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Coronavirus: We can’t spend our way to wealth

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To meet the new reality, the government should reduce spending on goods and services like submarines, Snowy 2.0, renewable energy subsidies, diversion of water from farmers, the ABC and SBS. Picture: AAP

In addressing the effects of the pandemic lockdown, the Morrison government has injected $84bn under the JobKeeper and JobSeeker programs and another $688m for home renovations. The Reserve Bank of Australia has, in addition, engineered cheap loans of at least $90bn, and possibly much more.

Though sometimes referring to these measures as a stimulus, the government would deny it is going down the same path as Kevin Rudd, who spent $200bn attempting, ineffectually, to combat the global financial crisis.

A justification for this generous support is that shutdown policies causing workers to be evicted from their jobs were taken in the national interest. But now we face an economic slump.

While the federal bureaucracy, and Treasury in particular, is full of credentialed economists, they are, for the most part, Keynesian — and therefore to counter a fall in output they prescribe demand stimuli through government spending, or tax cuts unmatched by spending cuts.

A minority would have been schooled in Friedman’s monetarism and would favour creating phantom savings, which depress interest rates in the hope that this will persuade businesses to invest, thereby igniting a virtuous cycle of spending and investment.

The government has adopted both forms of demand stimulation policies, neither of which can work. Effective demand cannot exist without supply. All of us have unlimited wants but these can only be satisfied if we also have earned, been gifted or borrowed money in order to satisfy them. The same is true for the nation as a whole. We cannot pay ourselves money to buy goods and services unless these have already been created.

Unless the supply of goods and services is there, attempting to create demand will only bring about inflation or, at best, unspent bank balances.

Government has no effective resources itself so it can only redirect funding from one part of the economy to another.

The most comprehensive attempt to reflate a modern economy into self-sustaining growth is that of Japan. In the years to the mid-1970s, Japan's economy grew rapidly as a result of small government, an absence of tax on household savings, a skilled labour supply with weak unions and good access to the affluent world markets.

Fuelled by massive increases in savings and private investment, between 1956 and 1975 industrial production increased by more than 10 per cent a year — a sevenfold increase — with GDP increasing at more than 9 per cent annually. By 1975, Japan had caught up with Western industrialisation by marrying its high internal savings/investment with easy productivity increases available from a shift of surplus labour out of agriculture. A slowdown was inevitable — all the more so as a result of OPEC changing energy costs. This was aggravated by policy directions that reduced the saving incentives of households, and so the availability of funds for investment.

For the 40 years to 2020, Japanese governments sought to restore the growth cycle with deficit spending and cheap money. Interest rates were reduced from 8 per cent to almost zero. The budget deficit, which in 1990 was already 15 per cent, expanded to 70 per cent and debt rose from about 50 per cent of GDP to 235 per cent. The outcome was a mere 1 per cent average annual growth between 1990 and 2020.

Government stimulatory policies are seductive but have proven to be a poisonous elixir. Government expenditure unmatched by taxation coverage brings either stagflation or debt. But for politicians and advisers alike, attempting to trick the economy into an automatic recovery is enticing, far more so than adjusting to the new reality with cost reductions and institutional measures to improve supply flexibility.

Improved flexibility means deregulation, including of labour to bring about remuneration levels that better match reduced productivity. Labour market change is very difficult for Australia, with its award system preventing wages being reduced to reflect the market; this is especially the case for the 16 per cent of employees who work for governments. Moreover, the difficulties have been aggravated because almost 500,000 of us prefer the gift of $1500 per fortnight to looking for work. The marginal tax rate of relinquishing this and other benefits for a $1000-a-week job is 80 per cent or more.

For part-time workers previously earning less than this, there is actually a cost in re-joining the workforce.

Rapid write-off of investment stands out as one beneficial government policy measure (though confining it to small business is an unwelcome distortion). This lowers the tax on productivity improvements. But an alignment of policies to our new realities also means reducing government spending in general, and particularly on goods and services that are themselves of poor value: submarines, Snowy 2.0, renewable energy subsidies, diversion of water from farmers, the ABC and SBS.

Australia faces a formidable challenge to make such changes with the constellation of political forces and a Senate that amplifies the power of minor parties.

It might be argued that no two economic shocks are identical and that we can ride this one out by simply sacrificing our relatively low level of debt. Hopefully so, but the Prime Minister this week sounded as though he has in mind further active stimulus. If so, and without deregulatory measures, there is a greater likelihood of us experiencing the permanent paralysis that has blighted Japan.