Australian budget figures mean major attacks on spending

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Australian Treasurer Wayne Swan has recommitted the federal Labor government to what would be, if carried out, the largest spending cuts in post-war history.

Announcing the final budget results for the 2011-12 fiscal year, Swan said the government would still meet its pledge to return the budget to surplus in the 2012-2013 fiscal year, which ends next July.

The 2011-12 budget deficit came in at $43.7 billion, almost twice the original estimate of $22.6 billion in May 2011, when Swan delivered the budget. The treasurer said that, at 3 percent of Australian gross domestic product (GDP), the result was less than half the average deficit recorded by the major advanced economies. Australia's public finances, he claimed, were among "the strongest in the world, in large part due to the decisive actions taken to avoid recession and the strict fiscal discipline delivered by the government."

However, the sharp fall in commodity prices in recent months, especially for iron ore and coal, two of Australia's major exports, has dealt a blow to government revenue. Swan said that while this would "inevitably make it more difficult to return the budget to surplus in 2012-13, the government remains committed to doing so."

To achieve this objective, which the government adopted under pressure from the international financial markets, will require a withdrawal of government spending from the economy equivalent to 3 percent of GDP. Such an economic shock would lead directly to a recession.

The downturn in the global economy and its impact in Australia have already cut the government's finances. Swan reported a "hefty fall of $876 million in company tax receipts, due largely to lower corporate profits."

This is just the latest expression of a deepening trend. For 2011-12, overall tax receipts were down by $26 billion from the estimates made before the onset of the global financial crisis in 2008-09.

National accounts data released earlier this month showed that company tax payments had fallen from an all-time high of 6.2 percent of GDP in 2007 to 3.8 percent in the June quarter this year.

Over the past decade, the Australian economy has become increasingly dependent on the income and profits generated by rising prices for minerals. Construction associated with mining developments, including new infrastructure, has made a no less significant contribution to overall economic growth.

Construction activity bound up with exports of minerals and liquefied natural gas now comprises half of all construction activity, compared to a historical average of 20 percent. If mining construction activity returned to this average, that would slice more than 2 percent from GDP growth. In other words, instead of its present rate of around 3 percent, Australian growth would be closer to the zero to 1 percent range.

There are signs that mining sector construction has started a sharp downturn. Figures compiled by Infrastructure Partnerships Australia (IPA), reported in the *Sydney Morning Herald* last Friday, show that construction work in this area dropped by 27 percent in the June quarter.

IPA chief executive Brendan Lyon told the newspaper that while investment levels still remained historically high, there had been a "clear retreat". If the trend continued in the September and December quarters, "then it would paint a worrying picture for the construction sector. Once you strip out mining investments, it's pretty clear that the tide is still running out for infrastructure spending by the public sector."

Desperate to maintain the fiction that Australia can somehow be insulated from the storms in the global economy, in a speech last Friday, Swan likened the present slowdown in the Chinese economy to Usain Bolt "easing off a bit at the end of 100 metres," having already smashed the world record.

According to Peking University finance professor Michael Pettis, such views reflect a complete lack of understanding of the shifts under way in the Chinese economy, which mean that demand for commodities will slacken. While global demand for steel had risen by about 6 percent a year over the past two decades, two thirds of that increase had come from Chinese demand. However, the Chinese investment boom of the past decade—the construction of roads, apartments and infrastructure—could not continue at the same rate and so the demand for steel and iron ore would fall, even if the Chinese growth rate remained relatively high.

In a recent article, published on the *Business Spectator* web site, entitled "No soft landing for hard commodities," Pettis warned that this shift would come as a shock to many people, including senior officials in commodity exporting countries such as Australia and Brazil, who had been "insufficiently sceptical of the Chinese growth model" and unaware of how dramatic the changes of the past two years had been.

Besides promoting the myth of a never-ending China boom, Swan and Finance Minister Penny Wong have claimed that severe spending cuts in health and education being implemented by state Liberal governments, especially in New South Wales and Queensland, bear no relation to the program of Prime Minister Julia Gillard's federal government.

"We don't resile from the fact that you have to make difficult decisions," Wong told reporters, "but we certainly take a very different approach to the ones that have been demonstrated in coalition states."

This is in line with what is shaping up as the Labor government's theme for the next election: that while cuts are necessary, a Labor government will not take the axe to vital services. This is belied by the fact that the state cuts are a direct result of the reduced flow of funds from Canberra.

In a speech earlier this month, Victorian Premier Ted Baillieu noted that his government was in a worse position today than in 2008-2009. That was because the states were then benefiting from federal government stimulus measures, which had since been withdrawn.

With even bigger cuts to come, as the Gillard Labor government carries through the drive for a budget surplus, attacks on jobs, education, health and other social spending, whether carried out by federal or state governments, are going to rapidly accelerate in the coming months.