WEEK ON THE DRY SIDE 355

Des Moore

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Whether a particular debt was well or badly incurred depends, in large measure, upon what the money was used for. If our foreign debts had, on average, financed investments which are more than generating or saving the foreign exchange, then we could, on average, enjoy higher living standards because of them. If, having thought about the consequences, we had, on average, decided to live high on the hog or tide ourselves over rough spots, that might also be rational. If, on the other hand, we are incurring debts because we are reacting to perverse signals, sooner or later, somebody is likely to curse the fact.

Many academic commentators have been arguing that because new foreign debt is being incurred by the private sector, it is not a worry. This opinion has tended to divide them from their business and Treasury colleagues. Des Moore of the IPA weighed into the debate with a paper which argues that debt does matter. It was, by coincidence, released on the day that Federal Cabinet decided that we could afford to do without the income from the Coronation Hill mine.

These facts seem pertinent:

- Australian foreign debt levels and interest payment obligations to foreigners are high by almost any test. They exceed 'danger points' by which the financial market has judged other countries. The cost of servicing debt and equity investments in Australia by foreigners has exceeded 25%, the point that seemed to presage the 1890s and 1930s recessions/depressions.

- Three quarters of the current account deficit reflects the cost of servicing the accumulation of past current account deficits.

- 45% of the foreign debt is government debt for which taxpayers are ultimately liable.

- Foreign debt ballooned only during the 1980s but it has been growing since the mid 1970s.

- From 1970/1 to 1985/6 total consumption increased in proportion to GDP by almost 6 percentage points---almost 5 of these were government consumption. At the same time investment fell by about 1 percentage point. We may argue about the mechanism, but plainly a consumption binge was financed by reduced investment and particularly by borrowing from abroad.

- Since 1985/6 the trend has started to be reversed but the total consumption to GDP ratio is still above that of the early 70s and government consumption is still well above that of the early 70s.

There is argument about whether the government can or should do anything, or stop doing something it is now doing, that would affect the accumulation of foreign debt.

Governments, which are more interested in re-election than efficiency, cannot absorb the millions of individual pieces of information that cause markets to function, and even in a democracy have totally inadequate feed-back mechanisms, cannot expect to improve upon markets. It does not follow, however, that the private sector never makes mistakes, nor that market aberrations necessarily cancel each other out. Ideas that, with hindsight, are seen to be wrong have often influenced markets.

It may, nevertheless, help to reconcile the differences between the debt-does-matter and the debt-does-not-matter schools, if it can be shown that private-sector savings-and-investment behaviour has been distorted by government policies. Moore lists three such distortions during the 1970s and 1980s. These affected market behaviour so as to encourage the accumulation of debts which were not covered by income-earning investments:

- inappropriate monetary and fiscal policy,

- tax policy which penalised savings and unduly favoured debt finance, and

- social security which has obviated the need for personal savings.

Australians have got themselves into this situation because, for the past 15 years or so, we have been increasing our borrowings from all sources [domestic and foreign] at a faster rate than our income. For each of the three major sectors of the economy---government, corporate and household---the cost of servicing these borrowings has been taking an increasing proportion of receipts. The fact that the public sector has recently ceased to be a net borrower does not obviate the need to service past debt.

Government consumption has crowded out both government and private investment. Private consumption, far from being replaced by government consumption, much of which is 'social-wage' type expenditure, actually rose a little. This is understandable. The alternative to consumption is saving, and the combined effect of direct taxation and the huge increase in inflation had made after-tax earnings insufficient to even maintain the real value of most savings. Such savings as were made were invested in housing, which boomed in price. The enjoyment of housing is not taxed. Business sector savings were similarly affected. Another reason for households to reduce savings at this time was that, when pensions, sickness and unemployment benefits, and healthcare were made more generous by the Whitlam government, there was less need for individuals to hold liquid savings. The government, did not increase its savings to fund these new obligations. On the contrary, it chose to increase its own borrowing, i.e. dis-saving.

Had economic growth been greater, a more satisfactory level of saving and investment would have been possible without reducing living standards below those we actually enjoyed. That is not to say that, faced with the perverse incentives, we would have increased our savings. Since we are ultimately as wealthy as our production, the recommendation to deregulate stands whatever the state of the current account.

Moore's other recommendations include the inevitable, the cautious, and the radical. Monetary policy must be tight---the inevitable. He concedes the advantage for investment, but recommends against replacing direct taxation with a consumption tax as New Zealand has done---the cautious. He calls for a 2 percentage point reduction in the share of GDP spent by government, i. e. a $7,000 million cut, in each of three years. By implication this is without further reducing government investment. Should this be achieved, I promise to applaud.

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