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The Election and the Debt

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Australians are worried about their economy---about debt, uncompetitive industry, inflation, the rising number of bankruptcies and the potential for living standards to fall. Even at this late stage, people's assessments of the parties' general economic competence could determine how more of them vote than issues such as the environment, health care and capital gains tax together. For this, however, the public must be able to decide which political party would display more economic resolve, when elected.

In spite of the opportunity for political advantage offered by our political troubles, both Government and Opposition are avoiding serious economic discussion. They avoid it because neither feels it can afford to admit that the short-term economic options are, in fact, very limited, when the other party might not make the admission. Instead, the Bob and Andrew Follies continue to promise falling interest rates even when, in the process, the 'leaders' make themselves sound stupid, dishonest or both.

Neither party is game to take advantage of the fact that the Australian public is more economically literate than ever before and, I believe, more willing to accept straight talking. Both parties' campaigns are, instead, being driven by opinion polls. The party leaders betray the public they seek to lead. The pollsters don't ask: would you vote for someone who will say what ought to be done; vote for someone who instead of following your opinion tries, by argument, to change it; in short, vote for a leader?

It is hard to imagine either party 'leader' abandoning 'followship' for leadership, but, as the campaign advances, one of them is likely to be faced with a leeway he cannot expect to make up unless he changes tack. Then he will have to consider a bold move: he might, at least, consider explaining macro-economic imperatives truthfully.

The incoming government must tackle the problem of excessive foreign debt. The present macro-economic settings are not addressing the main problems. Current policies will not cut the current account deficit by enough to stabilise the debt ratio unless the economy is plunged into recession. Even recession will do no lasting good unless the accompanying decline in the nominal exchange rate leads to a real decline: that is, unless real unit labour costs are held down. In the long run, improved productivity is the only way to avoid lower living standards and recurring balance-of-payments crises. In the meantime we have to get through the short run without burdening ourselves in the long run with even more debt. Whatever may be their privately-held, post-election intentions, neither party is publicly facing this issue.

The present policy to reduce the rate at which foreign debt is increasing is to squeeze demand. Just how deep a recession this policy on its own will necessitate can be seen from the following simple calculation. To reduce the deficit to 2.5% of GDP (at which level external debt would stabilise), will require a cut in the import bill of $10,000 million or about 20%. Since a 1% variation in GDP has, in recent times, produced about a 3% variation in imports, to stop the external debt from growing, by acting on imports alone, would require a 6% fall in GDP---a severe recession.

High interest rates are, in large measure, self-defeating. As well as reducing demand, they maintain a high dollar which discourages exports and encourages imports. Better, therefore, to the extent that the government must rely on demand management, to apply the squeeze by fiscal means, that is, to have a bigger fiscal surplus. Unless taxes are to be increased, encouraging a wages blow out, this implies cuts in government services.

More fundamentally, the real exchange rate must be reduced. Interest rate reduction, made possible by fiscal restraint, will cause the dollar to fall, but that is by no means a sufficient condition for economic recovery. There must also be mechanisms which prevent the price rises consequent upon the devaluation feeding through wages into producers' costs. It is here that the political parties are distinguishable: Labor offers us more of the Accord while the Coalition offers us labour market deregulation.

Labor has increased real disposable incomes while reducing real wages. Their policies have increased employment, increased government benefits, and increased interest and profits. The room for further gains in any of these areas, however, is now negligible. Indeed, that some ground will be lost is almost inevitable. What is more, the strategy hasn't worked. The Accord mechanism may be judged by reference to the following table of relative unit labor costs. It is taken from the OECD "Economic Outlook" for December 1989.

	1987	1988	1989	1990*	1991*
Australia	100	109	118	121	125
Canada	100	108	115	120	122
Germany	100	98	95	92	90
N Z	100	106	101	99	99
U.K.	100	108	107	104	106
U.S.A.	100	91	92	91	91

* = OECD estimate

The Coalition strategy is less predictable in the short run. But it does at least offer the possibility of the productivity gains, without which living standards cannot improve, even in the long run. The big question is whether the Coalition will have the ability and the courage to deregulate and privatise the rest of the economy. Note New Zealand's much better performance in the table above. The Coalition has some of the strategies necessary to claw our way out of the present dilemma. On that count it deserves our vote. It is not, however, being any more honest than the Government is about other preconditions for recovery.

In the short run, interest rates will remain high and living standards will fall. Government benefits must be reduced, and the many vested interests currently enjoying monopoly profits must get their come-upances. None of these will be changed by the election result.

The we-will-not-be-frank strategy is preventing the Opposition from explaining how, and how completely, the Government has failed. Want of courage, honesty and intelligence has, so far, prevented it from offering an entirely credible alternative to failed Government policies.

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