Stop splurge now to avoid going from Gatsby to Grapes of Wrath

Economics & Deregulation | Alan Moran

Bookmark

The Australian 19th June, 2013

The latest data coming out of the US shows an economy lethargically sidestepping towards stagnation. The same debt-loaded moribund economic picture is seen in Europe and Japan.

The giant economies of the developed world have seen their industrial capabilities hollowed out as a result of stalled reinvestment. This in itself is caused by government excesses in spending mopping up investable savings. And credit creation from quantitative easing is failing to ignite the investment resurgence.

And so, do we now see a re-run of Scott Fitzgerald's Gatsby 1920s partying being replaced by Steinbeck's 1930s Grapes of Wrath?

The economic exuberance of the 1920s rested on credit creation by the US Fed. This financed a roaring stock exchange and funded European imports of US farm produce. At some stage the pell-mell increase in credit had to end. If money is growing more quickly than production, prices will eventually take off.

In 1929 the stock exchange crashed soon after the Fed pulled back on easy money. As David Stockman, president Reagan's head of budget, demonstrates in his book The Great Deformation, the damage this did to the real economy was largely confined to the farm sector following the cessation of risky loans to European importers of US food. The lower demand resulting from turning off these loans was greatly compounded by aggressive government regulations and protectionist trade policies, which brought the 1930s Depression.

Fast forward to the current century.

Current policies have entailed central bank credit injections on an unprecedented scale. Having already cut short-term interest rates to near zero, quantitative easing in Japan since 2003 and in the US and Europe since 2007 has targeted longer term rate cuts by buying long-term securities. Even so, investment as a share of GDP has plummeted in virtually all OECD countries.

Meanwhile government spending continues at record levels. There is hardly a single OECD government spending less as a share of GDP now than in 2007. Australia's government share is up from 34 to 37 per cent, Japan's from 33 to 41 per cent and the US from 37 to 40 per cent. Most EU countries' governments spend in excess of 50 per cent of GDP.

Much of this government expenditure is borrowed -- that is, taxed from future incomes. Budget deficits are 8-10 per cent of GDP in Britain, the US and Japan and accumulated sovereign debt exceeds 90 per cent in the US, the larger European economies and Japan (where it is 238 per cent). Australia is better placed with a budget deficit at around 3 per cent of GDP with debt still under 30 per cent of GDP.

Growth that has been achieved since 2007 in the developed world has been accompanied by increased debt. Last year, Australia's 3.6 per cent growth came with a 3.1 per cent jump in the debt to GDP. Other countries paid more: thus Britain's 0.2 per cent growth came on the back of a 5 per cent increase in debt to GDP; the US's 2.2 per cent growth came with 4 per cent debt to GDP growth.

Increasing debt levels are bringing diminished returns in terms of growth. And servicing the debt will present severe future problems.

We have now had six years of failed government attempts to stimulate growth through budget deficits and monetary injections. In the present downturn governments have avoided the beggar-thy-neighbour protectionism that caused world trade to fall by two thirds in the 1930s. But economic imbalances in the form of budget deficits and credit expansion are worse.

Illustrative of the difficulties in making policy corrections is the depiction as "austerity" of modest spending economies even in the face of huge budget deficits. In Japan the government has even embarked upon a policy of increased credit creation in addition to its ongoing deficit financing.

A permanent stagnation in the OECD world is inevitable without movement towards balanced budgets, lower government spending and central banks allowing interest rates to balance the supply and demand for capital. Australia has been insulated from the malaise seen in other developed economies by its role in supplying the resources for developing Asia. Even so, poor policies have brought insipid levels of growth and mounting debt. The Australian economy too will need corrections with spending cuts. Slower Asian growth will make this all the more urgent.

Back to news page

Bookmark

Become a member of IPA today

Enter keywords here...

Archived news

2014
> August
> July
> June
> May
> April
> March
> February
> January
2013
> December
> November
> October
> September
> August
> July
> June
> May
> April
> March
> February
> January
2012
> December

> November
> October
> September
> August
> July
> June
> May
> April
> March
> February
> January

2011
2010
2009
2008
2007
2006
2005
2004
2003
2002
2001
2000
1999
1998
1997
1996

IPA

Home
About
Key Sectors
News
Events
Publications
IPA People
Contact us
Site Help
Payment

News

Useful links

Top of page:: Site help
:: Site map
:: Privacy
:: Copyright
:: Subscribe to IPA email updates
:: Unsubscribe