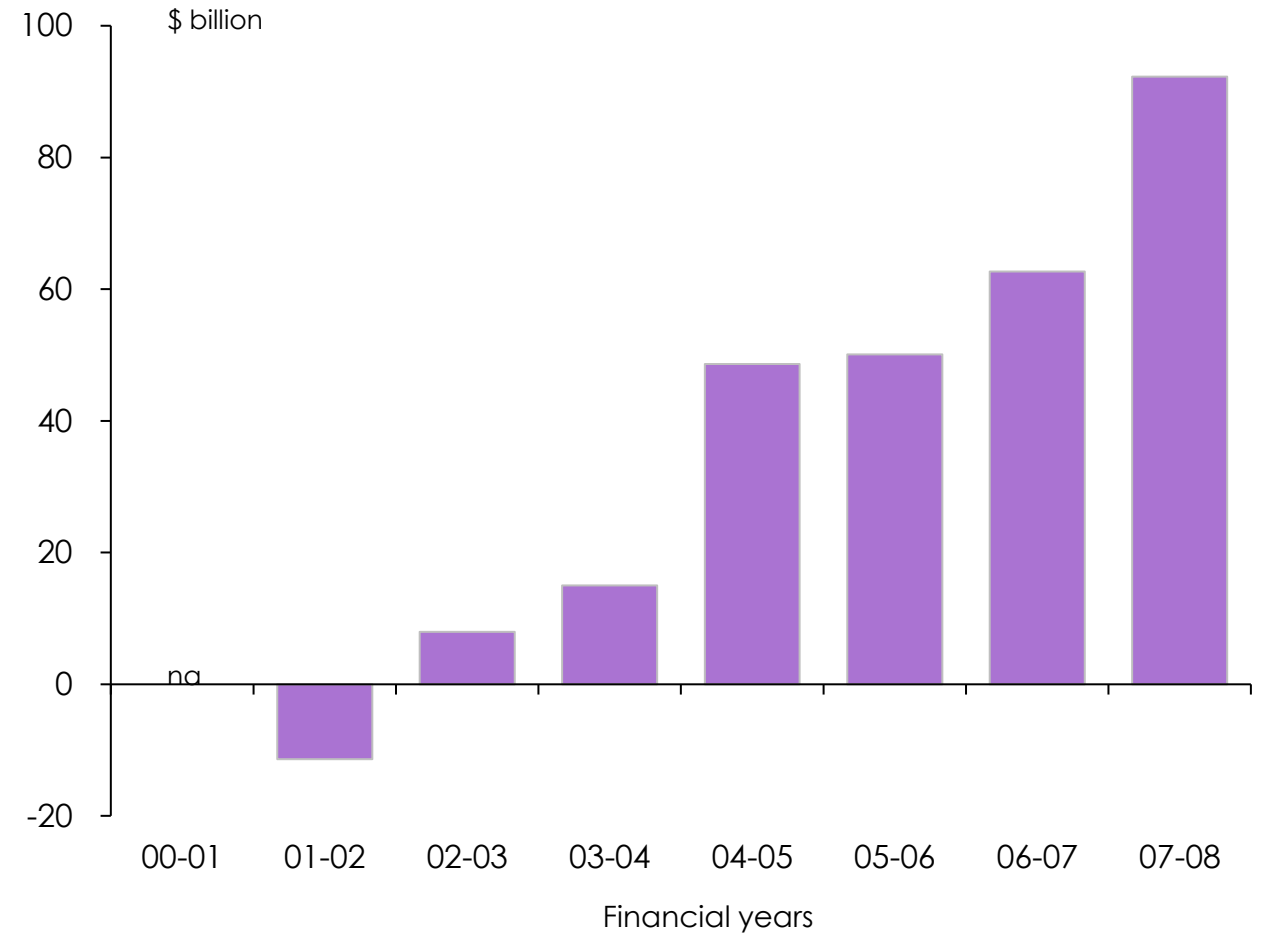
Note: Figures depicted in these charts are based on accrual (rather than cash) measures of expenses, receipts and the 'bottom line'. They show the impact on the fiscal balance of 'policy decisions' taken in the lead-up to each financial year's Budget and the subsequent Mid-Year Economic & Fiscal Outlook over the five years from the year in which the Budget was presented (ie, the year before that to which the Budget pertains) through the fourth year of the forward estimates period covered by that Budget and MYEFO. Sources: Australian Government, *Budget Paper No. 1* and *Mid-Year Economic and Fiscal Outlook*, 2000-01 through 2007-08.

The Howard Government was able to increase spending and cut taxes whilst still running budget surpluses thanks to huge 'windfall' revenue gains

Net impact of 'policy decisions' on the fiscal balance, 2001-02 through 2007-08



Net impact of 'parameter variations' on the fiscal balance, 2001-02 through 2007-08

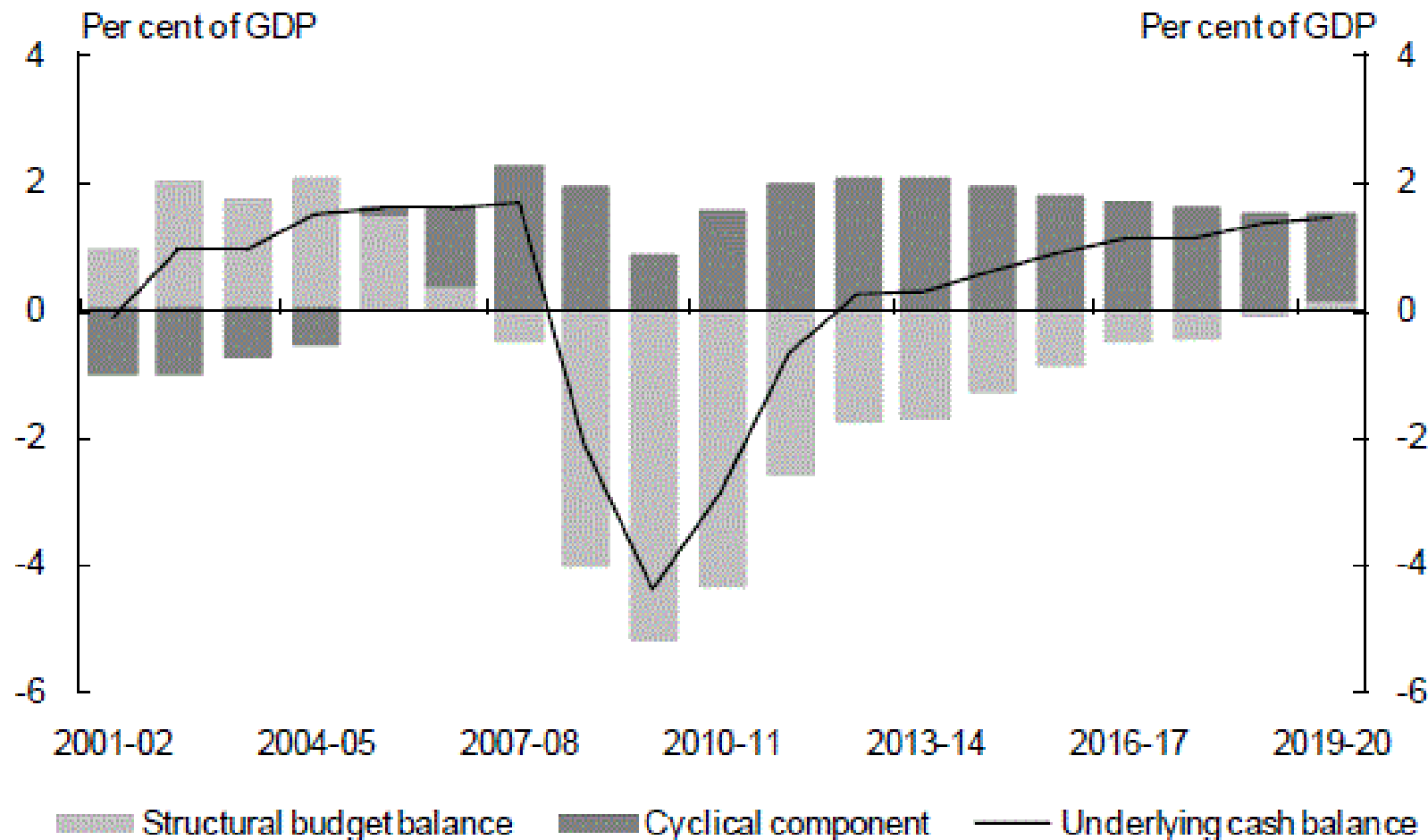


Note: Figures depicted in these charts are based on accrual (rather than cash) measures of expenses, receipts and the 'bottom line'. They show the impact on the fiscal balance of 'policy decisions' taken in the lead-up to each financial year's Budget and the subsequent Mid-Year Economic & Fiscal Outlook over the five years from the year in which the Budget was presented (ie, the year before that to which the Budget pertains) through the fourth year of the forward estimates period covered by that Budget and MYEFO; and the impact of 'parameter variations' (that is, changes in economic and other assumptions used in estimating expenses and receipts) on the fiscal balance over the four years from the year prior to that in which the Budget was presented to the third year of the relevant forward estimates period (reflecting data limitations).

Sources: Australian Government, *Budget Paper No. 1* and *Mid-Year Economic and Fiscal Outlook*, 2001-02 through 2007-08.

As a result, the budget's 'structural' or 'underlying' position wasn't nearly as strong as implied by the succession of large budget surpluses

Treasury estimates of the structural budget balance

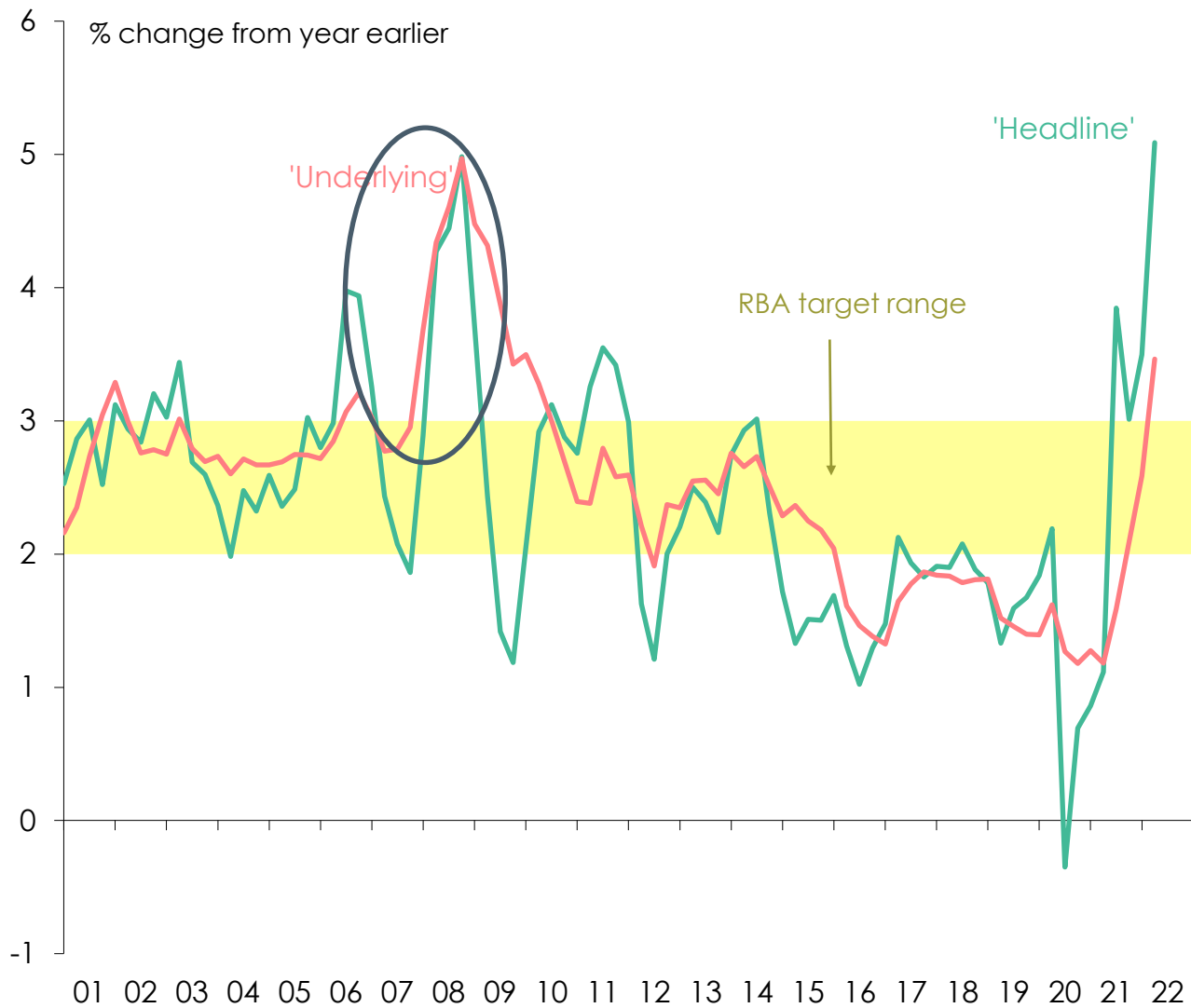


- ❑ Spending and revenue policy decisions taken by the Howard Government during its third and fourth terms in effect converted what were *temporary* revenue gains into what became, in most cases, *permanent* increases in spending or reductions in taxation revenues
- ❑ As a result, the *structural* position of the budget wasn't nearly as strong as portrayed by the succession of large budget surpluses between 2002-03 and 2007-08
- ❑ This became apparent during the global financial crisis, when the revenue windfalls disappeared, and afterwards when they didn't 'come back' as the economy recovered from the financial crisis

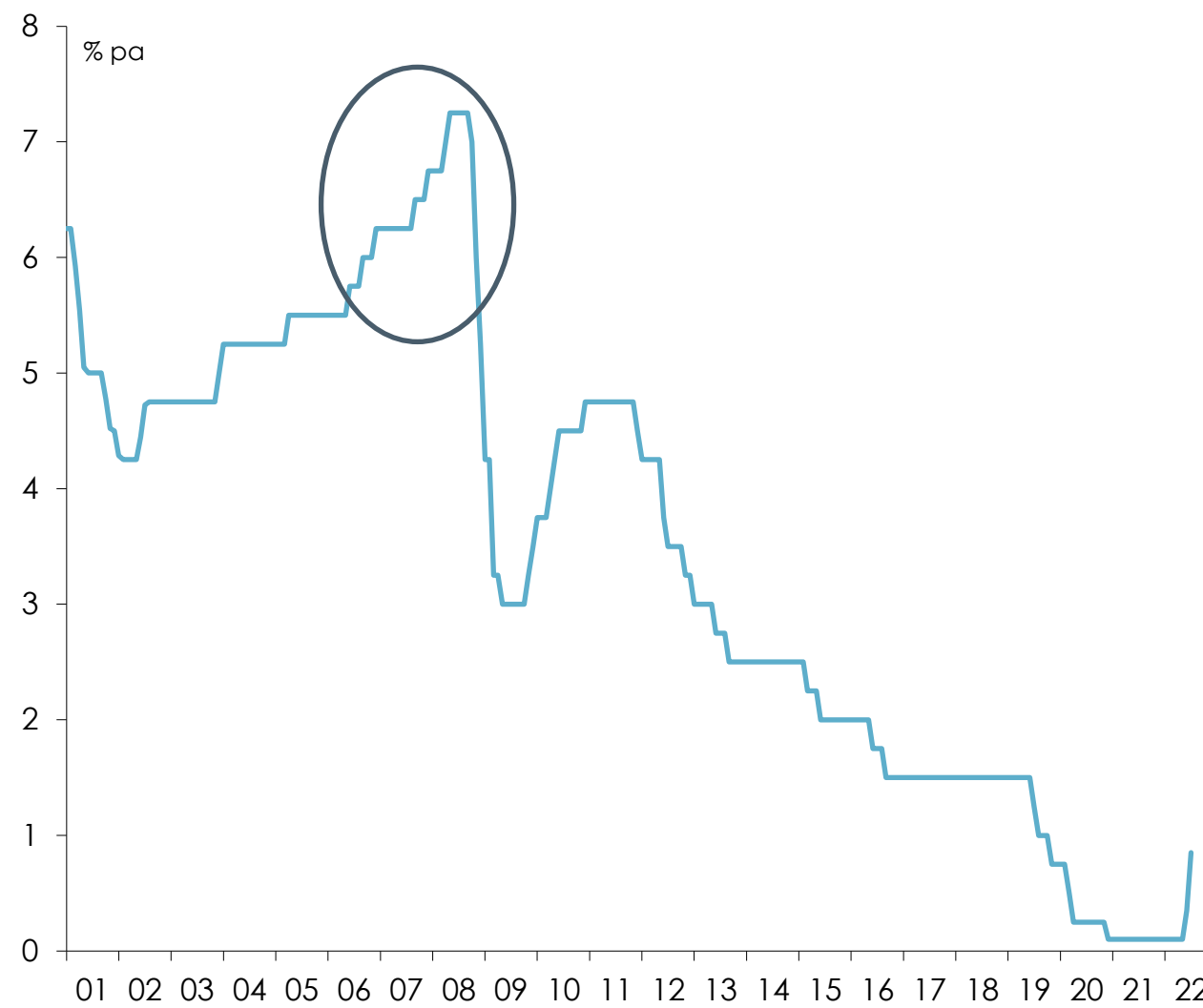
Note: The structural budget balance shows the 'underlying' position of the budget after adjusting for the impact of major cyclical and temporary factors, including deviations between actual and 'potential' output (GDP), large fluctuations in Australia's terms of trade (the ratio of export to import prices), and temporary fiscal stimulus measures such as those implemented during the global financial crisis and Covid-19. Source: Tony McDonald, Yong Hong Yan, Blake Ford & David Stephan, [Estimating the structural budget balance of the Australian Government](#), Economic Roundup No. 3, Australian Treasury, 23rd May 2014.

The expansionary fiscal policies which the Howard Government pursued during 2004-07 put upward pressure on inflation and interest rates

Inflation



RBA official cash rate



Note: 'Headline' inflation is the annual change in the All Groups consumer price index; 'underlying' inflation is the 'trimmed mean' of annual increases in the components of the CPI. Sources: ABS; RBA.

Some lessons and implications

- ❑ **Cutting government spending is really difficult**
 - especially if the government doesn't have a mandate for spending cuts, or if there isn't a sense of crisis which makes the electorate more accepting of a 'need' for spending cuts
- ❑ **Making an effort to ensure a perception of 'fairness' is important to gaining public acceptance of spending cuts**
 - the 'superannuation surcharge' introduced in the 1996-97 Budget – though 'bad' from a tax policy perspective – was important in this context
- ❑ **The particular circumstances in which the Howard Government was able to make significant cuts in spending in its first Budget are unlikely to be repeated**
 - ironically, because of one of the Howard Government's more important fiscal reforms, the Charter of Budget Honesty, which requires an independent, arms-length, statement of the fiscal position and outlook from the Secretaries of the Departments of Treasury and Finance after an election has been called
- ❑ **The Howard Government could – and from a (perhaps narrow) economic perspective should – have run even bigger budget surpluses during its third and fourth terms than it actually did**
 - the establishment of the Future Fund was an attempt to do that
 - but doing more (as in eg Norway) may have been 'a bridge too far' politically
- ❑ **'Tax cuts' and 'tax reform' are different beasts altogether**
 - if it was politically necessary to 'give away' a large part of the revenue windfalls from which the Howard Government benefited during its second and third terms, it would have been preferable to have done so in ways which improved the efficiency and equity of the tax system rather than simply 'cutting taxes'
 - the experience of the Howard Government's (successful) 2000 tax reforms (and the less successful experience of other governments) suggests that it is very difficult to 'do' tax reform in the absence of budget surpluses that can be used to 'compensate' losers