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THE FISCAL PROBLEM John Hyde

Although both are desirable, eliminating the deficit is more important than cutting taxes. The Australian Institute for Public Policy (AIPP) publication "Mandate to Govern: a Handbook for the Next Australian Government" calls for only one tax cut---indexation of the tax thresholds---and that is a cut in politician-speak only. It asks politicians to reduce total outlays by one percent in real terms without touching defence in each of three years and to balance the budget. That does not satisfy everybody and AIPP is accused of being 'wet'.

Mandate's authors adopted this "wet" approach for two reasons. First, in their judgement, deficit elimination and deregulation are far more important than tax reduction, and tax cuts which prevent elimination of the deficit would be a disaster. Of course, to eliminate the deficit is to make future tax cuts possible. Second, again in their judgement, political courage will remain at a premium; they doubted whether real politicians will cut the forward estimates by more than the nine to ten billion dollars needed to satisfy even their modest requirements.

Reforming politicians, with fine records in other areas, make ringing speeches about public sector waste but they do not cut government expenditure. Neither Thatcher nor Reagan nor Kohl nor Chirac have managed to more than nibble at it. David Lange who spared New Zealanders the rhetoric but who has done more to deregulate his economy more quickly than any other leader has not cut government expenditure. I can think of no government, not actually faced with immediate default on debts it could not wriggle out of, since Peel's in Britain in the 1820s, which has. Where the government's share of gross national product has been reduced, as it was in post-war Japan, the reduction was achieved as a by-product of deregulation and tariff reduction causing the private sector to grow more quickly than the government.

Mandate, therefore, directed the available political will-power to areas, such as tariff reduction, which within living memory have been associated with several economic miracles. The judgement that politicians are, and will remain, weak stands by itself. It does not mean government expenditure should not be slashed to assist economic growth, alleviation of poverty and reduction of unemployment. It should, and for the past three years AIPP has published a list of recommended budget cuts which have been condemned as 'impossible'. This year Brian Buckley will add to the list to bring the total up to Mandate requirements. The Centre of Policy Studies is about to publish its list. But, so long as politicians waffle on in general terms refusing to discuss in public the biggest budget lines, States Grants and Welfare (including pensions), it is dangerous to base policies on the expectation that expenditure will be slashed. The debate on the deficit, at least, is coming around.

Australian politicians of all shades have been talking of tax cuts, but the public, who are smarter than the politicians credit, are asking about public debt. In one mail I received a learned paper by Mr Des Moore, a Research Fellow with the IPA, explaining the Twin Deficits problem; an issue of Trim, the journal of Taxpayers United, which led with the delightful headline "Cut the Crap and Balance the Budget"; and a piece of paper which has apparently done the rounds in Queensland demanding that Sir Joh bring in a mini-budget to cut his government's expenditure by \$289,597,263.45. Sir Joh says elimination of tax shelters and a 7.5% reduction in Commonwealth spending, other than welfare and interest payments will pay for his tax proposals. The proposed mini-budget cut was calculated by applying the 7.5% criterion to Queensland's budget.

This year, the Australian public sector is borrowing about \$12.5 billion or 4.8% of gross domestic product. Of this, about \$7.1 billion is borrowed for or by the States. This should be eliminated by cutting government expenditure but the pollies prefer to talk about cutting taxes.

A way to get politicians to cut expenditure is said (by some businessmen and political advisers) to be to commit them to tax cuts---then, if they are responsible, they will have to cut outlays. My worry is that politicians are not always responsible. The tax cuts already promised by all parties---some more than others---cannot be responsibly financed unless expenditure is cut; I want to be convinced they have the stomach for it.

The supply-side theory that tax cuts will cause the economy, and tax base, to grow so fast that the deficit will be self eliminating did not work out in the relatively unfettered US economy and certainly will not apply here.

It requires great faith to believe that politicians will not finance at least some of the tax cuts by generating even more debt. The strategy for corralling them with their promises therefore has an appalling downside.

Rapid elimination of the deficit will probably depress the economy. But what is the appropriate short-run management for an economy where inflation is four times higher than most well run economies and whose people do not yet believe they must accept a fall in living standards just to allow foreign debt to stand still? The alternative of reducing domestic demand with tight money and even higher interest rates does not look all that attractive in the short run either; while in the long-run it has none of the advantages which will flow from budget balance.

The public sector borrowing requirement must be eliminated. The Commonwealth must move quickly to a modest surplus and the States must come close to balance. The Commonwealth can

demonstrate its resolve to achieve this on May 13 and the Premiers should come to the premiers conference with proposals which demonstrate the States willingness to share public sector restraint. The Premiers should undertake to cut their own outlays in the years 1987-88 to 1990-91 by about one per cent per year in real terms---measured against 1986-87, not against forward estimates.

If the Commonwealth is to cut taxes the States should at least accept a pro rata reduction in revenues received from the Commonwealth, at least by \$1200 or 7.5%. Perhaps these undertakings will be forthcoming; perhaps AIPP seriously underestimated political foresight, courage and rectitude; perhaps it will be a truly historic Premiers Conference.

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