COMMONWEALTH OF AUSTRALIA

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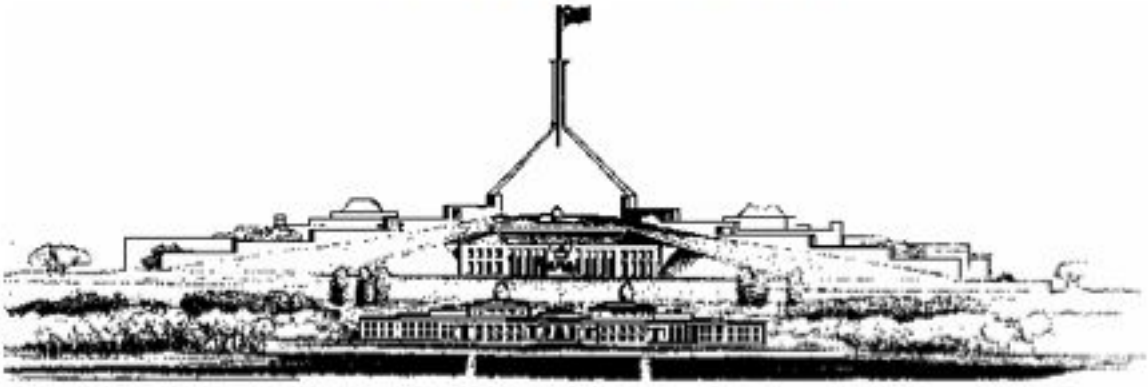

HOUSE OF REPRESENTATIVES

Main Committee

APPROPRIATION BILL (No. 1) 1999-2000

Second Reading

SPEECH

Wednesday, 9 June 1999

BY AUTHORITY OF THE HOUSE OF REPRESENTATIVES

SPEECH

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Questioner		**Responder**	
Speaker	Cox, David, MP	**Question No.**	

Mr COX (Kingston) (11.46 am)—The budget has been accompanied by a certain amount of hyperbole from the Treasurer and the rest of the government about both economic growth and the surplus. However, I think it is appropriate here to sound a cautionary note. The first sentence of statement No. 1, fiscal strategy in budget paper No. 1, says that `the 1999-2000 budget demonstrates the government's commitment to maintain the budget in surplus while Australia's economic growth prospects remain sound'. The key word is `while'—while Australia's economic growth prospects remain sound. There are two fundamental questions here: the first, how robust is Australia's economic outlook; and the second, how solid are the current forecasts of revenue?

Australia is operating presently with a current account deficit of around six per cent. A large contributing factor is the high level of domestic demand which is sustaining a higher than expected growth performance. A current account deficit of more than six per cent has only occurred three times before in Australia's economic history. The first time was in 1986 and resulted in a currency crisis. The second time was in 1989-90; that was corrected with monetary policy, which resulted in a recession. The third time was at the beginning of 1995; that was, however, controlled without crisis by intelligent use of both fiscal and monetary policy. Let us hope that this high current account deficit can be moderated without crisis.

It is certainly the case, as was demonstrated in 1995, that, as a result of the economic reforms of the last Labor government, Australia is much less vulnerable to external shocks than was previously the case. However, personally, I still find it hard to be sanguine about a six per cent plus current account deficit after those experiences. To me, it implies a significant degree of risk that there could be a rapid market response with implications for the real economy and, flowing from that, the fiscal balance. The question of what `while economic growth remains sound' means depends on whether and how far economic outcomes diverge either up or down from the budget forecasts.

One of the reasons for the early election last year was that the government was, at the time the election was called, much more concerned about the outlook for growth this year than it seems to be now. Nevertheless, the government has forecast a slowing in the rate of economic growth to three per cent, and that means there will be little or no progress in reducing the unemployment rate. Most worrying is the fact that the government is not forecasting any major improvement in the current account deficit, so it will remain a significant threat and a constraint on future growth.

To the extent that our outlook for growth is positive, it is predicated on an assumption that the world economy will be picking up in 2000, and that will result in some improvement in Australia's terms of trade. Statement No. 2 on the economic outlook contains a section specifically dealing with the uncertainties. Weighed against doubts about the sustainability of recovery in East Asia and Japan is the possibility that the US could continue to exceed expectations.

Of course, US economic performance may not continue to exceed expectations. Treasury admit that the downside risk is a worsening of the current account deficit should the world economy not pick up. Treasury have failed to contemplate the effect on domestic activity of any increase in interest rates which may be necessary if the current account deficit—either the one we have at the moment or a larger one—results in a requirement to adjust monetary policy. Treasury are already expecting a decrease in the household demand, a decrease in domestic demand and a reduction in business investment. The downside risk is for greater contraction in activity and employment and a lower fiscal balance than the relatively benign set of forecasts presented in the budget suggests.

That high current account deficit means this is not a good time to be loosening fiscal policy in the manner prescribed by the renegotiated ANTS package. The consequence of that is that people on high incomes will have a large lift in their disposable incomes and will be spending much more of that on imports. The surplus will be consumed more rapidly and the Treasurer may find himself looking at a much less robust fiscal outcome.

On the other hand, we must also look at the upside risks. If growth is stronger than expected, particularly if a contributing factor is higher than expected United States economic growth and even a monetary tightening there, which would be combined with the impact of the government's loosening of fiscal policy with its raid on the surplus and some additional inflationary pressure, including from the GST, then pressure on the current account deficit will be higher than would otherwise have been the case and the monetary authorities may decide that interest rates have to go up. This concern was raised in a Senate estimates committee last night by the Secretary to the Treasury. If that monetary tightening came to pass, it would impact on growth and on the fiscal position in the projected period.

In his post-budget Australian Business Economists speech, the Secretary to the Treasury, Ted Evans, said:

In recent years, we have not been asking monetary policy to address the current account problem. Rather, emphasis has been appropriately put on the role of fiscal policy—the generator of budget surpluses and contributor to national savings—to do that job, leaving monetary policy free to concentrate on its objective of maintaining low inflation without undue constraint on growth.

This is a very desirable balance in the use of monetary and fiscal policies which may hold part of the answer to our longstanding current account concern; it is also part of the framework which underlies the judgments on medium term growth potential.

The simultaneous achievement of sustainable CAD outcomes and low and stable inflation would be put at risk by a complacent attitude to the use of fiscal surpluses. A breakdown in the performance of one policy inevitably compromises the other.

My fear is that the complacent attitude to the use of fiscal surpluses is exactly what we are about to see with the dramatic loosening of fiscal policy provided by the Howard government's so-called A New Tax System. If fiscal policy is the chosen instrument to control the current account, then why is the Howard government contemplating a large fiscal loosening through its tax package when the current account deficit is already at an historically high level? The second question is: how large is the surplus on which this fiscal loosening is being built?

Let us look at how the Treasurer got his $5.4 billion surplus. The first thing I noticed was that there has been a 43.2 per cent increase in dividends from government business enterprises. That is an increase of $1.8 billion in one year. After all the privatisations, there are not very many of these assets left. So there are only two major sources of revenue—Telstra and the Reserve Bank of Australia. The estimates of their dividends contained in the budget are determined prospectively by the government after some discussion with the Chief Executive Officer and the Governor. When there is a 43.2 per cent increase in the dividends in one year, it is justifiable to question whether those discussions have not been conducted with a view to achieving some cosmetic budgetary objective.

Telstra is such a strong organisation that it would probably cope with this kind of extra demand, particularly if it sees the prospect of losing the Commonwealth fairly shortly from its share register. Similarly, the Reserve Bank is a large and profitable organisation. But even it cannot provide a continuous source of above average dividends except by running down the nation's foreign exchange reserves. There is obviously a finite limit to that. Paradoxically, in those years when the value of the Australian dollar drops, there is a short-term fiscal benefit. That is because foreign currency reserves which have been sold were valued in the balance sheet at their buying price—a smaller number of Australian dollars than their selling price. Because of the devaluation, a larger number of Australian dollars and therefore a larger profit is booked which can be used to pay a higher dividend and improve the fiscal balance.

The 43.2 per cent increase in dividends from government business enterprises amounts to about $1.8 billion. Taking that $1.8 billion off the fiscal balance of $5.4 billion leaves $3.6 billion. That is a very modest improvement on the estimated 1998-99 fiscal balance of $3.1 billion. There are always extraordinary items in any budget or set of financial statements, but I am making a case here that suggests that there has not been much, if any, real growth in the size of the surplus. With the large fiscal loosening provided by the ANTS package, the fiscal surplus is projected to rise to $7.2 billion in 2000-01. However, the underlying cash surplus next year is projected to be only $3.1 billion. The principal reason for that discrepancy is the bringing forward of the pay-as-you-go system under accrual accounting, although the tax is paid in subsequent years. That suggests that after the introduction of the ANTS package the government will not be left with much latitude as far as the surplus is concerned.

The consolidated financial statements issued in March 1999 for the year ended 30 June 1998 show a less dramatic fiscal miracle than the Treasurer has been claiming these last three years. The operating results before

abnormals, starting with Labor's last budget year of 1995-96, were a little over minus $4 billion. The Treasurer's first budget for 1996-97 resulted in an operating result of about minus $2.5 billion. His second in 1997-98 resulted in his first positive operating result of about $1.5 billion. In his post-budget speech to the Australian Business Economists, the Secretary to the Treasury, Ted Evans, put this in some historical perspective. He said:

Looking at Chart 1, which shows the underlying cash balance over a long period, we see that surpluses stretch out into the projection period. We should keep in mind, however, that of the six years of surplus there shown, only one is currently behind us. The 1999-2000 surplus we could take as being reasonably assured, but beyond that we are talking about mere projections, subject to all of the uncertainties of the world economy. Taking the 1999-2000 surplus as being `in the bag', the cumulative surplus over the three years would amount to 1.5 per cent of annual GDP. The scale of that might be assessed against the surpluses in the late 1980s, our last period of fiscal consolidation. On that earlier occasion, the cumulative surplus over the first three years amounted to 4.1 per cent of annual GDP—well over twice that achieved in the latest round.

The Secretary to the Treasury is not the only person sounding this warning. Access Economics' *Budget Monitor* released in May says:

A champagne economy (rather than policy-driven increases in tax rates or bases) is handing the Treasury rising revenues on a platter. However, it is at times like this that clients should remember that the revenue bonanza of the moment is rather more cyclical than structural. What the upswing of the current business cycle has delivered to the Budget may be swept away just as easily in the next downswing of the business cycle.

For the record, Access Economics' estimate of the structural underlying budget cash surplus for 1998-99 is only $221 million and is only $584 million for 1999-2000 on a no policy change basis. Revenues and projected surpluses are quite vulnerable to any slowing in economic activity. The original A New Tax System had a negative effect on fiscal balance of almost $5 billion. To that must now be added the further loosening resulting from the Howard government's agreement with the Democrats, at least a further $1.4 billion. In my view, there are risks which need to be considered after eight years of continuous economic growth when loosening fiscal policy to such a significant degree.

I was pleased to see that today's release by the Productivity Commission of a research paper on Australia's productivity performance notes that multi-factor productivity averaged 2.4 per cent a year in the period 1993-94 to 1997-98. This represented a significant step up from the 1964-65 to 1997-98 period average of 1.4 per cent. It is not a coincidence that this jump occurred given the significant micro-economic reforms undertaken by Labor since the mid-1980s. As the report notes, there is likely to be some, and possibly major, dividend from reform. Our solid growth performance since 1991-92 is a direct result of the major reforms Labor put in place. As the Reserve Bank Governor noted on 11 March:

In Australia's case, these micro-economic influences have been quite important, not just in explaining lower inflation, but also in explaining the economy's growth and resilience in the face of external contraction. Among the changes made have been:

. to sustainably lower tariffs;

. to deregulate financial markets;

. to introduce a more stringent regime for competition policy;

. to privatise a lot of public utilities; and

. to introduce a good deal more flexibility into wage bargaining.

The recent Hong Kong-Shanghai Banking Corporation report *The new Australian economy* also comments that much of the resilience of the economy is due to reform over the past 15 years. The report states:

The product of 15 years of rigorous economic reform, the transformation has allowed Australia to not only withstand recession in two-thirds of its export markets, but maintain through the nineties one of the highest growth rates in the OECD.

The boundaries of the electorate of Kingston currently coincide very closely with the McLaren Vale wine region. South Australia accounts for half the nation's wine production. It is therefore a matter of great concern

to both my electorate and my state that the Howard government proposes to increase the tax on wine. In its new tax system package, the government said:

Wine, and beverages consisting primarily of wine, will become subject to a Wine Equalisation Tax to replace the difference between the current 41 per cent wholesale sales tax and the proposed GST. The Wine Equalisation Tax will be levied at such a rate that the price of a four-litre cask of wine need only increase by the estimated general price increase associated with indirect tax reform; ie 1.9 per cent. The concessional tax treatment of cask wine will therefore be preserved.

No further details were given. The industry was horrified to discover after the election that what the government had in mind meant a significant increase in the tax on wine. The Howard government has set the WET rate at 29 per cent whereas a general increase in the price of wine of 1.9 per cent implies a rate of 24½ per cent. The difference is how Treasury and the Winemakers Federation of Australia calculated the effect of the GST on margins.

I understand that Treasury has since admitted that the Winemakers Federation's calculations are right but are refusing to say so in writing. The difference between the higher and lower WET rates according to research commissioned by the Winemakers Federation is additional tax on the industry of $147 million and a loss of 500 jobs in regional Australia. Pro rata, that is 250 jobs in South Australia and 25 jobs in McLaren Vale. The other problem raised by WET in the GST is that the GST will go to states while WET will go to the Commonwealth, both for general revenue purposes.

This changes the current arrangements where a proportion of the current 41 per cent wholesale sales tax on wine, which is collected by the Commonwealth, is collected on behalf of the states to replace the state liquor franchise fees which were struck down by the High Court as an excise. The states are currently handing back a 15 per cent wholesale sales tax rebate on cellar door sales to replace the exemption on liquor franchise fees they previously gave cellar door sales. It seems likely under the new arrangements that the states will quickly say that the GST is their source of general revenue and they will not be much interested in giving a rebate on the WET tax since it is a Commonwealth tax and they are getting none of the revenue.

The Howard government's policy makes no provision to allow for the cost of running cellar door sales which are so important to underpin the viability of many small wineries. These small wineries are a large part of the attraction for wine tourism which is boosting regional economies. To complicate matters, small wineries, particularly in Tasmania and Margaret River, have for some years been pressing for a volumetric tax regime. This would give a tax advantage to their premium wines but, unfortunately, at the expense of the overwhelming majority of the industry, which is based on the production of quality value wines. The domestic demand for those quality value wines underpins the investment on which the recent success of the wine industry is based.

A volumetric tax regime could do far more damage to the industry as a whole than the general increase in the tax on wine, which is the current policy of the Howard government. I have been pursuing these issues on behalf of my electorate, South Australia and the wine industry more generally. I organised a meeting in Adelaide between a full spectrum of local winemakers, ranging from the smallest to the largest multinationals, and the Leader of the Opposition to talk about the WET rate, cellar door sales and the question of volumetric versus ad valorem taxation. Kim Beazley had some things to say to them which have proved very useful to the industry in this debate, and they are worth recording here. He said:

Looking after SA industry requires vision and commitment from both Federal and State governments.

But I think the Hippocratic oath is also important here—and I mean the bit that says "First, do no harm".

One of the critical issues for South Australia, having half the national wine industry, is the Government's proposed additional tax on wine.

The WET is not a wine equalisation tax, it is a wine increase tax.

In the context of a GST, if it were an equalisation tax it would be set at 24.5% not 29%.

Labor's aim is still to defeat the GST.

I interpolate here that this was the day and the meeting was the time that Kim Beazley and I found out that Senator Harradine would vote against the GST. To go on with what Kim said at the meeting:

Our strategy is not to try and make amendments at the margin but to leave the package in its present unacceptable form so that the pressure for its defeat will be maximised.

We have however made one exception and that is to move amendments to provide an exemption from the WET for cellar door sales of $100,000.

We believe small wineries need and deserve that help.

Volumetric taxation has also been raised by the small wineries, particularly in Tasmania and Margaret River in the context of the current debate.

Volumetric taxation is a separate issue to the WET.

We intend to keep it separate.

We will not be contemplating volumetric amendments to the WET bills.

Instead we have established a process within the Labor Caucus to examine all of the arguments for volumetric taxation as well as other wine tax issues.

We will be consulting widely.

We want to make sure we can offer the industry the best possible wine tax regime and the sort of certainty and stability that the very large amounts of recent investment and increasing international competition demand.

As a result of what Kim was told at that meeting, he agreed to look at raising the level of Labor's proposed cellar door exemption, and we are currently working through that issue. But his comments, in general, had the intended affect. They have united the Australian wine industry in a campaign on two issues: reducing the government's proposed WET rate and obtaining an acceptable exemption for cellar door sales. I was pleased last week to chair a meeting between the Winemakers Federation of Australia, led by Brian Croser and Ian Sutton, with delegates from peak bodies in all states, including Tasmania and Western Australia, and all the members of Labor's frontbench whose portfolios touch on issues relating to the wine industry. They of course are Simon Crean, Gavin O'Connor, Joel Fitzgibbon, Bob McMullan and Cheryl Kernot. I am quite sure that, as a result of those discussions, Labor will successfully pursue this issue on behalf of the wine industry.