

To: The Secretary, Senate inquiry into the Abbott Government's Budget Cuts

I congratulate the Senate for initiating this important inquiry, and offer the submission below.

Frank Stilwell

## **The 2014-5 budget: erroneous assumptions, adverse outcomes**

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In my judgment as an economist who has observed Australian budgets for over 40 years, the currently proposed Federal budget is probably the most ill-conceived and potentially socially-damaging that I can recall. No wonder it has provoked criticism from across a quite broad political spectrum. It has a shaky macroeconomic rationale and, if implemented, would have adverse distributional effects. These two aspects are interconnected, because the former paves the way for the latter.

The budget's central assumptions are the existence of a budget emergency and the need for major cuts in government spending. But the posited fiscal crisis is nowhere near emergency or crisis levels, as many independent professional economists have pointed out. Indeed, the Australian government's debt is one of the lowest of all the OECD countries. The size of the current budget deficit relative to GDP is also quite manageable. It could be eased back over a number of years by a combination of further economic growth and revenue measures targeted at those with the greatest capacity to pay. But it would be economically irresponsible to jeopardize that growth now by expenditure cuts that cause job losses and reduce aggregate demand. That sort of posited 'fiscal consolidation' could indeed exacerbate the deficit because of the impact or reduced levels of macroeconomic activity on revenues and expenditures.

By focusing on Federal Government expenditure reductions and targeting the cuts as announced by the Treasurer, social hardship is also disproportionately imposed on the relatively poor. This widespread concern has been given particularly sharp bite by the Federal Treasury's own estimates which show that the budget, if fully implemented, would hit the poor harder than the rich. Treasury's modeling estimates that the total effect of the spending cuts and tax changes would leave the richest third of households \$517 a year worse off but make the poorest third of households \$844 worse off. So it is not surprising that the budget has provoked widespread opposition. The predictable concerns of those most directly affected by the austerity measures that the Treasurer announced have been swelled by other expressions of broad social concern about unfairness. Even people who emerge relative unscathed from the tax and spending changes seem to sense that it runs counter to social

concerns with equality and social cohesion. It is perceived as violating the cherished Australian ethos of 'the fair go'.

Back to the drawing board...

A sensibly restructured budget would shift the focus from expenditure cuts and new charges such as the proposed medical co-payment towards improving the flow of revenue. This would redress the erosion of the tax base that has occurred over the last two decades, particularly during the period when Peter Costello was Treasurer in the Coalition Government led by John Howard. The current Treasurer's budget actually worsens the situation further by abolishing two significant tax measures that the previous government put in place – the carbon tax and the minerals resource rent tax - as well as reducing the corporate tax rate at the margin. The dominant budgetary emphasis needs to be changed towards restoring a fairer and more substantial revenue base.

Although there is no immediate fiscal emergency, as previously noted, there are good reasons for improving the Australian government's revenue base for the medium-term. Financing Australia's need for improved infrastructure and public services needs a more buoyant public revenue stream. And it needs to be targeted at those with the ability to pay, especially where their wealth derives from rent-seeking, inheritance and other forms of unearned income. It is time to abandon the inappropriate politics of unnecessary austerity, and embark on developing a new agenda for a fairer and sustainable society.

Options for tax reform include:

- cracking down on the abuse of family trusts and other tax rorts
- making the tax arrangements for superannuation less generous to high income earners
- dropping negative gearing that operates primarily as a way of reducing tax rather than redressing housing problems
- increasing the effective rate of capital gains taxation
- increasing taxation on environmentally damaging activities, coupled with financing a full transition to renewable energy
- extending land and wealth taxes.

These are all potential tax reforms that could be developed in ways that would be both potent in generating revenue and equitable in their social impacts.

I would be happy to elaborate on any of the above reasoning and/or the proposed policy measures if invited by the Senate inquiry to do so.