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Why are we borrowing from Build Back Better?

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Seventeen Nobel winning American economists have said that the Biden Administration's $1.7 trillion "Build Back Better" program, will increase growth without inflation. They include well-known names like George Akerlof – husband of US Treasury Secretary Janet Yellen — Daniel Kahneman, Robert Shiller, Robert Solow and Joseph Stiglitz. Other US based Nobel economists, of which there are 27, (incongruously, including the left-wing Paul Krugman) did not sign the petition. Almost all Nobel Prize-winning economists are US based.

The President claims the “Build Back Better” program’s cost, itself seriously underestimated, is fully offset by taxes. This is untrue and, moreover, not relevant since increased taxation will cause reduced incentives to save and its inevitable avoidance measures will markedly reduce the actual revenue raised.

Only about 20 per cent of the program’s funding is on roads, ports and other assets commonly considered to be “infrastructure” and widely agreed to be legitimate avenues for government spending. Moreover, the value of much of that is diluted by tying the expenditure to costly measures aimed at mitigating the effect of climate change and promoting favoured but unpopular forms of transport like passenger rail.

The rest of the Build Back Better program, as acknowledged by the Nobel Economist signatories, “employs a broader conception of infrastructure by making critical investments in human capital, the care economy, research and development, public education, and more, which will reduce families’ costs.” The President’s agenda, according to the 17 economists “invests in long-term economic capacity and will enhance the ability of more Americans to participate productively in the economy, it will ease longer-term inflationary pressures”.

This interpretation is contrary to the traditional economists’ view, as originally expressed by the father of economics, Adam Smith. Smith, in a timeless statement, identified parsimony and not government spending as the immediate cause of an increase in capital, investment and hence wealth. He added, increased production and productivity “indeed, provides the subject which parsimony accumulates. But … if parsimony did not save and store up, the capital would never be the greater”. Smith saw government frugality and restraint on government taxation as vital to keeping interest

rates low and thus facilitating entrepreneurship (which he called "undertakings").

The Smithian view of sound economic policy was unchallenged until the "Keynesian" revision of economics in the 1930s, which said under certain conditions deficit spending by government could trigger increased demand and a virtuous circle of more investment and greater production. Some of the 17 economists' views may be actuated by a neo-Keynesian view favouring government profligacy rather than parsimony, though most are probably motivated by a view that modern society requires a far wider definition of the nature of infrastructure.

If they are wrong, they are advocating pouring oil on a fire that, even without the infusion of the Biden program, is seeing money supply increasing at 35 per cent a year. US government spending jumped to over 45 per cent of GDP last year from 36 per cent previously (Australia's showed a similar pattern) and the Biden Administration seeks it to remain at that higher level.

The US "Build Back Better" measures are being accompanied by a policy-induced paralysis of domestic coal, gas and oil investment. This is part of a widespread hostility from global investable fund managers and business leaders generally to capital expenditures in hydrocarbons and other venues deemed to fall short of non-financial environmental, social, and governance criteria. As well as sapping productivity, this is igniting inflation. Though US inflation is still is only at 6 per cent it seems certain to increase and is already being accompanied by falling real wages that are likely to fall further as a result of the diverting of savings and capital expenditure towards unproductive outlays.

Australia is seeing the same pattern. Commonwealth economists follow the woke investment agenda. In part to deflect hostile US-EU trade measures, industry policy is targeted at redirecting capital and government spending to speculative areas like hydrogen and to subsidies for renewables, carbon capture and storage and for farm-based carbon sequestration. Treasury has been quick to recommend spending splurges beyond protecting those placed in distress as a result of government actions on Covid and into deliberate inflation, supposedly to ignite the apocryphal Keynesian virtuous circle.

And former Treasury secretary Ken Henry is sponsoring a report "Starting Better: A Guarantee for Australian Children and Families". Drawing inspiration from the Biden "Build Back Better" approach, it claims a "triple dividend" of benefits from this investment: children growing up healthier and happier, leading more productive and fulfilling lives; less stress on families and better opportunities to work, especially for women; and more rewarding careers for early childhood professionals."

Other voices in Treasury will be promoting this line to a government all too ready to accept its advice (and to an Opposition fully sold on the philosophy behind it). And Australia has highly politicised industry superannuation funds estimated soon to control half of the nation's investable capital.

Unless things change quickly, for Australia with or without Ken Henry's augmented spending, policies will bring, at best, slow economic strangulation and, at worst, rampant stagflation.

Alan Moran wrote the chapter "Current trends and perspectives in Australia" in Local Energy Markets *edited by Tiago Pinto et al and recently published by Elsevier.*