BOMA4 Interest Rates John Hyde

I represented a large portion of the Western Australian mortgage belt in Federal Parliament . It exercised its democratic right and threw me out. Some of the Liberal Party's good and great accused me of throwing the seat away by calling for interest-rate deregulation. It requires blind conceit to believe them. Not more than several hundred of my ninety five thousand constituents knew or cared what I was calling for.

Money lenders are always reviled while borrowers, however foolish or venal, enjoy sympathy. Antonio was clearly a very bad risk and Shylock understood the price of money. Antonio got a good deal better than his deserts when he won for Bassanio the noble Portia and for himself the opportunity to go on baiting Jews in the Rialto.

My electorate did not understand why the price of money should be high but, as they had been misled by a Prime Minister and Deputy Prime Minister who, by saying interest would fall by 2%, implied omnipotence, and by a Labor Party which didn't mind why interest was high so long as the government was blamed, who can blame them? Labour promised lower regulated rates. One of the local building societies, with rather less respect for facts than Shylock, and against the advice of its own chief economist, was calling for the impossible, blaming the government for high interest rates and demanding it bring them down. They have since embraced deregulation.

When Mr Hawke said in November [this/last] year that interest would fall gradually over 1987 Mr Keating was quick to make a contradictory statement saying that the exchange rate would remain steady even if that meant high interest rates. They were speaking to different audiences but no doubt the treasurer also remembered the trouble Mr Fraser and Mr Anthony once got themselves into.

Campaigning in Queensland in the run-up to the 1977 election, under pressure to be specific, Doug Anthony said interest rates will fall by 2%. Fraser backed the prediction. What was merely a prediction, shared by many informed people of the time, quickly took on the status of an undertaking. Nothing was done to deny the impression that the government was promising lower interest. No doubt in the short run it suited the government to have the public believe that it could deliver lower rates.

Interest rates did fall a little but went back up again. To make its prediction (now seen as a promise) come true, the government tried to bully rates down.

The principle means by which the money supply is managed is the sale and purchase of government bonds. The deficit was contributing to the money supply but the government tried to reduce the interest at which it could be financed by selling bonds to the public. It did not seem to understand that it is impossible to control the supply and the price of anything; money being no exception.

By trying to control the price of money the government lost control of the quantity. Although it did not realise it at the time, it put itself on the long and slippery slide that five years later ended in defeat.

Since then, what is disparagingly called 'doctrinaire monetarism', as an instrument of policy, has fallen under a bit of a cloud. But the central tenet of monetarism is more widely accepted than ever. We now know that if the quantity of money is increased relative to the quantity of goods and services the dollar value of goods and services will rise or, which is the same thing, the goods and services value of the dollar will fall.

The difficulty for the policy-maker is that anything to which a dollar value can be ascribed and which can be exchanged is potentially money. The more it can be exchanged----that is, is negotiable----the more it is 'money'. Negotiability varies over time and from cash to paper securities to cowery shells to commodities. Policy-makers got over the problem of indefinable money with various proxies for money, called M-1 to M-umpteen; each successive 'M' adding slightly less negotiable instruments to the previous definition. This worked well for so long as the public's preferences for the various monetary instruments remained fairly stable. The Ms let the policy-makers watch the proportional changes in money supply fairly well. However, lately financial deregulation and tax changes have caused people to change their preferences for the instruments and the speed with which they turn them over. Today the reserve bank watches the Ms but it also watches other indicators such as business activity too. It is the Ms, not monetarism, which is under the cloud.

Money management through the 1970s was an up-and-down affair. The McMahon Government left Whitlam an exploded money supply, which he was slow to correct, resulting in the wild inflation of 1974 and 1975. Money was conservatively managed through 1975, the year Hayden was treasurer, and through 1976 and 1977. By 1977 inflation was falling slowly but steadily. Our position relative to our trading partners was improved and good.

Then the government missed its money supply targets three years together. Our inflation rate tended up slightly and relative to other countries, where inflation was falling, it rose sharply. Monetary discipline practiced elsewhere fed into Australian prices and actually masked what was happenning here, but the favourable comparison with our trading partners was reversed. Australian inflation is now three times that of our trading partners.

The wage explosion of 1981 and 1982 was just one predictable consequence of three years of loose money management---of an attempt to bully down interest rates. Unions could see inflation rising and had become convinced that their wage gains would be reflected in rising prices rather than unemployment. Employers had come to expect that the government would validate pay rises by printing more money which would let them charge higher prices.

The coincidence of the wage hike and the need to take money in hand again, as Whitlam and Hayden had had to do in 1975, plus bad commodity prices and a drought sent the economy into recession. Loose money management when it should have been tighter left the government with no strategy to ease the economy over the misfortune. Denied the monetary stimulous it could have adopted if inflation had been 2% or 3%, where it should have been, the Government panicked. It discarded all the economic argument Liberals had employed since Fraser defeated Snedden, increased government spending and the deficit with the full-year effects of both being far greater than those shown by the 1982 budget. Keating claimed the deficit he had been left was $9.6 billion. A fair comparison shows less than that, say $7.5 billion, but still one that is disgraceful.

The government's credibility in the vital area of economic management was in tatters. It had been sacrificed to a populist prediction that was allowed to become a promise. Since then no-one, until Mr Hawke's recent little slip, has promised to lower interest rates. Naturally, without disinformation the public's understanding of the real world has impoved.

The Fraser government's defeat was inevitable and of course proper.

Since then the Hawke government has done remarkably little about the problems it inherited. It has continued with huge eficits. Its second budget was an easy one to write, and in all the circumstances was as disgraceful as the last Fraser effort. In other times the most recent budget would have been reasonable, but by then the situation had become so parlous that much more restraint was called for.

It is difficult to be precise about Labor's monetary policy. Financial deregulation started by John Howard against the opposition of the cabinet conservatives, has been continued by Labor. This is a very desirable policy in itself but one which has caused the Ms to fluctuate so as to tell us little about money supply.

Keating seems to have vacated the field of monetary policy to the Reserve Bank under a new and tough Govenor, Mr. Bob ~~S~~Johnston. That too is thoroughly desirable. Money management is a technical matter ill-suited to political manipulation. Politicians do not manage the money supply in the countries with the best inflation records, such as Switzerland and West Germany.

With hindsight I think we can say that money management has been tight enough to keep interest historically high but not quite tight enough to offset very slack fiscal policy. People used the money generated by the deficit to buy more foreign goods than we exported or could afford.

However, monetary policy probably did most of what could be asked of it. Keating has been a far stricter monetarist than Fraser. The real problem has been wages policy which prevented real Australian wages falling when they did in other countries, and industrial relations policies entrenching work practices which vetoed productivity improvements comparable with other countries.

The rest is well known: the dollar collapsed and Moodies downgraded our credit rating.

Mr Keating is promising that the dollar will be held around 62 cents US by higher interest rates if necessary. That is an acceptable policy only if the underlying problems of the budget deficit and costs are tackled this time. Unfortunately his own party can, and probably will, veto really decisive action on either front.