ON THE DRY SIDE 175 THE TRILOGY John Hyde

Whether Mr Hawke planned to commit his government to the trilogy or whether it was a rush of blood to the Prime Ministerial head we will never know. Either way it was a good idea - a much better idea than his tax summit.

Like Mrs Thatcher's medium-term financial strategy and the Gramm-Rudman legislation in the US, it provides a disciplined framework for constructing budgets. The trilogy puts pressure on the cabinet to achieve expenditure restraint and encourages the government to return in tax cuts the revenue which it gains from the effect of inflation on the tax scales (fiscal drag).

Mrs Thatcher's strategy proved too ambitious but the trilogy promises are less so; they can be satisfied even if it means that Mr. Howe and others of the Left raise merry hell.

The president of the ACTU, Mr Simon Crean, is reported to have described investment as the missing link in the Government's economic strategy.

Businessmen like profits; if they are not investing then it is reasonable to assume that there aren't any - that is they do not expect investments over their life to earn enough to service their own cost. One obvious reason for this is that interest rates are high; another is that businessmen do not expect the advantages of devaluation to be sustained.

Because world prices for farm produce have fallen farms make an extreme case, but one which illustrates the problem well. Even though real-terms farmland prices are no more than half those of two years ago and the values of developed farms are much less than the costs of developing them, interest rates, costs and commodity prices together make it impossible for a farm to pay for itself. Agriculture's special tax advantages have been eliminated. Even those who are buying developed farms, where sunk capital has already been heavily discounted, must expect things to get better, otherwise they would not buy. Partly developed properties, into which more capital must be sunk, are almost unsaleable.

In spite of devaluation, farmers and manufacturers are slow to invest. Maybe they understand that their terms of trade must deteriorate when our inflation is 7.5%, Japan's is zero, Germany's 1%, the United States' 2% and our trading partners' taken together are no more than 4%. They cannot retain the benefits of devaluation if the trade unions demand TWU-like work practices, Accord-like indexed earnings and employer funded superannuation increases.

If Mr Crean is right, and I think he is, then long term investment must be given a chance. Part of the solution to that problem is as much in Mr Crean's hands as anybody's. For the rest the government must reduce its demands on the nation's savings.

National investment is financed by domestic savings and by borrowing the savings of foreigners. The various Australian Governments are borrowing 5.6% of GDP. They absorb about half our savings. Private investors can invest only what the governments have left for them or what they borrow abroad.

We have already borrowed too much. Lenders, many of whom have had their fingers burned in Latin America, Mexico and Poland, see that our economy too has large debts and is run by unions so naturally they increase interest rates to compensate for risk. Potential Australian investors are timorous about borrowing foreign currency lest there be further devaluation. It is little wonder that private investment is too little and too short term.

Post-tax earnings must generate more domestic savings and governments must take less of what is saved. Taxes and local, state and federal deficits must be reduced.

That is where the trilogy is relevant to investment.

The trilogy promises are:
* a reduction in the federal deficit
* no increase in tax revenue, and
* a reduction in federal budget outlays
all as a proportion of GDP and during the life of the present parliament.

Dr. Ed Shann writing for AIPP (25 Mount St Perth) has estimated the effect of the trilogy on the 1986-87 budget.

The tax third will be broken in 1985-86 partly because the government will have collected more oil tax than budgeted but it will not be a constraint in 1986-87. After allowing for the promised $2 billion tax cuts and lost oil revenue the government could actually raise taxes by $500 million and satisfy the promises. (Governments always calculate 'tax cuts' from the revenues they would collect if the tax scales remain unchanged in the presence of inflation and economic growth.) The 'cuts' allow revenue to increase by about 7.5% - a real increase of about 1% - if, after the oil price reductions take effect, inflation falls to 6.5%. The tax cuts promised by Accord Mark II for 1986-87 and again for 1987-88 are broadly those promised by the trilogy.

Neither should the expenditure third present the government with difficulties. Only the requirement to hold the Commonwealth deficit to around $5.5 billion or 2.2% of GDP will be difficult satisfy. This too would have been easy but for the unanticipated decline in oil revenues. In February the government recouped three quarters of the lost revenues by raising the petroleum products excise by 5.3 cents per litre.

If the government were to make no further policy changes the deficit would be about $6.4 billion. To achieve a deficit of about $5.5 billion would require expenditure to grow by only 1%

if additional taxes are not raised. To achieve in 1986-87 the same deficit as budgeted this year, that is $4.9 billion, would require zero real expenditure growth. Business managers faced with a no real growth budget would regard it as tight but not difficult.

With no new spending a deficit of $5.5 billion would require cuts like these proposals from treasury leaked in February:
* $150 million from paying family allowance at a flat rate
* $450 million by cutting the Medicare rebate
* $150 million from cutting job programmes
* $20 million from youth training
* $50 million from the first home owners scheme
* $100 million from veterans' benefits.
They are all sensible savings but Mr Howe will no doubt vent his displeasure.

The States have, quite irresponsibly, been promised 2% real growth but I doubt they will be allowed to get away with that much. Even if the general revenue grant is increased by 2% cuts can be made to specific grants.

If the Federal deficit is reduced to $5 billion and State and Local governments reduce their borrowing by $1 billion to $6 billion the public sector borrowing requirement (psbr) will come down from 5.6% to 4.6% of GDP. The trilogy does not mention total psbr and therefore does not require this modest restraint. If investment is to be adequate much more is needed.