Spending the savings will not help in long term

Economics & Deregulation and The Global Financial Crisis | Alan Moran Bookmark
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What is needed is to correct the imbalance between deposits and consumption.

This past week, 21 economists endorsed the federal government's spendathon as an antidote to recession. Similar advice has previously been offered by economists. In 1981, 364 economists advised British prime minister Margaret Thatcher against trying to balance the budget. Disregarding their advice, Thatcher proceeded to rein in the budget deficit.

This and her other reforms transformed the British economy from the sick man of Europe.

Like the 21 Australian economists, the 364 Brits promoted deficit spending to supplement demand and restart the economy. The Australian economists also saw infrastructure spending as important.

Australia's stimulus packages have included $10.4 billion to low-income earners, $30 billion allocated to the property market, and the $42 billion Nation Building Economic Stimulus Plan.

The productivity-enhancing infrastructure expenditure in the $42 billion Nation Building package is 5.5 per cent of the total, comprising $2.2 billion allocated to roads and rail. Doubtless much of the rest - including increased welfare housing, Pink Batts, school extensions and toilet blocks - is worthwhile expenditure but it is difficult to see it delivering a productivity return. And no part of the package contains information indicating that there will be a positive return on the outlays.

The 21 economists might contend that the more important element of the Rudd spendathon is its income re-allocation. The argument goes that to jump start the economy it is better to take from those who were simply salting money away in savings and give it to those who would spend. And the March-quarter national accounts show some "success" in this direction in that the measures to date have engineered a renewed collapse of household savings to less than 2 per cent of income.

The hope is that increased consumer demand will bring capacity constraints, thereby creating incentives to invest. This "accelerator" theory rests on business confidence being restored and igniting a renewed take-off.

It is difficult to find an occasion when this has ever happened and, on the evidence thus far, there is little sign of it occurring in the contemporary Australian economy. The March-quarter national accounts show investment in machinery and non-dwelling construction down 9.5 per cent and 4.3 per cent respectively.

The government's spending has been financed by bond sales. Though this avoids depreciating the currency, it diverts national savings into consumption, reducing funds available for investment and lowering the economy's capacity to generate income.

Together with increased retail sales, stronger housing approvals and unemployment levels that remain at 5.5 per cent, many see comfort in the March-quarter national accounts. But growth in the quarter is due to a temporary export surge and a recession-induced reduction in imports. Without these factors gross domestic product would have declined by 2 per cent instead of increasing by 0.4 per cent.

Injecting funds into the economy can bring an immediate upsurge in demand but it does so by impairing the economy's capacity to supply future demand. The 21 economists' prescription is

digging holes and filling them up in order to create work. At best, that will drag demand forward.

The world economy confronts a financial crisis generated by a fundamental imbalance between savings and consumption in the US. Australia has a similar, if lesser, imbalance but even without that it cannot avoid being caught in the undertow. Fabled "green shoots" of recovery will not mature until the imbalance is corrected. Money creation or fiscal policies that commandeer savings can only retard that process.

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