O N T H E D R Y S I D E

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THE NEXT DEFICIT

Now is the time of the year when all men of good will should be thinking about the next budget deficit; by June it will be too late to knock sense into either the avaricious or the weak kneed.

Government paper is becoming harder to place and we can expect it to become more so. Interest rates are high because reasonable people are demanding high premiums to hold money assets instead of real assets. The real interest rate, that is the difference between inflation and the nominal rate, for the most secure borrowers, had averaged around one or one and a half percent, from 1900 until the late seventies. However, the apparent real interest rate is now around five percent.

In the all too well remembered past, debt, including government debt, has not been fully repaid. Instead, inflation has been allowed to erode it away. Having once been conned out of savings by governments which did not maintain the value of the currency, lenders have become more careful. After all, who would lend his neighbour a hundred bags of grain if the neighbour was free to choose a hundred smaller bags in which the grain was to be returned? Money owed by governments is no longer seen as a reliable store of wealth.

People are demanding larger uncertainty premiums. Perhaps this is because they have lost faith in any government's will or ability to control inflation. Certainly the large volumes of government paper have more than satisfied those investors who would take government securities at lower (more normal) rates of return. The public sector has been forced to offer higher rates to attract money which otherwise would have purchased corporate securities or undertaken some entrepreneurial activity.

In 1982 public sector debt was equal to 33% of our Gross Domestic Product. Only two years later, this year it is expected to stand at 42%. The taxes will not service that rate of increasing government indebtedness for very long.

When lenders put their money with private borrowers they look at asset backing and profits. When they lend to governments they are concerned with the government's capacity to raise the taxes necessary to service the debt. Taxpayers are already showing signs of impending revolt.

Those worldly wise men of affairs who once told us that the money markets could not handle half the deficits they have already handled, now say that they can cope with one more eight to ten billion deficit. A properly functioning market should be able to cope with almost anything at a price. The right question is: what price? (With each succeeding deficit, whether the answer is given in terms of lost opportunity or interest rates, the price will be higher.)

It is only six months since Mr. Hawke gravely informed us that the deficit in the last budget was a temporary expedient appropriate to the depressed state of the economy and that it would be, at least, greatly reduced with the next budget. By retreating from the pension asset test, he is already abandoning one way by which the deficit was to have been reduced. I have been accused of being unkind to my former colleagues, now in opposition, so on this occasion I won't even mention their behaviour in the matter.

The last two budgets have been defended, not least by Mr. Fraser and Mr. Hawke, with the argument that large deficits are appropriate during recessions. In this they are both disciples of the economist Keynes. Within the constraints of a highly idealised society, they are probably right. It is even probable that in small part the present lift in economic activity is Keynesian in origin, since on this occasion the other necessary condition for Keynesian stimulus, a pause in real wage growth, was also achieved.

That such stimuli are ordinarily temporary in effect and must often give rise to nasty withdrawal pains once the community is faced with financing, or even worse not financing, the resultant debt, is all too obvious. The evidence of this is easily found in the last thirty years of almost any Western World country, including Australia.

The other side of the Keynesian coin is large budget surpluses between recessions to soak up the government debt, release funds for the private sector and drive interest rates down. The economy is thus fine tuned by prudent manipulation of fiscal balance. Unfortunately, we have now left the real world !

Politicians cannot reduce government expenditure as easily as they increase it.) It is difficult at the time for anyone to say precisely at what point in the business cycle an economy is situated and the wisdom of hindsight is no use. Politicians are not disinterested students of business cycles but are apt to get carried away by impending elections or the mad left of their party. The real world is a place where deficits are likely to be incurred swiftly and reduced slowly. In all the circumstances the last two Federal budgets seem to me to have been thoroughly irresponsible, but we can't relive the past.

According to the best estimates which I can find, Hawke's "no change in policy" deficit for 1984/85 will be about six to seven thousand million dollars. He should be finding policy changes to sharply reduce this but instead is subject to the pressures of short run politics associated with yet another premature election, and left ideology, to borrow even more.

The Australian community seems to have recently discovered that future taxpayers are facing an insupportable debt owed to future pensioners and superannuants. Future taxpayers are incurring a similar crushing obligation to bond holders. Interest on debt is already 7.3% of Commonwealth budget outlays; or looked at another way - more than half the present deficit is used paying interest on past deficits.