2016

LF Economics

Australia's Low Public Debt…

With Poor Infrastructure to Prove it

Parliament of Australia
House of Representatives

Budget Savings (Omnibus) Bill 2016

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www.lfeconomics.com

Executive Summary

- Due to concerns over the Australian federal government budget deficit, the *Budget Savings (Omnibus) Bill 2016* has been put forward by the government, outlining 24 areas where spending can be reduced from 2015-16 to 2019-20.
- The goal is to reduce the deficit and eventually shift the budget to surplus. In justifying this stance, governments are portrayed as 'irrational' actors when they incur a significant fiscal deficit (expenditures exceed revenues), causing unnecessary inflation and interest rates to rise by borrowing to meet the shortfall, as this supposedly 'crowds out' the private sector.
- This mainstream perspective is unsupported by evidence, however, as it is based upon highly unrealistic neoclassical economic models devoid of banks, money and credit. Accordingly, the usual policy advice provided ignores the effects that running public surpluses has upon the private domestic sector: reducing savings and/or increasing private debt.
- Despite the concerns (primarily from the LNP) about the rising stock of public debt, viewed over the long-term, it is low relative to GDP. The decline in interest rates has also resulted in low debt interest expenses to both GDP and revenue. This long-term data is rarely shown or referenced as it demonstrates the often hysterical commentary about the 'budget emergency', 'peak debt', 'bankruptcy', 'running out of money', 'record deficit' and so on is blatantly false.
- With an estimated deficit of 2.3% and 2.0% for 2015-16 and 2016-17 respectively and a historically low 10-year government bond yield, the deficit could be slightly increased to 3%, targeted to nominal GDP. This counters the slowing of the economy, demonstrated by rising underemployment and weak youth unemployment, falling capital expenditure, record low wage growth, compounded by the closure of the auto industry, a lacklustre innovation system starved of private capital, paltry R&D investment and pitiful transportation infrastructure.
- The real budget emergency lies in the household sector, with debts of 125% of GDP and rising. Government refuses to deal with this as the FIRE (finance, insurance and real estate) sector is generating immense profits and provides campaign contributions (bribes) to the government.
- LF Economics argues this bill be scrapped given (1) deficits are not evidence of budgets in need of 'repair'; (2) public debt is historically low; (3) the deficit is likewise small; (4) interest rates are historically low and will fall further; (5) deficit spending represents a source of growth and allows the private sector to accumulate net assets; (6) social welfare spending is limited and well-targeted by OECD standards; and (7) unfairly targets the poor and low-income earners.

Analysis

The focus by government and mainstream economics profession on the issues of the debt and deficit is almost entirely of that held by the public sector. Large deficits and rising public debt are considered economically harmful, potentially increasing general price inflation, crowding out lending to the private sector and increasing interest payments relative to the size of the budget. These issues, however, are the product of falsified neoclassical economic models devoid of reality.

Contrary to concerns about government delivering budget deficits, it is the growth and acceleration of private debt about which policymakers should be primarily worried. The rapid increase in private debt, however, is overshadowed by the apparent need to transition the budget back to surplus as an act of 'fiscal responsibility'. This is because any move to contain household sector debt would cause housing price growth to weaken and decline. It appears the narrative concerning 'out of control' public debt is a distraction by the FIRE (finance, insurance and real estate) sector and its allies in government opposed to low and affordable land prices.

Although there is much alleged concern about public debt, data on the long-term trends are rarely shown, likely because it would reveal the frenzy promulgated by government and the FIRE sector, such as 'budget emergency', 'peak debt', 'bankruptcy', 'running out of money' and 'record deficits', to be verifiably false. Total public debt peaked in 1932 at 170% of GDP when the economy was far less productive. Even in the worst case scenario of the federal public debt reaching $1tn by 2027 as recently noted by the Treasurer, the debt to GDP ratio would only rise to 44% and 49%, assuming nominal GDP growth of 3% and 2% respectively (see Appendix).

The trends in public debt confirm that it rises to finance wars and stimulate the economy during times of recession and depression, which are often caused by the bursting of private debt-financed asset bubbles. Contrary to much mainstream commentary, Australia does not have a significant problem (as suggested by the credit ratings agencies) with public debt and can safely increase it further.

Australian history provides an answer to whether high levels of public debt could be damaging to the economy. Coming out of WW2, the economy experienced three decades of sustained growth during the social democratic period following peak debt. Clearly, this experience suggests high levels of public debt are not necessarily detrimental, and the much smaller levels today are unlikely to be problematic. The focus should be upon the colossal stock of private debt, not on the government's current historically and internationally low public debt position.

A more accurate measure of the public debt burden is to compare net interest payments to measures of income: GDP and revenue. Today, these two ratios are lower than in the past, especially when nominal interest rates were higher during the 1980s. Low and falling interest rates today have resulted in smaller net interest payments. As long-term data shows both the stock of public debt and net interest payments to be at historical lows, concern appears to be largely fabricated. It may be the government and FIRE sector has done this to:

- Distract from the threat of the massive private sector debt boom, financialisation and the housing bubble. The diversion is understandable, for the FIRE sector has fuelled an immensely profitable land market bubble enriching its participants;
- Create a non-existent 'economic Armageddon' scenario facing the economy, thereby preparing a case for further privatisation of essential public assets and services as a 'solution' to reduce public debt. The end result is typically economic inefficiency: private monopolies, duopolies and oligopolies;
- Prevent government from funding infrastructure efficiently, given public borrowing costs and fees are significantly lower than that of the private sector;
- Provide a pretext for austerity which disproportionately disadvantages low and moderate income earners; and
- Ensure government has room to ramp up public debt to fund a future bailout of Australia's highly leveraged banking system once the housing bubble bursts and lenders become insolvent. Australia's low public debt is similar to Ireland's prior to the GFC.

It is critical policymakers reign in exponentially-growing private sector debts as this consists of a major source of future financial instability. Australia's household debt to GDP ratio is the highest in the world, at 125% and rising. Ironically, by ignoring private debt expansion which has generated a housing bubble, public debt will inevitably rise to stimulate the economy to counteract the economic downturn when it bursts. This is what we should be paying attention to.

Government Expectations of the Private Sector

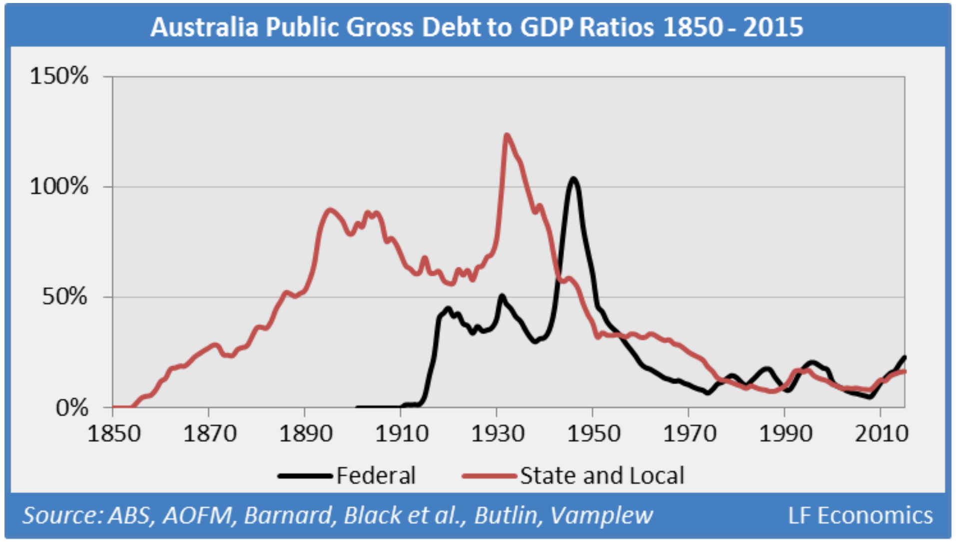
The government relies upon unachievable expectations of the private sector by assuming the Australian economy will continue to grow while government seeks to reduce its expenditures. Put simply, the government is not interested in investing for the future and expects the private sector to do the heavy lifting even as capital expenditure plummets and wage growth falls to record lows. Federal public debt, including that at the state and local levels, are low by global standards and Australia has some of the poorest infrastructure in the OECD to prove it.

Congested roads, slow rail transportation systems, monopolistic airport networks and Internet services are a national disgrace. Poor transportation infrastructure is generally more taxing to society and government revenue than the cost of investing and renewing such infrastructure. Reducing travel times by road and rail in our cities by half should take priority over balancing the budget. Opening new transport and communication corridors to rural and remote regions will assist in the revival of some of Australia's once popular towns now combating challenging economic conditions. The private sector has neither the capacity nor credit rating to rejuvenate Australia's ailing and second-class infrastructure.

Government cannot expect the so-called 'Ideas Boom' to successfully develop without significant upfront public investment over the next decade, building the nation's pipeline of R&D projects and innovations. Contrary to popular belief, most of the high-calibre technological innovations in the U.S. were initially developed within the public sector i.e. government laboratories and the university sector. U.S. government agencies such as DARPA, NASA, alongside the EPA, have been at the forefront of their innovation system whereby the public sector creates the technology then passes it onto the private sector to commercialise and mass-market the products and services.

The benefits of the government setting up and funding a similar group of public institutions - like the CSIRO - would significantly supersede any possible detriment arising from a constant but small public deficit. This would also assist in the recovery of Australia's dying manufacturing sector, renewables industry and export-exposed sector, harmed by the persistently high real effective exchange rate. If the government is serious about investing in Australia's future, it needs to abandon its aversion to historically and internationally small public debt and deficits.

Appendix


Australia Public Gross Debt to GDP Ratios 1850 - 2015
150%
100%
50%
0%
1850
1870
1890
1910
1930
1950
1970
1990
2010
Federal
State and Local
Source: ABS, AOFM, Barnard, Black et al., Butlin, Vamplew
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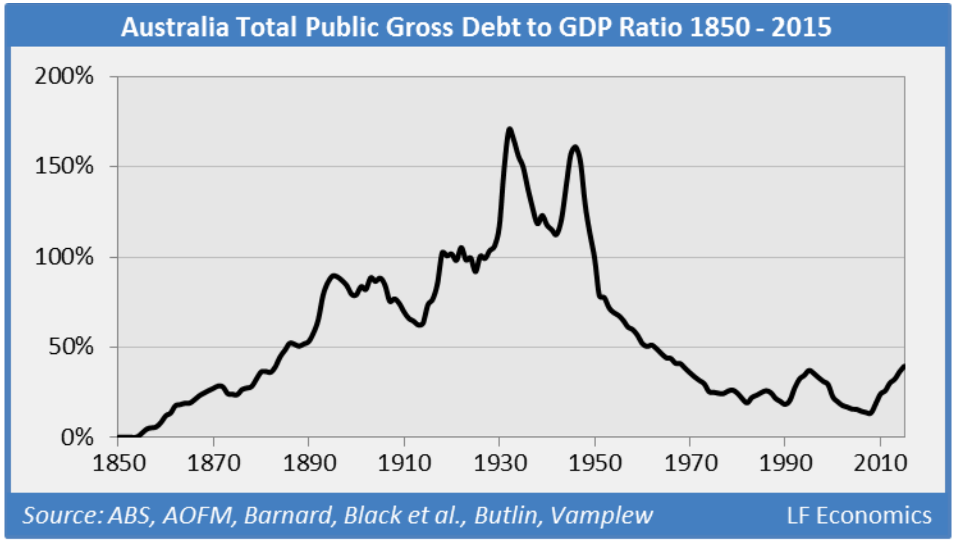
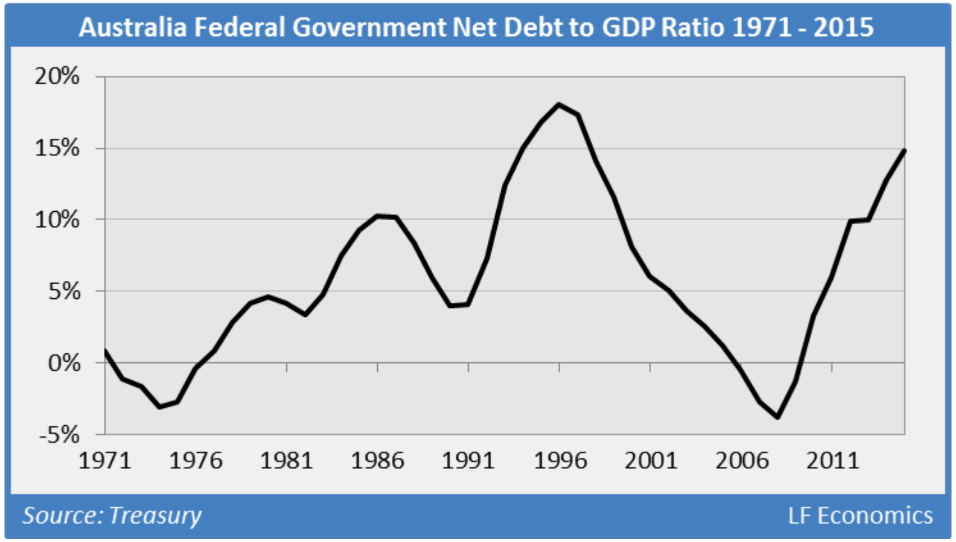
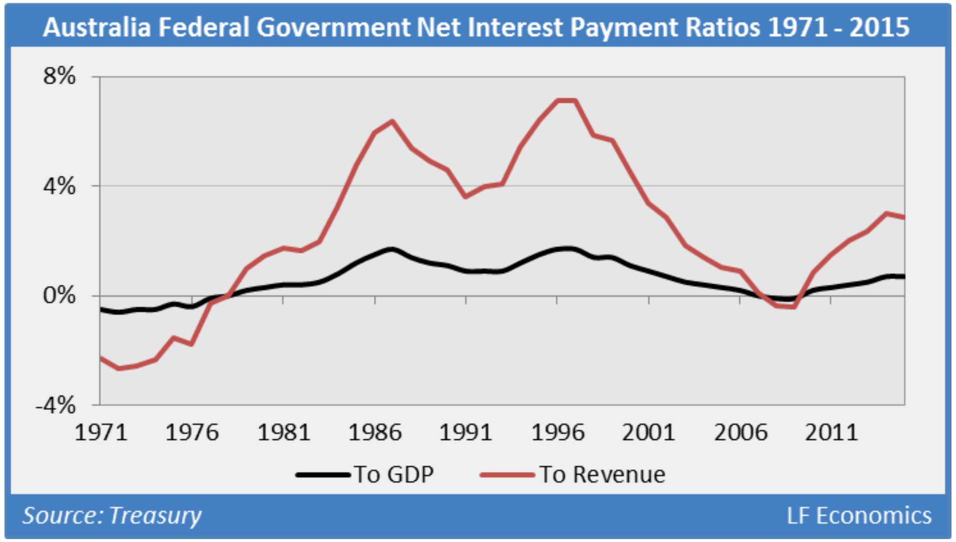
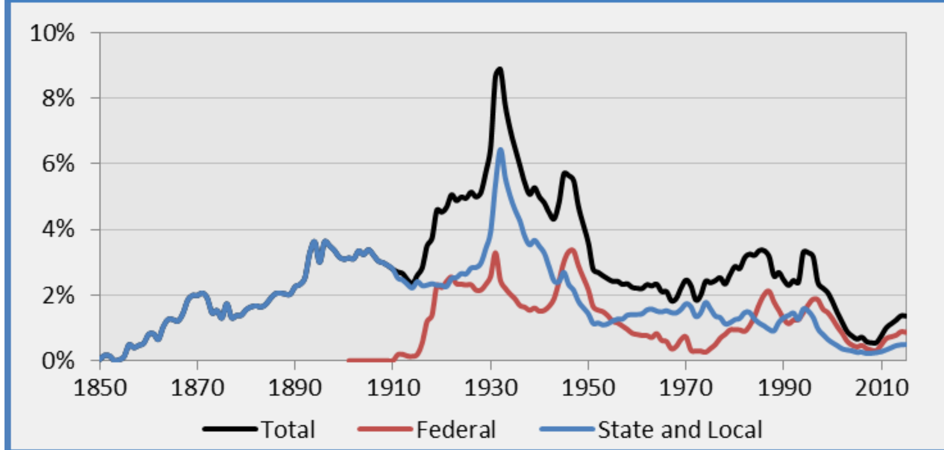

Australia Total Public Gross Debt to GDP Ratio 1850 - 2015
200%
150%
100%
50%
0%
1850
1870
1890
1910
1930
1950
1970
1990
2010
Source: ABS, AOFM, Barnard, Black et al., Butlin, Vamplew
LF Economics


Australia Federal Government Net Debt to GDP Ratio 1971 - 2015
20%
15%
10%
5%
0%
-5%
1971
1976
1981
1986
1991
1996
2001
2006
2011
Source: Treasury
LF Economics

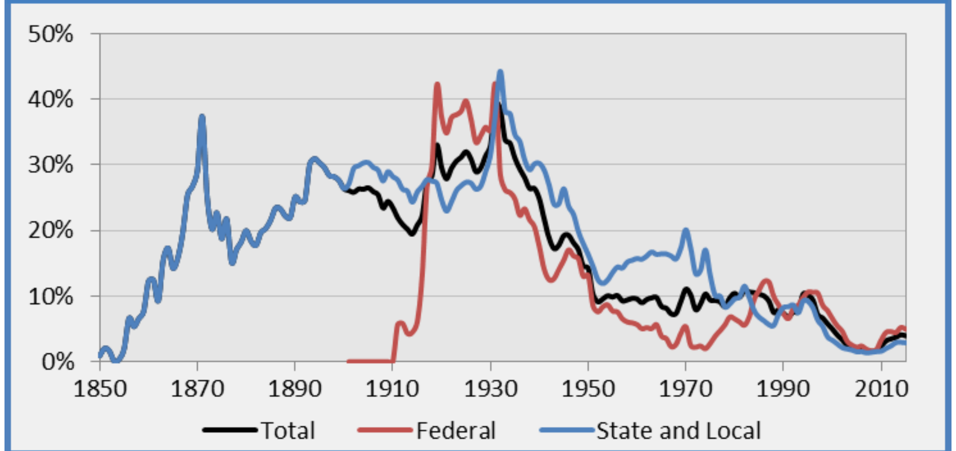

Australia Federal Government Net Interest Payment Ratios 1971 - 2015
8%
4%
0%
-4%
1971
1976
1981
1986
1991
1996
2001
2006
2011
To GDP
To Revenue
Source: Treasury
LF Economics

Australia Gross Public Debt Interest Payments to GDP Ratios 1850 - 2015



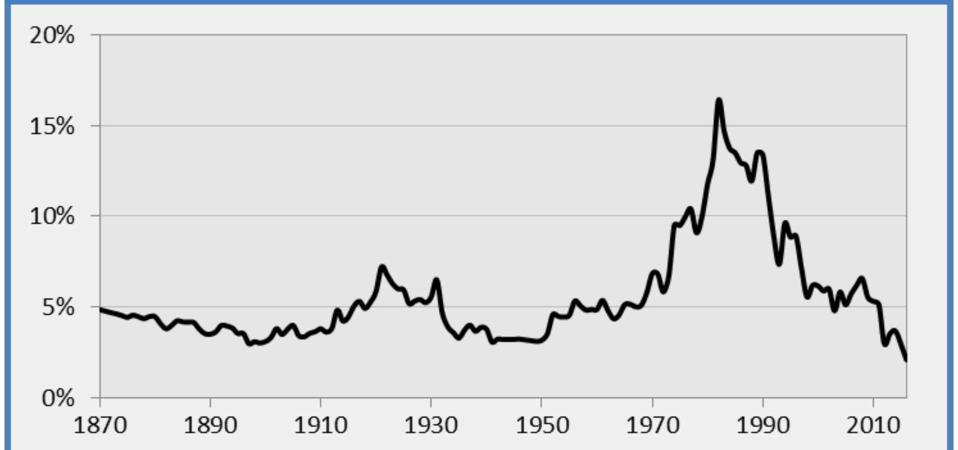
Source: ABS, AOFM, Barnard, Black et al., Butlin, RBA, Vamplew LF Economics

Australia Gross Public Debt Interest Payments to Revenue Ratios 1850-2015



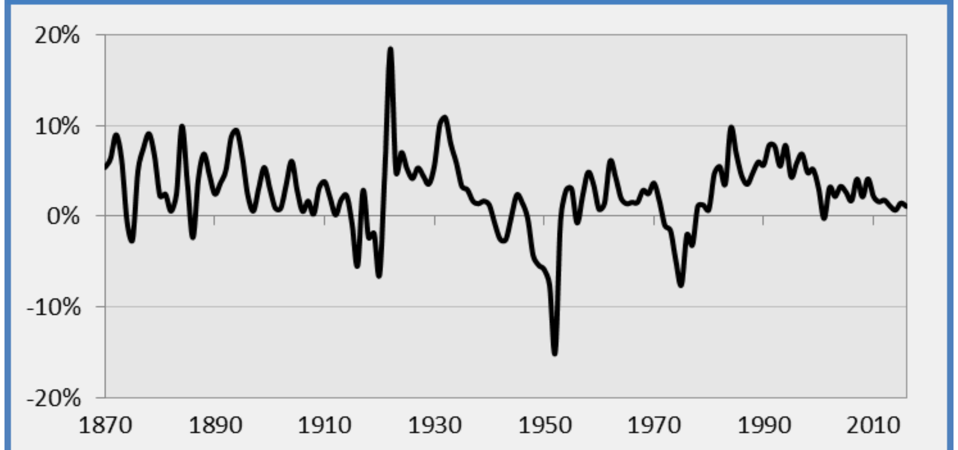
Source: ABS, AOFM, Barnard, Black et al., Butlin, RBA, Vamplew LF Economics

Australia 10-Year Nominal Public Bond Yield 1870 - 2016

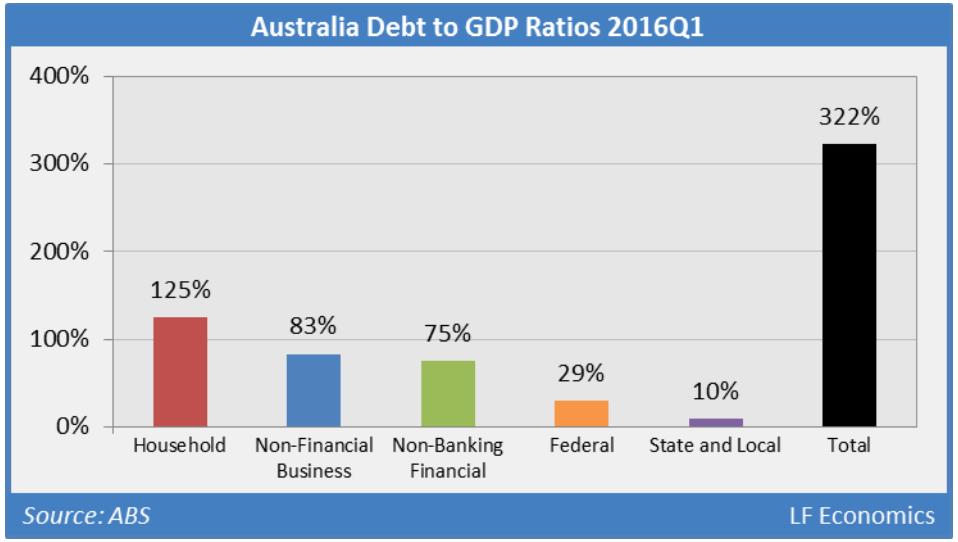


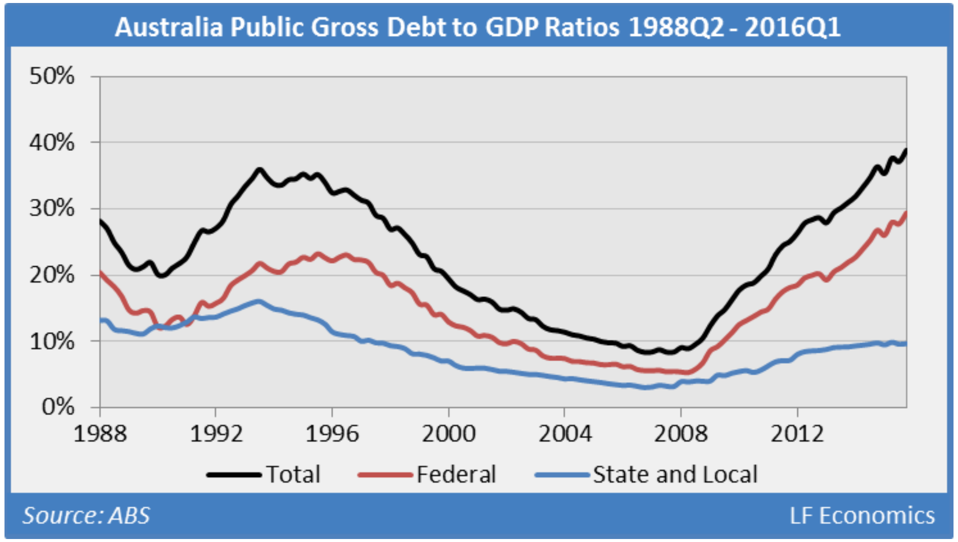
Source: RBA, Vamplew LF Economics

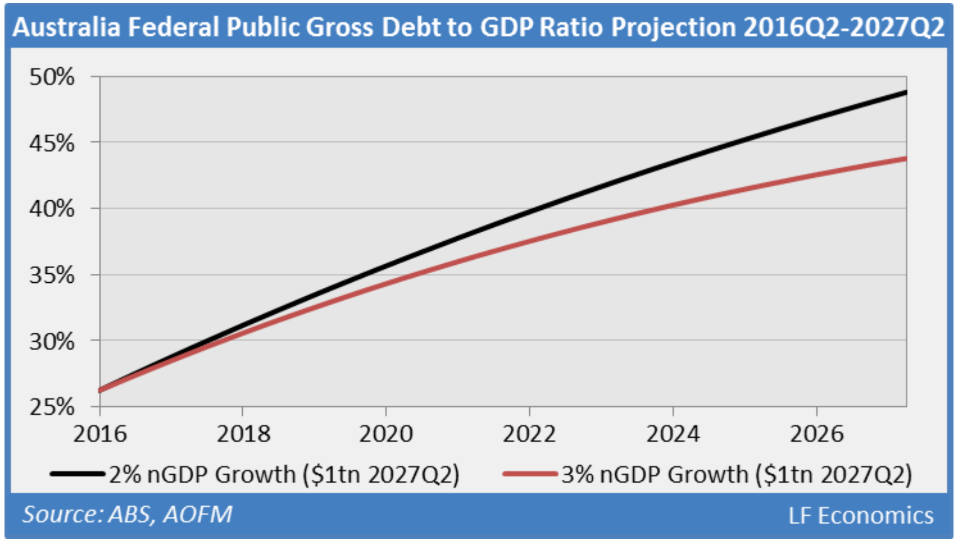
Australia 10-Year Real Public Bond Yield 1870 - 2016

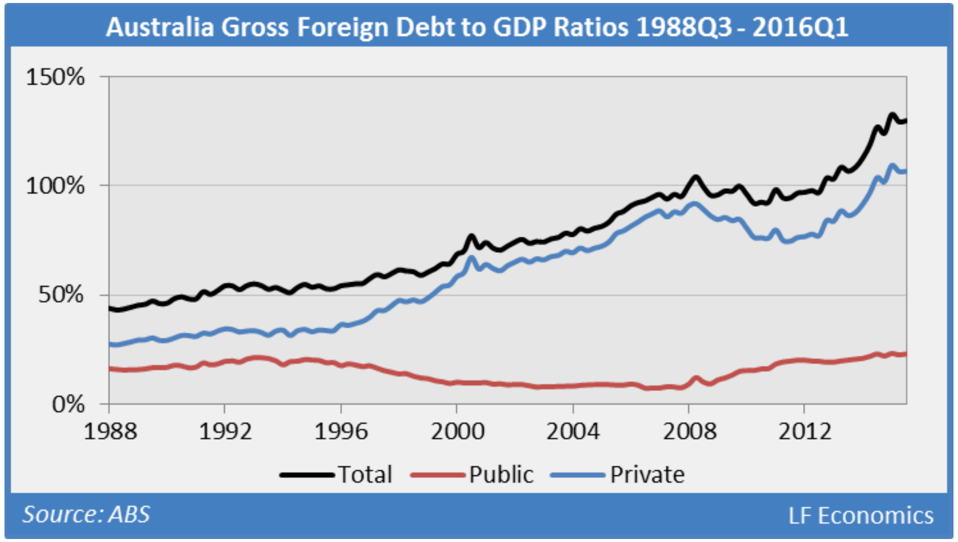


Source: ABS, Hutchinson, RBA, Vamplew LF Economics

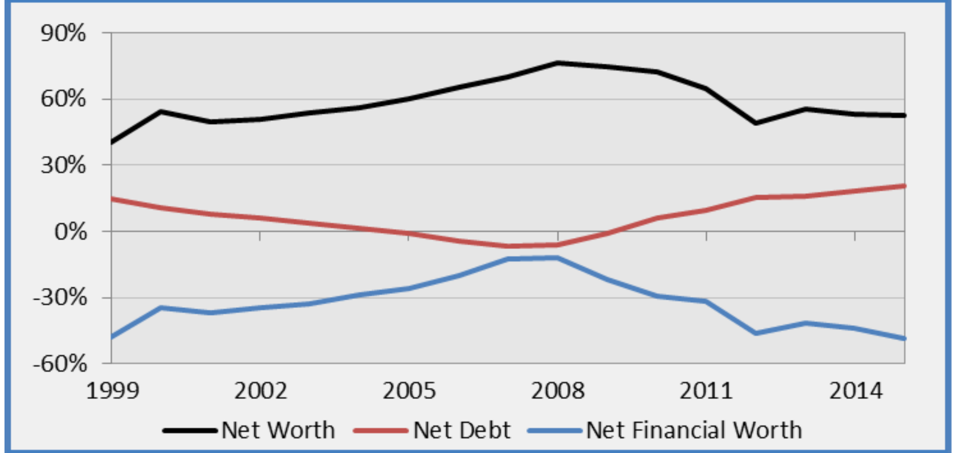

Australia Debt to GDP Ratios 2016Q1
400%
300%
200%
100%
0%
125%
83%
75%
29%
10%
322%
Household
Non-Financial Business
Non-Banking Financial
Federal
State and Local
Total
Source: ABS
LF Economics


Australia Public Gross Debt to GDP Ratios 1988Q2 - 2016Q1
50%
40%
30%
20%
10%
0%
1988
1992
1996
2000
2004
2008
2012
Total
Federal
State and Local
Source: ABS
LF Economics


Australia Federal Public Gross Debt to GDP Ratio Projection 2016Q2-2027Q2
50%
45%
40%
35%
30%
25%
2016
2018
2020
2022
2024
2026
2% nGDP Growth ($1tn 2027Q2)
3% nGDP Growth ($1tn 2027Q2)
Source: ABS, AOFM
LF Economics

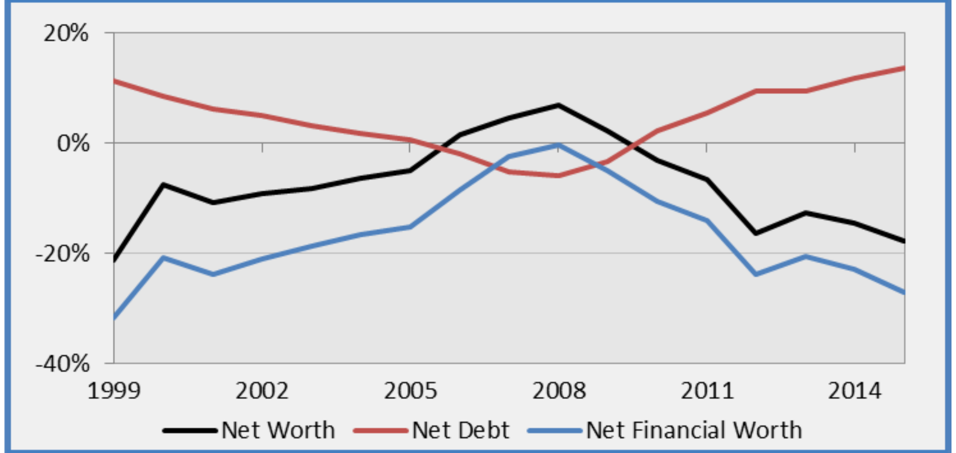

Australia Gross Foreign Debt to GDP Ratios 1988Q3 - 2016Q1
150%
100%
50%
0%
1988
1992
1996
2000
2004
2008
2012
Total
Public
Private
Source: ABS
LF Economics

Australia Total Public Sector Balance Sheet to GDP Ratios 1999 - 2015



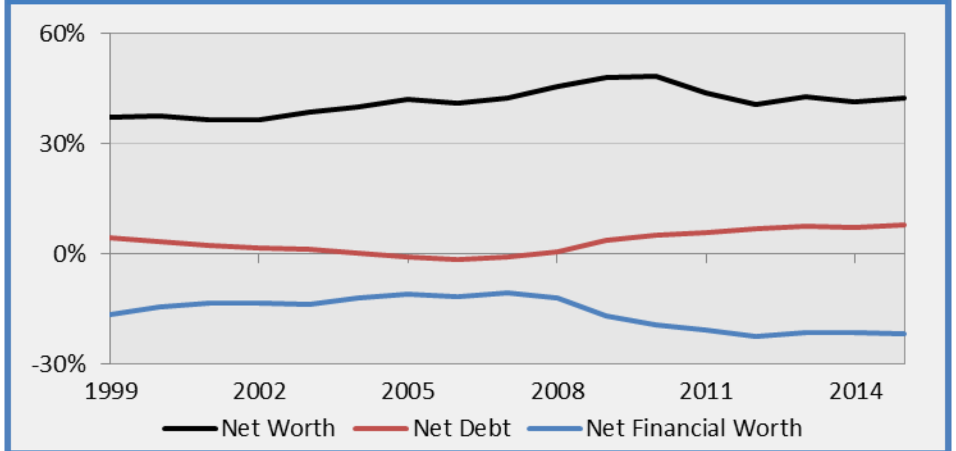
Source: ABS LF Economics

Commonwealth Total Public Sector Balance Sheet to GDP Ratios 1999-2015



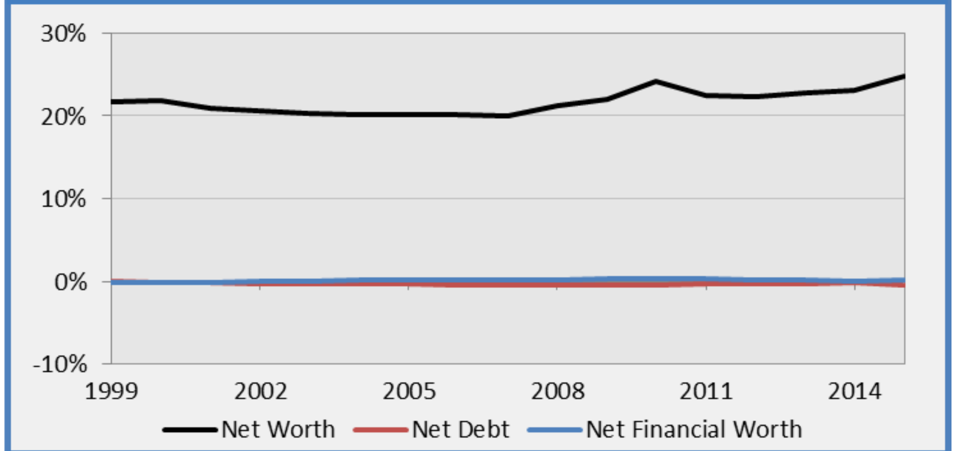
Source: ABS LF Economics

Australia State Total Public Sector Balance Sheet to GDP Ratios 1999 - 2015



Source: ABS LF Economics

Australia Local Total Public Sector Balance Sheet to GDP Ratios 1999 - 2015



Source: ABS LF Economics