The problem is simple: Australia has to generate three and a half per cent economic growth plus a one per cent trade surplus. The question of how to do it is a little more vexed.

TONY ASPROMOURGOS considers the national debt dilemma.

If the labour movement in general or the Left in particular wishes to be serious—and to be taken seriously—then it must accept the intellectual and political discipline of ensuring that its program is consistent with plausible ('sustainable') fiscal policy outcomes during the 1990s. In the absence of such discipline any proposed program will be impossible to implement and unlikely to receive an electoral mandate.

I have made reference to this before in ALR. After the May 1991 NSW election I mentioned that the "intellectual and political challenge for the labour movement aspiring to govern is to marry community-based programs with overall coherence in an age of economic austerity which is far from being over" (ALR 130). Last year, responding to the question "Is the Left Braindead?", I noted that on the one hand "we need a growth rate of the economy capable of systematically reducing unemployment towards the ultimate goal of full employment. On the other hand, and at the same time, we need to stabilise foreign debt and [the] current account deficit at levels which are sustainable". And I added that, "this also has definite and largely inescapable implications for the balance between public sector expenditure and revenue" (ALR 141). Let me here try to clarify these ideas.

The key concept behind economic debate in this area is "financial sustainability"—a concept which may be applied to both the 'balance sheet' for Australia as a whole and the balance sheet for the Australian public sector as a whole (not the same thing). The core of 'sustainability' is that financial obligations be stabilised in two key respects: the level of net liabilities as a proportion of income must cease increasing (and approach a constant number); and the level of income transfer (meaning interest, dividends, profits, rents, etc paid to foreigners) obligations arising from outstanding liabilities must also cease increasing as a proportion of recurrent income.

Applying this rather abstract formula to Australia as a whole, Australia's total liabilities to foreigners are the sum total of all past current
account deficits; the annual current account deficit is the net addition to total liabilities owed to foreigners. These liabilities consist of foreign debt and foreign equity in Australian assets (foreign ownership), and the associated obligations to foreigners consist of interest payments (debt) and dividends, profits, rents, etc (equity).

The ratio of Australian foreign liabilities (debt plus equity) to GDP or national income has been rising dramatically and virtually continuously during the 1980s and beyond. The same applies to the ratio of income transfers to foreigners as a proportion of Australian export revenue. When the economic commentators speak of 'external (financial) sustainability' they usually mean halting the rise of the former ratio and stabilising it at a roughly constant value of 50-60%. While I will spare readers such an exercise here, a little mathematics would demonstrate that the key requirement for stabilising foreign liabilities as a proportion of GDP is a trade surplus of about one per cent as a proportion of GDP. In other words, aggregate domestic expenditure must be kept sufficiently below aggregate domestic output as to allow a net one per cent of national product to be transferred to foreigners.

Moreover, this one per cent trade surplus must be maintained continuously through the 1990s and beyond, if the ratio of foreign liabilities to GDP is to be stabilised permanently. However, while this stabilisation requires a persistent trade surplus, it is entirely consistent with a persistent current account deficit (the trade balance plus income transfers to foreigners). Permanent current account deficits are not necessarily a problem if the economy is growing.

The same kind of financial sustainability conditions apply to the public sector. The relevant measure of liabilities is, roughly speaking, outstanding government debt (which may be domestic or foreign)—the sum total of all past government budget deficits. The income transfer obligations to foreigners in this case are, essentially, interest payments on public debt. Public sector financial sustainability requires one or both of two things. Either or both the ratios of public sector debt to GDP and public sector interest payments to tax revenues must be stabilised in the medium to long run. Again, this is entirely consistent (in a growing economy) with permanent budget deficits, though it does require that public expenditure net of interest payments is less than recurrent government revenue in the long run.

This sounds straightforward enough, yet the subject is replete with confusion. A few items of confusion should be sorted out first. Public sector financial sustainability is entirely compatible with a short-run fiscal stimulus such as that contained in last year's One Nation statement: it is the long-run financial trend which is relevant to sustainability, not short-run anti-cyclical adjustments. Indeed, sustainability is even compatible with a long-run fiscal stimulus—provided that equivalent increases in public expenditures and public revenues have an expansionary impact on aggregate national output.

Second, the sustainability of public debt and that of overall national foreign liabilities (debt plus equity) are distinct issues. The two are commonly confused in the minds of laypersons, partly because government has accepted a measure of responsibility for stabilising foreign debt in the national interest, even though only a small fraction of that foreign debt is public sector debt.

Public sector financial sustainability has to be conceived in terms of the total public sector: in other words, the three tiers of government together. It hardly needs to be emphasised that while Mr Keating was addressing with characteristic vigour the Commonwealth's budget position in the 1980s, two or three states (all with Labor governments) were wrecking their balance sheets. And while the Labor Left was not in control of state economic policy at the crucial moments in any of these cases, they sat in Cabinets and did nothing.

Finally, fully commercial public trading enterprises (at whatever level) should be considered separately from budget sector financial outcomes as a whole, since the debt of commercial enterprises should be self-financing from non-tax revenues (commercial charges), with no debt-servicing obligations imposed upon government budgets. It is inappropriate for the commercially-sound financing options of government enterprises to be arbitrarily constrained by global rules which are pertinent only to the non-commercial tax-financed budget sector activity.

There is one other aspect of the problem which needs to be outlined at this point. I have said that external sustainability requires a persistent trade surplus of about one per cent of GDP. This would necessitate a current account deficit of probably about three per cent of GDP. What does this mean? The trade surplus is the excess of domestic production over domestic expenditure. The current account deficit can be defined in several ways: as the excess of national expenditure (plus income transfers to foreigners) over national income (current account deficit), because income transfers to foreigners will exceed national income (current account deficit), because income transfers to foreigners will exceed the trade surplus.

It would therefore be a contradiction in terms, given the behaviour of private sector saving and investment, to acknowledge that government has a responsibility to stabilise the ratio of foreign liabilities to GDP (and hence the trade surplus and current account deficit as proportions of GDP)—
and at the same time to deny that it has a responsibility to meet budget outcomes consistent with that external sustainability. And this is a more binding constraint upon the public sector than the mere dictates of public sector financial sustainability outlined above. That is to say, in the absence of the external financial constraint, budgetary policy could be much looser.

Of course, private sector saving and investment are not 'given', and policy may directly seek to manipulate them. If the balance between private sector saving and investment could be improved—increasing the former and/or reducing the latter, as proportions of GDP—the external constraint on the public sector budget balance would be eased. For example, there is some reason for hoping that the extension of superannuation will increase household saving. Again, there is some evidence that workplace and other industry reforms may reduce (both private and public) investment requirements per unit of output. At the same time, however, changes in the public sector budget balance aimed at changing the current account balance may be self-defeating if they simply lead to offsetting changes in private sector behaviour. For example, reductions in public education expenditure which led to increases in private household education expenditure, at the expense of private saving, could be self-defeating from the point of view of the current account balance. In any case, it is indisputably true that consumption (public and/or private) and/or investment (again, public and/or private) will have to decline somewhat, as a share of GDP.

I have expended a good deal of space outlining the conceptual framework for the issue of growth and financial constraints. Now I will more briefly sum up the core problem and point to the required responses. There are two key objectives confronting the federal Labor government: external sustainability (trade surplus about one per cent of GDP) and a persistent growth rate which will generate sufficient employment growth to systematically soak up unemployment. The latter objective points to a real GDP growth rate of more than three and a half per cent. The higher GDP growth is above three to three and a half per cent, the more rapidly unemployment will be reduced. The government faces a genuine dilemma if these two objectives—external sustainability (one per cent trade surplus) and pursuit of full employment (three and a half per cent growth)—prove incompatible.

In these circumstances the government will be obliged to sacrifice employment growth in favour of a sustainable trade surplus. This gives a precise content to the notion of an external constraint; if the GDP growth rate required to systematically reduce unemployment generates an unsustainable trade balance, the pursuit of full employment therefore must be abandoned.

There are therefore two key economic difficulties to be confronted in relation to this 'external constraint'. First, foreign trade performance must be improved sufficiently to enable an adequate rate of employment growth for the 1990s to be combined with a sustainable trade surplus. Mr Keating has trumpeted Australia's strong export growth (and, in particular, the very strong growth of manufactured exports) in recent years; he has been more coy about the equally rapid growth of imports. What the latter points to is that in pursuit of sufficient export growth, Australia has to run just to stand still. The crucial question is what policies at the 'microeconomic' or structural level have a reasonable prospect of delivering the required trade performance—the crucial questions here are in the fields of industry policy, trade policy, and industrial relations.

Second, because of the external constraint it is also the case that tight fiscal policy will have to be maintained over the medium to long term. In other words, if the government pursues industrial and other policies to improve trade performance, it will have only a limited capacity to expand public expenditures as a proportion of GDP unless they are accompanied by increases in tax revenues as a proportion of GDP.

The political constraints upon the government proceeding in this manner are obvious. But the economics of more activist industry and other policies, to the extent that they have implications for the Budget, will also have to be confronted: an expansion of public expenditure (say, public investment) accompanied by increased taxation involves shifting resources away from private consumption and/or private investment. The only alternative would be to expand public investment expenditure at the expense of public consumption expenditure, which would not necessitate an increase in the tax share in national income. But all these options would have definite implications for public social expenditure, private consumption and income distribution. In short, an increase in the proportion of the national product going to net exports requires some decline in the proportion of the national product going to other uses. In any case, the Left and the labour movement must ensure that the fiscal outcomes implied by their policies "add up".

I conclude with a simple message. In the face of all the barrage of policy proposals and economic chatter doing the rounds it is wise to keep one's eye on the main game—that economic success requires a one per cent trade surplus plus more than three and a half per cent growth in output. This is the benchmark for economic success in attacking Australia's fundamental economic problems. All economic policies—Labor, conservative and otherwise—should be judged against this standard.

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