FIN ON THE DRY SIDE 229

DEFICITS John Hyde

I kmow it sounds churlish coming from someone associated by party affiliation with the last Fraser budget but the deficit reduction promised by Mr Keeting on Tuesday last did not go far enough.

Two weeks ago, when I wrote about reducing public sector borrowing requirements, I assumed that everyone thought them bad! After all aren't government deficits a super prospective tax levied on children who are not asked whether they want to accept the liability? Aren't the next generation being taxed because politicians are too gutless to tax current voters?

A friend objected: "I can see that governments spend my taxes badly and run inefficient commercial enterprises like Telecom. I accept that big government is bad. But why is a big government financed by taxes less bad than one financed by borrowing? Businesses borrow successfully; why can't governments."

The point is that governments don't borrow "successfully" in the commercial sense. Successful investments are those which more than repay their own cost at current interest rates. Failure results in loss and bankruptcy. Government borrowings, on the other hand, are apt to finance monuments---parliament houses, bicentennial road programs, dams, pipe lines and flag poles---which are not asked to service their own cost. Without an objective measure of whether the resources tied up are put to the best possible use, governments tend to waste them.

High levels of public borrowing reduce private investment. The Brookings Institute put it this way, "the result (of defict budgetting) is a shift in the mix of total spending---more resources for consumption, less for investment and housing. A low level of investment in plant and equipment is likely to reduce productivity increases and hamper economic growth in the long run. Penalising investment is borrowing from the future to increase consumption now."

The first objection to deficits is that the public works they finance are not as well chosen as the private investments they crowd out.

In life-and-death crises it is good sense to mortgage the future to survive now. Families facing illness and nations at war borrow against future income because they have no better option. Credit worthiness should be husbanded against such bad times. The second objection to peace time deficits is that the ability to borrow is being squandered.

Australian governments, like families addicted to buying consumer durables on hire purchase, are borrowing to fund ongoing consumption. And they invest for show rather than return. Like the fabulous Blue Skies NL their effective collateral, while it lasts, is nothing more than the ability to raise more money. However, as well as deception they may use force. In the last analysis, it is the ability of the police to force future tax payers to pay up that stands behind government debt. Faced with widespread tax evasion and avoidance sensible governments back off. Others, less wise, gain temporary relief by borrowing at even higher interest rates, but soon or late this debt too must be repudiated or serviced by taxation backed by the police and army. The third objection is that governments with unmanageable debts tend to run police states.

The fourth objectiob is that domestic borrowings spill into foreign account. Mr Des Moore, research fellow with the Institute for Public Affairs, writes of the "twin deficits" this way: "The connection is readily explicable. If the public sector seeks to borrow (and spend) more, the additional savings will have to come from overseas unless there is an offsetting increase in private sector savings or domestic spending falls away."

In 1975, Malcolm Fraser attacked deficit budgeting, comparing Whitlam's profligacy to a badly-managed household. Several academics rushed to explain how wrong Fraser was. We were borrowing only from ourselves and therefore it did not matter, they said. How wrong they were! Australians ended up owing money to foreigners.

The OECD explains a fifth objection: "The worry is that governments will attempt to 'inflate their way out of trouble' through increased money expansion. Such expectations would put upward pressure on interest rates by raising the risk premiums therein, thus threatening the growth potential of the economy, particularly if the ongoing budget deficits and the consequent accrual of public debt serve to finance public consumption rather than investment. Moreover, there is a danger that exchange markets will react unfavourably for similar reasons." The OECD was not referring to Australia in particular, but the lecture applies to us.

When governments borrow rather than raise taxes the choice itself changes several things. The young lose. The quality and quantity of investment suffers. The security of a good credit rating is thrown away. The police must be given the dificult job of compelling you and I to service the debt. Foreign debt accumulates. Governments are tempted to inflate the currency.

We were warned. A 1979 paper by Mr John Stone predicted that continuing public sector borrowing---State and Federal would cause:
* inflation (it is now four times that of average Western industrialised nations),
* weak private sector investment (new investment in productive plant is now barely sufficient to compensate for depreciation),
* currency collapse and foreign debt (we all know about those).

He said: "The longer deficits persist the worse those problems become." The State and Federal politicians, of all parties, who ignored the advice deserve at least a small measure of voter contempt.

In short, although taxes are bad, deficits are indeed worse.
ENDS