

# REVERSE IMAGE



# AUSTRALIAN vs. U.S. FISCAL POLICY

## As the United States drowns in debt, Australia stands high and dry.

BY HANK COX

PRESIDENT GEORGE BUSH, former Secretary of Defense Donald Rumsfeld, and *Washington Post* columnist Charles Krauthammer were waxing lyrical last summer about the steadfast loyalty of Australia during a time when most foreign nations wouldn't acknowledge our e-mails. In June, Bush hosted Australian Prime Minister John Howard at the White House, and Rumsfeld hosted Australian Defense Minister Brendan Nelson at the Pentagon. Both visits concluded with joint press conferences. Between those visits, Krauthammer penned a column entitled "Why I Love Australia," a paean to the Aussies' unequivocal support for American foreign policy.

But the Aussies have a lot more to offer us than mere loyalty. They could teach us a thing or two about sound fiscal policy.

While the United States runs up seas of debt for future generations to pay, squandering trust funds that are supposedly being set aside for future retirees, Australia is demonstrating how a modern industrial nation can balance its books, sustain economic growth, and also set aside tangible assets sufficient to take care of its aging population in the decades ahead.

Australia's budget went into surplus in 1998, which, oddly enough, coincided with our country's first budget surplus in 29 years. But after three years in the black, we reverted to our profligate ways. In contrast, Australia continued to run up surpluses year after year with only a minimal one-year interruption. On April 21, 2006, Australia's Treasurer Peter Costello declared it "debt-free day" because, after all of Canberra's borrowing and lending was taken into account, the government owed nothing.

"It is the day we pay off the mortgage," Costello said. In paying off its debt, Australia joined six other advanced nations that are debt free—Finland, Norway, South Korea, the Czech Republic, Sweden, and New Zealand.

Australia's success is a story of free-market magic that all the supply siders at the Heritage Foundation and *The Wall Street Journal* editorial page should love. A series of governments dat-

ing back to the early 1980s set out to free up the economy, letting the free market value Australia's currency, reducing tariffs and subsidies, limiting regulations on business, and curbing the influence of labor unions.

Under the leadership of the Liberal Party's John Howard, who has been prime minister since 1996, the government has stepped up the shift to privatization, selling off the airlines it once owned and about half of the telephone system. (In Australia, Labor is the liberal party and the Liberal Party is the more conservative one.) During the same period, Australia has repeatedly cut taxes, giving the private sector a boost. The country also has benefited from tremendous world demand for basic commodities, which Australia has in abundance, driven largely by China's rapid expansion. And thanks to its increasingly business-friendly climate, Australia is enjoying record-high business investment, growing 14 percent a year, replacing household consumption as the main engine of economic growth.

Meanwhile, the United States ran a record deficit of \$412 billion in 2004 that declined to \$318 billion in 2005 and came in at \$247.7 billion in 2006. A declining deficit is better than an increasing deficit, but it's expected to head north again this year. It's a lot of money, and year after year the red ink adds up. Last year, the total gross U.S. debt surpassed \$8 trillion for the first time—equal to well more than half of the nation's gross domestic product (\$13.1 trillion)—and is projected to top \$9 trillion by the end of fiscal 2007. The Congressional Budget Office projects that the gross federal debt will continue to grow over the next decade, hitting \$13.7 trillion in 2016. In an unhappy coincidence, that's probably the same year in which, as the baby boom generation begins to retire en masse, Social Security will begin to pay out more than it takes in.

This underscores yet another contrast between how the United States and Australia are handling their respective fiscal affairs and planning for the future. In this instance, it should be noted, the U.S. Congress actually did try to recognize fiscal

reality and prepare for the retirement of the baby boomers. Recognizing that the generation born in the years after World War II will put severe stress on the Social Security system when it hits retirement age, Congress required the baby boomers to pay into the Social Security system much more than the system pays out to retirees every year, creating mounting annual surpluses that reached \$173 billion in 2005 and hit \$177 billion last year. In theory, this excess is building up and being salted away for the future. The Social Security trust fund held \$1.8 trillion at the end of 2005. That's a lot of money. Current projections suggest it should keep Social Security solvent until 2042.

The fly in this ointment is that the Social Security trust fund is a liability, not an asset. As a matter of law, the excess funds paid into Social Security (and other federal trust funds) are invested in special, non-marketable Treasury securities known as the "government account" series. The real money goes into Uncle Sam's general fund where it's used to pay the government's bills. The Social Security trust fund is left with a few pieces of paper kept in a filing cabinet in Parkersburg, W. Va., that say the government owes itself a lot of money.

This is the paradox that seems to confound the very people who conceived the present system (the 1983 Greenspan Commission) and others who, like President Bush, realize the system needs an overhaul but apparently don't understand what the real problem is. Even when President Bush was holding forth in his campaign to reform Social Security in 2005, he referred several times to 2042 as the time of reckoning, implying the Social Security trust fund would sustain the system until then. But since there are no tangible assets in the trust fund to sustain the system until 2042, the real turning point is on or about 2017, when Social Security begins to pay out more than it takes in.

Stated more bluntly, the Social Security trust fund is a polite fiction that glosses over the grim reality that the excess money paid into Social Security is being spent as fast as it comes in, not put aside for the baby boomers. The only people for whom the trust fund has real meaning are those who actually work for the Social Security Administration and the Social Security trustees. When the system runs out of money, they won't have to go hat in hand to Congress to ask for additional funding. All they have to do is redeem their Treasury securities. No problem for them.

But when that happens, Congress will have to redeem the securities with real money, meaning less money will be left over for national defense, medical research, border patrols, environmental protection, highways, pork barrel projects, etc. As a practical matter, it's the same as if the trust fund didn't exist.

### Upper Hand Down Under

The Australians are also setting aside reserves to take care of future retirees, but absent a significant government debt, they can

**SINCE** the Social Security system collected **\$177 billion MORE THAN IT SPENT** last year, that extra **\$177 billion** made the federal deficit look smaller than it was. The **REAL DEFICIT** was **\$424.7 billion**. Any way you compute it, the deficits are creating a **VAST DEBT** that must eventually be paid, contributing to a huge trade deficit and **DEVOURING** our retirement nest eggs.

put little of it into Australian government bonds. Rather, they invest it in a diverse portfolio of shares, bonds, and real assets.

Among these is a joint venture between the Macquarie Infrastructure Co., an investment trust directed by Australia's Macquarie Bank, and a Spanish investment group that recently spent \$3.8 billion for a 75-year lease on the Indiana Toll Road. The same consortium also owns the Dulles Greenway that runs from Leesburg to Dulles Airport in Virginia, the 7.8-mile Chicago Skyway that connects the Dan Ryan Expressway to the Indiana Tollway, and the new South Bay Expressway in San Diego set to open next year. These investments, and others like them around the world, will provide steady, reliable income streams to provide benefits for Australian retirees throughout the century.

Comparing the United States with Australia isn't like comparing apples and oranges, but there are some critical differences worth noting. There are almost 300 million Americans and only 20 million Australians. Also, the U.S. and Australian retirement systems are structured differently. Just about everyone in the United States is covered by a government retirement scheme—Social Security, government employment, or military service—and Uncle Sam offers incentives for people to save more in private accounts, such as IRAs.

Employer-sponsored defined benefit pension plans were once a major factor in the overall U.S. retirement scheme, but that role is declining. Only 20 percent of Americans today are participating in such plans, down from 40 percent in 1975. Defined benefit retirement plans are increasingly seen as an anachronism by employers reluctant to set aside the funding needed to make them viable, and Congress keeps raising the ante on that score. Many defined benefit plans are essentially bankrupt and unable to provide the promised benefits to retirees.

Australia also has a national government retirement fund, but it's means tested and of diminishing importance as the country shifts to a system that bears more than a passing resemblance to President Bush's proposed personal accounts. Under Australia's

“superannuation” program, Australian employers set aside 9 percent of each employee’s wages for retirement and add 3 percent more as part of a “productivity package,” making a total 12 percent contribution. As in the United States, the Australian government offers tax incentives for people to invest additional funds in their retirement plans. All of the retirement funds are managed by private companies, such as Macquarie Bank, under government supervision, in the same way that employer-supported retirement plans are managed in the United States. Thus, Australia is committed to shifting its retirement system from the public to the private sector.

One more thing: Though Australia has cut personal taxes several times in recent years and has announced plans for more cuts in future years, its people pay higher tax rates than people in the United States. Canberra’s receipts this year represent about 23.3 percent of Australia’s GDP; the comparable share in the United States is 17.7 percent. But tax rates for individuals are about the same in both countries; the difference in total tax take is reflected mainly in higher taxes for business in Australia. In fact, according to the Organization for Economic Cooperation and Development (OECD), Australia has the fourth lowest direct taxation through the “individual’s income tax, social security contributions and payroll tax,” while the United States ranked eighth lowest.

### Things May Appear Smaller

So there you have it—a tale of two free-market countries, the first embarked upon a sound fiscal path into a secure future, the other intent on a lemming-like leap into a sea of future debt. The key difference appears to be the Australian government’s commitment to live within its means. And while Australian businesses pay slightly higher taxes than U.S. businesses do, it apparently doesn’t dampen their economic vigor. The Australian economy is growing faster than ours is, led by capital investment in business.

The budget deficits of the United States are the root of our fiscal dilemma, fostering a multitude of evils, and the real deficit is much larger than reported. The 2006 budget deficit of \$247.7 billion was actually much more. It must be remembered that the official deficit figure reflects the total amount of money collected and spent by the government. Since the Social Security system collected \$177 billion more than it spent last year, that extra \$177 billion made the federal deficit look smaller than it was. The real deficit was \$424.7 billion. Any way you compute it, the deficits are creating a vast debt that must eventually be paid, contributing to a huge trade deficit and devouring our retirement nest eggs.

Assuming no serious action is taken to avert the pending crisis—and, given the willful denial of reality that prevails in the nation’s capital these days, that seems almost certain—we will nine years from now encounter a perfect storm of calamitous fiscal forces that no amount of political posturing or quick fixes will remedy. And I haven’t even mentioned the biggest fiscal challenge of all—Medicare—which most experts expect to go broke before Social Security does.

We’re able to live beyond our means today, accumulating massive debt, precisely because the world believes we’re good for it, that we’ll pay the bills when they come due. But we need to understand that the national debt isn’t an abstraction; it’s real money that our children and grandchildren will have to repay.

As one with strong ties to Australia (my wife is Australian, and our children carry joint U.S.-Australian citizenship), I was heartened to see John Howard rubbing elbows with President Bush, but I wish our president—and members of Congress—could see more Down Under than a foreign policy cheering section. The Aussies are showing the world how to run a vigorous free market economy without impoverishing future generations. If only the world were paying attention.

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