Obsession with short-term buries the bad – and even the good

Comment

Richard Holden

Whenthefederalbudget ishandeddownon Tuesdaymuchofthe focuswillbeonthe deficitsorsurplusesover thenextfouryears. Thisso-called“forward estimateperiod”is supposedtobefar enoughintothefutureto bemeaningful,but closeenoughtotoday thatthepredictionsareaccurate.

In reality the forward estimates are neither meaningful nor accurate.

A better approach would be to require Treasury to present an estimate of the “steady state” deficit or surplus, as a percentage of GDP, based on the policies in place and outlined in the budget. It might seem paradoxical, but economists are actually much better at predicting the longrun steady state than the near future, which is subject to all sorts of random fluctuations. The steady state is precisely the time at which these short-run fluctuations have calmed down and washed out.

The big drivers of the size of this year’s budget deficit will be assumptions about variables like nominal GDP growth and the iron-ore price. Nobody knows what these are going to be in the coming year with even the slightest bit of accuracy. If you doubt that, then just look at how accurate the budget assumptions have been compared to the actual figures over the past, say, 20 years. It’s not a pretty picture.

Worse still, our collective obsession with the four-year forward-estimates period means the governments have every incentive to bury the true costs of policies just outside that window. Both sides of politics are serial offenders in this regard.

Have you wondered why the Coalition’s enterprise tax plan was described as costing $50 billion over 10 years last year but now apparently costs $65 billion? It’s because we are now one year later into the phase-in (with 2026-27 replaced by 2027-28).

Now I’m on record, on these pages, as being strongly in favour of cutting the corporate tax rate for all companies – not just small businesses – to 25 per cent. In the face of aggressive international tax competition, a small(ish), capital-thirsty country like Australia would be crazy not to do so. Even President Obama wanted to cut the US company tax rate by 7 percentage points. But I don't like the glacial 10-year phase-in, and I don't like politicians playing us for fools by pretending that something that will happen for sure in five years' time doesn't count because of some stupid budgeting convention.

The Gillard Labor government was just as guilty of these sorts of shenanigans with policies like university funding and the National Disability Insurance Scheme. Again, I am for these policies, but we should own up to what they cost and the trade-offs involved in implementing them.

Julia Gillard's Labor government played tricks with budget policies such as the disability scheme.

PHOTO: JASON SOUTH

Perhaps the canonical case of where the steady-state is instructive, and the short-run is meaningless, is the effect of immigration.

Immigration boosts total GDP in the short run because there are more folks in the economy. In steady state, basic economic theory tells us that immigration has no effect on GDP per capita, and the best empirical evidence bears this out. In fact, immigration tends to reduce per capita GDP in the short run because it lowers the amount of capital per worker.

Howdoesthefederalbudgettreat immigration? Ittakesthebizarrestanceof countingtheshort-runtotal(nominal)GDP benefits,butignoresthecostsfromadditional health,welfareandeducationexpenditures thatsurelycomewithmorepeopleinthe country.Why? Becausethoseexpenditures areassumedtobefixedintheshortrun.

Even a Mob accountant would be reticent to try and pull a fast one like that.

Insteadystate,however, weknowthereis noper-capitarevenuebenefitfrom immigrationunlessthe skillmixshiftsto increaseaveragehuman capital.Onthe expenditureside,thesenewimmigrants couldincreaseor decreaseper-capitahealth, welfareandeducation spending–itdepends, again,onwhothey are.Peoplecomingfrom awarzoneare goingtobedifferentthan peoplewhohavenot sufferedinthatway,for instance.Olderimmigrants willhavea differentprofilethanyoungerones.

Again,Iam generallyinfavourof immigration,butthe federalbudgetshould treatthecosts andbenefitsofimmigration symmetrically,andit shouldfocusonthe long-runnottheshort-run.Steady-state governmentaccountingdoesjustthat.

Thechiefpurposeof thefederalbudgetis toquantifytax andspendingpoliciesand informdebatearound thembothinthe parliamentandthe community.Thefouryearforwardestimates failtoachievethat andencouragegamingandobfuscation.

Agoodbudgetprocess forcesafocuson theunderlyingassumptionsbehindpolicies andtheirlikelyimpact inthelongrun.The currentprocesssimply leadstoheroic assumptionsaboutgrowth ratesandafocus ontheshortrun; togamingandguesswork.

Perhaps more than ever we need government to be transparent and focus on the long term. Steady-state government accounting would be a step in that direction.

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