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ON THE DRY SIDE 157 THE AUSTRALIAN DOLLAR John Hyde

The choice between sustained higher interest rates and a plummetting currency seems to be Buckley's. As Treasury head Bernie Fraser has pointed out, either will abort the recovery. What is more, neither is a long-term solution to fundamental economic weaknesses and both are political nasties.

The Government doesn't want to be responsible for the 'South Pacific Peso' so it is using high interest rates to screw down domestic demand and attract foreign investment. Short-term growth is being sacrificed for stability and a better long run prospect. No-one in the Government is saying so but this returns us to the Malcolm Fraser strategy.

In June 1982 one US dollar was needed to purchase one Australian dollar; now 68 US cents are needed. The Trade Weighted Index has declined from 105 ten years ago to 61 today.

Our currency reflects a foolish and ultimately forlorn attempt to live beyond our means, borrowing abroad to support consumption. The process is institutionalised by deficit budgeting and wage indexation.

In the 1970s the value (price x volume) of our exports fell relative to the cost of our imports but we neither reduced our living standards nor increased our productive effort.

Since then, populist politicians have piled deficit on deficit, keeping our economy in a state of permanent fiscal (Keynesian) stimulation. Demand has spilled over into imports which have contributed positively to living standards but also to debt.

Net borrowing balanced the foreign account until foreigners started to wonder whether Australia was as safe and profitable as some other places. Then the Australian dollar fell.

Our response was to raise real interest rates (risk premiums). This attracted more foreign money and dampened demand, stopping the dollar falling even further. But the capital account surplus continued to pay for imports, allowing us to continue to live on more than we produced. Interest premiums have risen until Australian real interest rates are among the highest in the OECD block.

We go around and around like a dog chasing its tail, catching it every now and again, yelping and letting go. Eventually, like the dog, we must lie down exhausted.

The Wage Pause and the Accord were supposed to avoid the necessity of high interest rates. They were supposed to prevent us living beyond our means while still maintaining high demand and growth. They were intended to avoid resort to credit squeezes and the necessity of balancing Federal and State budgets.

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The strategy never was capable of delivering the goods. Its flaw is the strength of labour market monopolies, and to a lesser, but significant degree, the strength of product-market monopolies. In the presence of high demand these uncompetitive elements raise earnings without improving productivity.

Senator Button and Mr Kerin have been beavering away at the product market monopolies but Mr Willis has not freed up the labour markets. There the strategy founders.

The low dollar is primarily a symptom rather than a cause of our troubles. This is not to say that a rapidly changing value does not cause windfall gains and losses, or that the consequent uncertainty does not make investments in capital goods, stock or contracts - including 'the Accord' - more difficult.

Australia cannot go back to a fixed exchange rate. The alternative to a floating dollar is high-level decisions to set the rate (sometimes after fights that take days), and vast transfers out of (or in happier circumstances into) Australian currency while people argue.

Computer networks have integrated the world economy. Money can be shifted so fast and the reserves are so vast that it would be silly to defend the currency for very long. The Reserve Bank's reserves of foreign currencies are only $12000 million of which $3700 million is in gold it may not wish to sell. The Hawke government had little choice but to float the dollar.

If the authorities had twenty/twenty foresight they might somtimes iron out market aberations but in practice whether any Government should defend its currency against a downward plunge depends on whether it can use the time it buys to work on the underlying problems. Australia's government needs to renegotiate the Accord and cut public-sector borrowing.

Without a spectacular improvement in productivity, living standards must fall until some of the debt is repaid, or until falling foreign interest rates or a rising Australian dollar make debt servicing less onerous.

Only higher productivity can sustain improved wages and living standards. Productivity growth can be improved by deregulating, reducing trade barriers and privatising. These are disciplines we must accept if for pride or convenience we want other people to think the Australian dollar worth holding or taking in payment.

It has become so easy to exchange one currency for another that a speculative gaze into the future has me wondering whether the days of many national currencies are not numbered.

There is no law of nature that says a nation must have a currency, or, having a currency, that its citizens must use it.

The whole point of money is that it is widely acceptable. As we travel more, and as modern technology makes transactions with the rest of the world more common, 'widely acceptable' takes on a wider meaning.

The citizens of Israel, Liberia and Panama do not use their own currencies. They prefer US dollars. Israeli laws have been unable to stop the practice. Australians can hold their liquid balances and deal with each other in Greenbacks, Sterling, Deutschmarks or whatever.

If the Australian dollar does not maintain a reasonably stable value internally (inflation) and externally (the exchange rate), Australians will one day demand payments in something they trust more. There will be nothing the Government of that day can or should do about it. In fact it will be a wonderful discipline, but the treasury benches will have changed hands a few times on the way there.

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