Australian budget based on shaky foundations

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As many commentators have noted, the Australian budget, brought down on Tuesday night, was based on what are termed "heroic" assumptions covering the COVID-19 pandemic, as well as the Australian and global economy.

The clearest example of such assumptions is in relation to the pandemic. According to the budget papers prepared by Treasury, "it is assumed over the forecast period material outbreaks of COVID-19 occur but are largely contained" and that "a population-wide COVID-19 vaccination program is assumed to the fully in place by late 2021."

This brings to mind an old joke about bourgeois economics. A physicist, a chemist and an economist are trapped on an island with cans of food but no implements. The physicist and the chemist develop plans to open them, but the economist develops a "model" to solve the problem by saying, "assume a can opener."

The Treasury assumption has been made under conditions where the virus continues to spread out of control on a global scale, no vaccine has yet been developed, and considerable uncertainties remain. Even if an effective vaccine is developed, there is no assured plan for its acquisition and distribution.

The assumptions on the economy are equally flimsy. The Treasury forecast is that in calendar year 2020 real GDP in Australia will fall by 3.75 percent, before rising by 4.25 percent in 2021. But this is based on the premise that global growth, after falling by 4.5 percent this year, will bounce back to 5 percent in 2021.

Even the International Monetary Fund (IMF), which generally tries to put the best face on a bad situation—its forecasts for global growth in the years leading up to the pandemic were consistently overstated—is more cautious.

In a recent blog, IMF managing director Kristalina Georgieva warned that there was a "risk of severe economic scarring from job losses, bankruptcies and the disruption of education." Because of this loss of economic capacity, Georgieva wrote that global output will remain "well below" pre-pandemic forecasts, resulting in falling living standards for almost all countries.

The Treasury is forced to acknowledge that "the extent of any longer-lasting effects from the COVID-19 pandemic, both domestically and globally, are difficult to predict."

The central feature of the budget was the major handouts to business, with a column in the *Australian Financial Review* describing the "tsunami of money headed for the corporate sector over the next few years" as "absolutely staggering."

Investment allowances to major businesses at a cost of $26.7 billion over two years enables them to write off in full any eligible depreciable asset for tax purposes, with no limit. This measure has been touted by the government as a boost to jobs, the central theme of its budget spin, coupled with income tax cuts and subsidies for cheap youth labour.

But the crucial question is whether any such investment, which depends on increased demand in the economy, will actually be made. Even before the pandemic hit, the Australian economy was marked by years of negligible wages growth, stagnant household incomes and the lowest growth in productivity ever recorded. This situation led to the Reserve Bank of Australia cutting its base interest rate to a record low even before the pandemic struck.

The Treasury's assessment of investment is somewhat at variance with the upbeat scenario presented by Treasurer Josh Frydenberg on Tuesday night.

It noted that new business investment was expected to fall by 9.5 percent in 2020–2021, "driven by a significant deterioration in the outlook for non-mining investment." Treasury forecast a growth of 6 percent in 2021–22.

It said the "highly uncertain environment" created by the pandemic would see a "sharp decline in machinery and equipment investment in the near term" and a "gradual run-off in non-dwelling construction" as demand for new projects declines and work already in the pipeline is completed.

The upturn in 2021–22 is predicated on the assumption that "easing restrictions, improving confidence and newly introduced government policies to support business will drive the recovery in business investment, particularly in machinery and equipment." There is round robin at work here. The government bases its actions on Treasury forecasts while those forecasts are in turn based on assumptions about the effects of government action.

But even if the predicted investment were to take place, this would not give rise to an increase in well-paying jobs. This is because one of the main reasons businesses undertake expenditure on new machinery and equipment is to reduce labour costs as they struggle to maintain profits in conditions of falling overall demand. Any increase in jobs will be in part-time and low-paid work aided by government subsidies for cheaper youth labour.

One of the most significant features of the Treasury forecasts is the exclusion of any mention of global financial conditions and the threat of another financial crisis as debt, both corporate and government, reaches new records.

Twice in the past 12 years—during the global financial crisis of 2008 and the freezing of all markets in mid-March this year—the international financial system has come to the point of a total meltdown. The conditions for another disaster are clearly in the making.

In contrast to the real economy, now in the midst of its most severe contraction since the Great Depression of the 1930s, stock markets have been on the rise, led by Wall Street which is now back close to the record highs it reached in February. The market rise has been fuelled by government spending, estimated by the IMF to reach a record high of 100 percent of global GDP this year, and by the injection of trillions of dollars into financial markets by the world's central banks in the past seven months.

As former Liberal leader John Hewson noted in a comment published in the *Sydney Morning Herald* on Thursday, entitled "Heroic forecasts omit debt crunch," an inherent weakness of COVID economic strategies is that they "ignore the longer-term consequences of massive monetary expansions by central banks… and fiscal expansions by governments.

"The possibility of a pandemic-induced systemic debt crisis cannot be ruled out—compounded by bubbles in many stock and property markets, all threatening stability in bond and currency markets."

In fact there has already been a preview of such a crisis in mid-March, when financial markets around the world froze, including in Australia, where the dollar experienced one of the sharpest falls of any international currency. A total collapse was only prevented by the intervention of the US Federal Reserve to act as the backstop for all American financial markets, while providing dollar swaps for major central banks around the world.

The intervention alleviated the immediate crisis, but only by creating the conditions for another meltdown through the provision of essentially free money for the very speculation that led to its eruption.

But all of this ignored in the Treasury assessment. The nearest it comes to even acknowledging the explosive contradiction at the heart of the global capitalist system—the divorce between the rise of financial markets and the depressed underlying real economy—is to point to "the risk that global markets have not fully accounted for the economic consequences of the crisis."