

**\*WEE\* ON THE DRY SIDE**

**INVESTMENT: WHERE WILL IT COME FROM?**

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Mr Keating says the Liberal tax package won't be delivered and also that it will make huge and unpopular inroads into the social wage. He really can't have it both ways.

The only plausible reason not to deliver tax cuts will be that expenditure cuts have been blocked by people protecting the social wage, whether wets in the Liberal party room or ALP and AD senators. United States tax cuts were financed by a burgeoning deficit, but Mr Howard has undertaken that tax cuts will not be allowed to precede expenditure cuts.

Mr Keating could virtually undertake to ensure that the Howard package will fail in the Senate but he hasn't and he won't because he expects to win the election and is positioning himself for his own cuts to the social wage. This is why:

Mr Hawke is disengenuous when he says that the worst is over---the worst is yet to come. The foreign account imbalance will dominate the next government and everybody in politics, except perhaps Janine Haines, knows it. Politicians who say living standards will be maintained in the next year or so are deceiving themselves and us.

Gross foreign debt---what we owe---is already some 42% of Gross Domestic Product and accumulating at the rate of 3.5% to 4% per year. We cannot service this debt and stop its growth without a modest drop in living standards. Three years ago, when the problem was already evident, we could have set about increasing productivity and avoided the need for belt-tightening, but it is too late now.

The differences between the parties' calculations of each others' packages won't matter a row of beans in the end. They will be swamped by bigger wrong guesses about growth, inflation and unemployment and what can be got through the political system. Future terms of trade and balance of payments figures will affect future judgments about what ought to be done, wrong guesses then will swamp accounting errors now.

By concentrating on the detail of the packages we are allowing the wood to obscure the trees. Up to any conceivable level of cuts; the bigger the better, so long as they are not achieved at the expense of other things, such as labour market

reform, for which there is even greater need. The deficit must be eliminated promptly.

The following figures were presented to an Australian Institute for Public Policy seminar by Mr Les McCarrey of the Institute of Public Affairs. As public sector borrowing rose in the 1980s, private fixed investment expenditure fell from 19.1% of GDP in 1981-82 to 15.9% in 1985-6. Private savings were fairly constant (18.3% of GDP in 1985-86) but not enough to meet both the requirements of private investors and the demands of governments, which increased from 3.7% of GDP in 1980-81 to 6.9% in 1985-86.

Government borrowing would have been less bad if it had not been blown on consumption expenditure. It's not unfair to accuse successive Federal governments of using our savings to buy or attempt to buy our votes in the 1983, 1984 and 1987 elections. Total domestic net saving---government and private---has plummeted from a lousy 15.1% of GDP in 1980-81 to a totally inadequate 11.4% last year.

This means:

- \* We have had disgraceful spendthrift governments.
- \* Government consumption has displaced private investment.
- \* New investment is crowded out to the point where we can barely maintain our capital stock.

The Fraser Government must share some of the blame but why the Hawke/Keating government should be let off this hook is beyond me. Its fiscal management has clearly been inadequate.

Both Governments were unwilling to reduce their demand; too much total demand was sucking in more imports than we could pay for, driving the dollar down even further, so private demand was choked off with tight monetary policy.

Tight money keeps interest rates high. High interest rates affect investment and consumption unequally; they are harder on investment; they are the mechanism which has depressed Australian investment and attracted foreign loans. Budget deficits and high interest are at the heart of the investment malaise and the foreign debt problem. Mr Hawke and Mr Howard must both know they cannot continue to rely on monetary policy to undo the damage done by their budgets.

Ever since election in 1983 Mr Hawke has talked fiscal restraint but it was not until last year's Budget that we saw real action. Even then, real expenditure cuts were only about \$1.5 billion of the vaunted \$4 billion. The expected consequence of the deferrals were one reason for calling the early election. In truth, in spite of more obvious need for restraint, the 1986-87 budget was no better than Fraser's record up to the 1982 pre-election budget.

Because the fiscal problem was not seriously tackled last year, a \$7000 million deficit appeared in the forward estimates this year. The May statement clipped that back ostensibly by \$4000 billion but again only about \$1400 million is actual spending cuts. \$1000 million is asset sales which

make the same call on private savings as the deficit does, and \$1000 million was deducted from the States which may make it up by drawing down their reserves, again reducing the sum available for fixed private investment. Real Commonwealth expenditure will still exceed last year's, and the total public sector borrowing requirement will be about 4% of GDP: no better than pre-1982 Fraser.

Suppose the goal is to increase new private investment by 2% of GDP---not enough to get back to the level of 1982. Unless households and corporations elect to increase private savings, even this apparently modest goal requires a further genuine reduction in public sector borrowing of \$5000 million.

Deferrals and asset sales won't do. If private savings are to increase, people must voluntarily reduce living standards---consumption---even more than will be forced upon them by the adverse terms of trade and foreign debt service costs: and pigs might fly! There is some danger that with falling incomes households might maintain living standards by saving less.

Les McCarrey suggests a 2% of GDP improvement in private investment can be achieved by a \$1000 million Commonwealth surplus and a further \$1000 million reduction in State expenditure. I can think of no better formula to divide the political pain. If Labor is re-elected Mr Keating will have some recalculation of his own to do. He too will regard the social wage as less than sacrosanct; he will have no option if he wants investment to recover to levels which will generate decent living standards in the future.

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