

Coronavirus: Pump-priming is economic folly

ALAN MORAN

• 12:00AM MARCH 17, 2020

In normal times we have a healthy disdain for the insights and capabilities of our political leaders. In Australia, the commentariat has just emerged from agendas that blamed them for not acting fast enough to combat the bushfire crisis — even having contributed to it — and from looting taxpayer funds to curry favour with voters in the sports rorts saga. In the US, half the population thinks their President is so corrupt that he should be placed on trial. Yet suddenly, with the coronavirus crisis, politicians and their advisers are thought to have powers and the wisdom to turn back tides and lead us out of the wilderness. The US is focused on stopping the spread of the disease, finding a cure and easing the discomfort of those afflicted. Britain, like Australia, has added measures to assist business with investment support.

It is essential to provide for the daily living expenses of those that suddenly have inadequate resources, perhaps through becoming unemployed. It also makes sense to reduce tax and regulatory barriers to efficiency and adjustment — and there are many of these in Australia including high corporate taxes, and regulations on energy, land-use planning and industrial relations.

But Australia has gone further than the US and Britain with \$4.8bn of the \$20bn package allocated to pensioners and billed as an economic stimulus. This was followed by \$7bn injected into the money markets by the Reserve Bank, predictably leading to nothing more than a short-term bounce.

These measures address a problem incorrectly seen as a deficiency in aggregate demand. In fact, as testified by the jostling in supermarkets, the reduction in demand is only for particular goods and services.

That part of Australia's policy seeking to lift aggregate demand — and hints are being dropped that the \$4.8bn in handouts constitutes only phase one — is difficult to distinguish from the much-vilified

measures of the Rudd government in 2008, in response to the global financial crisis. Those measures blew the Howard-Costello budget repair of the Hawke-Keating government's maladministration. The giveaways had no effect in boosting the immediate economy and left a legacy of debt that remains to this day.

Aggregate demand cannot be increased by government deficit spending or money supply increases. Demand has to be covered by supply. And right now, there are huge swaths of the economy's specific supply capabilities that have a much-reduced market. Most people think this is likely to remain the case for years.

Effectively, there is an imbalance in the capability of the economy's current capital and workplace skills that produce the goods and services that consumers no longer want. Government pump-priming, either fiscal or monetary, can only intensify the problems by cannibalising real income and redirecting it in ways that are contrary to the changed preferred spending patterns of individuals. This "borrowing from the future", far from repairing the damage, retards the adjustment process.

In the present situation, sectors involving crowds — including restaurants, pubs and sports — will join the travel and tourism sector in plunging custom. Output from these activities will decline as will the income of those employed in them and of those owning the industry-specific capital.

Other sectors such as food and other consumables are likely to remain strong. Some sectors, such as healthcare, cleaning services, telecommunications, and in-home entertainment, will see increases. So will delivery services, though maybe not restaurant meals.

The net effect constitutes a reduction in the economy's aggregate supply capability — real GDP. That can only be recouped when the adjustments to the use of the labour and capital have been made. The economy, even the current demand-deficient activities, will adjust faster if governments do not impede this process.

But sadly, nowhere more so than in Australia, governments have been infected by a political hubris much more potent than in earlier times. Keynesian economists who (at least in Australia) reign over the Treasury and Reserve Bank and much of the commentariat have promoted a response to downturns with the policy of trying to stimulate aggregate demand.

It may well be that our fears of a new disease have brought an exaggerated response by the community and governments, but the coming world economic meltdown is now unstoppable. It will be the first in over a century that has not resulted from war or government economic mismanagement.

But even the coronavirus has come at a time when the world economy is vulnerable due to unbalanced government budgets and loose monetary policy that have brought high national indebtedness and inflated asset prices.

Back in 2017, Ronald Reagan's former budget director, David Stockman, was warning that the stock exchange boom could not be sustained in light of Trump's loose fiscal policies and the debt at 105 per cent of GDP (compared with 30 per cent prior to the Reagan boom). In July last year Stockman predicted a 40 per cent drop in stock prices.

This now looks prescient. But much more important than a stock price correction is the correction of the real economy that can easily be impeded by the pump-priming policies.

Alan Moran is with Regulation Economics.