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The new Socialist government, which started the election campaign telling us that it would increase the Commonwealth budget deficit to pay for some of its "expansionary" program, now finds itself trying to cope with the problem of reducing a deficit that even it believes will be too big. In the predicament in which he finds himself, Hawke has aroused some sympathy, and there is widespread relief in financial circles that there are signs that the Hawke government intends to tackle the problem rather than adding to it.

It took the Fraser government, which claimed to abhor deficits, six years to reduce Whitlam's $3,500 million borrowing program to nothing. In those six years during which the Fraser government borrowed decreasing amounts to finance its, in my view, profligate outlays, it increased total Commonwealth borrowings by $15,525 million compared with a total of $6,396 million for the three Whitlam budgets. In the last and seventh year it undid six years of attrition by running the deficit up to the order of $5000 million with worse implications for 1983-84. Nothing has yet been done to repay the government debt that has been accumulating since 1972.

If the Hawke government were to proceed in the manner of Fraser's last year, then the problem would very quickly get out of hand. Yet the Australian economy is in a deep and - we hope - cyclical recession; when the recession abates, the tax base will grow and the deficit will, all other things and caucus permitting, get smaller.

This year's deficit and next year's projected deficit have the same two-fold genesis. First a blatant, inexcusable (and, in the event, futile) attempt to buy office that put this year's deficit at $1764 million plus post-budget outlays of $300 to $400 million and projected next year's

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deficit to $4,200 million, plus some carry over from those same post-budget outlays. Those figures are bad enough, but the rest of the blow-out has been brought about by a sharp economic reversal which was not forecast. Revenue estimates for 1983-84 have been pruned from $48.5 billion down to $45.0 billion; that is, to less than the current year.

If the current malaise is the bottom of steep-sided trough out of which rising world demand will drag us and if wages can be prevented from rising, then a case might be made for increasing Australian demand by increasing government outlays. These are big ifs and even if they are conceded the case is most often badly made but it has wide currency.

All of the above, and a natural sympathy for the incoming government's lack of choice, has led several commentators on Hawke's economic options to talk of deficits as if they were not a serious problem in themselves. That is a long way from the truth.

Deficits initially add to liquidity, which may be reflected in inflation, may leak off overseas or can be soaked up by official borrowing from domestic money markets. In practice a little of all three is likely. In theory a tight monetary stance could offset the inflationary effects of loose fiscal policy but, in practice, the monetary authorities get sick after a while of being the bad guys who must set interest rates high enough to prevent a haemorrhage on foreign account and high enough to attract investment capital away from private investments into government bonds. They relax interest rates, usually at the insistence of a short-sighted politician; in due course foreign account ruptures; the currency is devalued and inflation moves up a few more points.

Let us suppose that monetary policy keeps its nerve and the deficit is funded by domestic borrowing. The US Federal Reserve Board (The Fed.) managed, with very high interest rates, not only to keep the mighty Reagan deficits funded but actually kept a very tight rein on money, substantially reducing inflation. So it is possible. But what then was the point of the deficit, financing government expenditure by borrowing rather than taxation?

The effect has been that of a discriminatory tax levied through the capital markets. The same quantum of resources has been transferred from private hands to the government but the incidence of the burden has been much narrower; it has fallen on investment; people who would have invested in the private sector have been induced by high interest rates offered by the government to invest in the government instead. That can help the economy only if the government makes better use of the transferred wealth. But, as Bernard Shaw remarked - "Not bloody likely". Further, within the private sector high interest has effected a transfer from borrowers to lenders - from long-term investment in future earnings to current consumption.

The only way a deficit can stimulate an economy is if it is not fully funded, so that the money supply does blow out a bit; and that is a dangerous policy with an appalling record of failure round the world. The idea is that a little bit of inflation will reduce real wages and restore profit margins. Now it is the unions' turn to use Shaw's line.

A budget deficit is a very unsatisfactory way of increasing money supply. If monetary stimulus is the order of the day (and I'm not recommending it) then it is far better, with fewer untoward side effects, to buy back some government or semi government paper - there is enough of it in the capital markets. Such is the fear of inflation and of government profligacy following upon the experiences of

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the seventies that it is most likely that the most stimulatory budget is a balanced budget and the most stimulatory money management is firm and steady. Certainly overseas investors will not wish to face the prospect of an ever-weakening Australian dollar. Since access to foreign resources is the only way that even present levels of employment can be maintained without a sharp fall in real earnings, Hawke would be very unwise to do anything including looking iffy on monetary or fiscal management, frightening investment away.

The prime role of deficits is to disguise politician's expenditures so that they can appear better managers than in fact they are. Deficits are all paid for in the end either by inflation or future taxes. They are an attempt to live high at our children's expense and to the extent that they are funded overseas they probably succeed. They can be used to tide governments through wars and recessions but too often they are used to tide governments over elections. Budget deficits should be matched in better times by budget surplusses and they should be saved for the really rainy day. Lord Keynes did not suggest that deficit could, without consequence, be piled upon deficit.

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