Fix budget before the crunch hits, urges Ken Henry

Former Treasury secretary Ken Henry.
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National Australia Bank chairman and former Treasury chief Ken Henry warns that Australia faces an unacceptable risk with its budget deficit and fears the nation will wait for a painful economic crunch before confronting true financial repair.
In an exclusive interview, Dr Henry issued his most powerful warning about the failure of politicians and the national parliament, saying responsible fiscal policy had become a “pretence”, the economic reform narrative “no longer exists” and politicians are fixated by “appeals to populism”.

Dr Henry said Australia was now running the risk that its AAA sovereign credit rating might be downgraded, coinciding with another global financial disturbance, and in this situation the consequences for Australia “would be truly catastrophic”.
He said this was a “small risk” in relative terms but “the consequences are so large you cannot take the risk”.

Dr Henry said politicians through domestic economic policy failures were now exposing the nation to such risks that the entire reason for the reforms of the 1980s and 90s had been forgotten.
Unless the momentum was recovered, Australia would find “we are right back with Paul Keating’s banana republic statement”.

Warning that Australia was dependent on foreigners to finance the gap between its investments and its national savings, Dr Henry said “We should not kid ourselves that the rest of the world is going to continue to support the Australian economy the way it has right through since 1983” and the float of the dollar. He was scathing of political hypocrisy over abandonment of proper fiscal discipline.
“People hear that the budget is going to be brought back to surplus because both sides of politics are committed to that and what they see is behaviour in the parliament that means the budget will never come back into balance,” he said.

Anxious to hold the parliament to account, Dr Henry argued that, after the recent deal to improve the budget bottom line by $6.3 billion, he calculated there was still $360bn to be raised to honour policy commitments and discharge debt. If this could not be delivered then “parliament will have to say we are not committed to that medium-term strategy”. “I don’t think we have a lot of time to re-establish confidence with those who are looking at Australia as, say, an investment destination,” he said.
Referring to the current political generation, Dr Henry said: “The conclusion I draw is that there is an insufficient sense of urgency.”

In order to highlight our current risks, Dr Henry warned of the lessons from the 2008 global crisis and his conversation with prime minister Kevin Rudd in February that year. “I said the worst thing that can happen to us, prime minister, is that foreigners just say ‘Sorry, we are not going to finance the gap between what you invest and what you in Australia save’,” Dr Henry said. “What happens? What happens is the Australian dollar will tank. That would certainly happen. The currency would depreciate a long way, unemployment would obviously go into double-digit figures, businesses would fail, banks would be unable to continue to provide credit to homeowners, to businesses, small and large, infrastructure financing would stop dead in its tracks. It sounds catastrophic and actually it would be. We should not assume we are completely immune from this. We should not allow ourselves to be exposed to this risk.”

Dr Henry said the evidence suggested “it looks like we are waiting” for an economic crunch before putting our house in order. He branded that “really dumb” for a country, particularly “because we have stared into this abyss previously” — a reference to the banana republic crisis during the 1980s. He said Australia had been given plenty of warnings about its current fiscal position and any excuse that it was being taken by surprise would be unavailable. In the 80s, it confronted the situation and acted — but that was not happening now.

Dr Henry said: “What has happened is that people have forgotten where this came from, where the discipline came from. And the reform narrative is lost. That narrative no longer exists. It does not characterise policy debate in Canberra at the moment.
“The way we absorbed the message in the 80s was that Australia had to be absolutely first class, world’s best policy, that if we were going to be exposed to the world we really had no choice.” He argued there was something “fundamentally wrong” with the current economic debate. “You know I am not a psychologist,” Dr Henry said. “But it seems to me that there is cognitive dissonance here.” He said the nation faced a situation where the politicians were pledged to balance the budget over the cycle, agreed on the analysis and the solution — but then failed to act. “The conclusion I draw is that those who are declaring a commitment to it either don’t really understand what it is they are committing to or they are not really committing to it,” he said.

Dr Henry said of the current political generation: “I wonder if they weren’t thinking this will be a problem that I can leave to my successors.” He was scathing of the present debate about the banks and demands for a royal commission. He said a royal commission was unnecessary and would be a distraction. “It would be costly to both the taxpayers and to the banks but, if held, ‘we will co-operate fully’,” he said. “I am prepared, as the chairman of one of the banks, to take absolute responsibility for whatever poor conduct that there has been.” He said the banks had to pay far more attention to their customers and this was the key to extracting them from their current predicament.
Asked about the role of the banks in sustaining the financial system, he said: “It is absolutely key. It is the banks, the Australian banking system, that channels most of these foreign funds into the hands of Australians who are borrowing money to invest. The banks do most of the heavy lifting.”

Dr Henry said the debate about a royal commission was missing the central point — the role of the banks in the macro-economy — and this omission was yet more evidence that “the policy narrative doesn’t exist” any more.