

ECONOMIC NOTES

It's three years since the current recession hit Australia. No post-war economic downturn has been so severe or lasted so long.

Perhaps for this reason, but also because no-one likes to be too pessimistic, economic debate in Australia at the moment mainly consists of pious wishes rather than hardheaded analysis. Politicians, businessmen and economists are hard at work trying to talk the economy into a recovery but so far with little success. One reason, of course, is that Australia is plugged into the still depressed world economy.

Economic debate in Australia has traditionally ignored this simple fact. It has been thought that keeping the economy humming is the main job of the government of the day; conversely, if anything goes drastically wrong, it must be the government's fault.

The Labor Opposition ran just such a line every time the economy faltered between 1949 and 1972. In fact, they were so successful in convincing people of this that when they eventually won office and had to handle Australia's most serious economic downturn since the 1930s the voters knew exactly who to blame.

While it was in office, Labor pleaded that both aspects of the recession - first soaring prices and then growing unemployment -

had international causes. But the excuse sounded lame, even to the Party's own supporters.

If anything, last December's election result shows that many voters still blame Labor for the recession. The Fraser government, for its part, is banking on the same psychology working in reverse when the recovery comes. So long as the government hangs on and sounds confident they'll get the credit for the eventual recovery and govern till the end of the century with the continuing support of a thankful electorate.

At least that's the strategy. It could come unstuck, of course, if there is no recovery internationally. This is why any survey of Australia's economic prospects and the political future we can expect must start with the international economy.

An Inside Story

The latest and most authoritative survey of the world capitalist economy from *within*, as it were, can be found in the Organisation for Economic Co-operation and Development's **Economic Outlook 22**, published in December last year.

"The pick-up in activity in late 1976 and early 1977 was short-lived", the OECD points out in a survey of developments since the recession. "Total OECD growth weakened markedly in the second quarter of 1977 and has since remained sluggish.

Industrial production has broadly stagnated since April. In the United States there has been some slowing down, and in Japan industrial output is flat."

The immediate consequence: worsening unemployment. "Total unemployment in the area", the Organisation reports, "is now about 16.3 million, some half a million *higher* than the trough of the 1975 recession.

"In Europe, unlike the United States, unemployment has in fact been rising constantly, from 4.7 million at the beginning of 1975 to over 7 million today. In many countries the weakness of the labor market has led to an actual fall in employment and a rise in the under-utilisation of employees."

This year will make things worse, the OECD predicts, with unemployment at the end of 1978 reaching 17 million.

The good news is that the inflationary surge that hit the capitalist world in the early 1970s is now receding, though inflation is still running at twice to three times its pre-recession rate.

Consumer prices in the OECD area rose at an annual rate of 6 per cent in the four months to October - markedly better, as the Organisation points out, than the 11 per cent registered earlier in 1977.

Unfortunately, food prices — partly for seasonal reasons — have been the most important factor contributing to the better performance of most countries which means further cuts in inflation are not assured.

The problem, the OECD believes, goes back to weakening output. Inflation through 1978 should average 7 per cent, compared with 8 per cent over the whole of 1977 and 8 per cent also in 1976. An improvement, perhaps, but hardly a dramatic one.

These present forecasts, the OECD warns, "assume no marked deterioration in business or consumer confidence, and this might be optimistic for most countries in view of the current weakness in both domestic demand and foreign trade".

'A particular source of risk'

"Demand trends are weak almost everywhere. In the absence of new policy action, therefore, there could be an important downside risk in the forecast. A particular

source of risk is the possibility that the pattern of international payments which seems implicit in the demand and output prospects would not, in fact, prove supportable."

This is a very careful way of saying that the world monetary system faces a new crisis that is at least as serious as the one that set off the last bout of inflation.

Again, the culprit is the American dollar.

Since much of the world's trade is done in US dollars and since many countries hold their foreign reserves in American currency, everyone has a stake in the health of the dollar. And right now, it is looking pretty sick.

The irony is that the United States was the only capitalist country to significantly expand production last year, but it was just such an expansion that set off the dollar crisis.

When the US economy picked up and unemployment fell slightly from 7.8 per cent to 7.0 per cent, Americans began buying again. Imports soared, swollen by a \$45 billion oil bill. However, other countries, with thousands of their own workers still unemployed, refused to buy American exports.

The US last year spent \$30 billion more on imports than it earned by exporting. The \$30 billion, of course, ended up overseas, swelling the already massive pool of US dollars held by foreigners to an awesome \$300 billion. Naturally, the dollar's value began to slide, falling, for example, 12 per cent against the Deutschmark over the year.

'A fully-fledged depression'

Non-Americans holding dollars began to get nervous. "The fall of the dollar", warned editor Theo Sommer of the leading West German daily *Die Zeit*, "if unchecked, would plunge Europe into a fully-fledged depression. The political dislocations in countries like France would be grave.

"Such a failure would quickly turn a monetary crisis into a crisis of confidence that will shake the foundations of the Western system."

While this may sound exaggerated it certainly highlights a real problem other

countries haven't learnt to deal with. After all, the last time the world was flooded with US dollars was during the Viet Nam war. America wanted to finance its unpopular military adventures without raising taxes. Instead, it printed dollars and pumped them into the world monetary system, setting off an unprecedented inflation. All currencies were affected, including Australia's. Everyone paid for America's war.

Now a similar thing is happening. As US dollars flood the world and drop in value, it becomes easier for the US to sell its exports overseas - and harder for other countries to sell in the US. Thus, the US is actually better off, which is why President Carter has held off so long before intervening to support the dollar.

It was only very strong international pressure that forced Washington to start buying up dollars with its own foreign currency reserves and so stem the slide in the dollar's value.

At the same time, the US Federal Reserve Board raised the interest rate it charges member banks by half a per cent to encourage all US rates upwards and so attract more capital from abroad.

These moves were lauded in Western Europe but clearly will check American domestic economic growth. For example, the "prime" bank rate on business loans is now 8 per cent compared with 6¼ per cent at the beginning of last year, and Wall Street predicts it will go to 9¾ or even 9 per cent by the end of 1978, according to *Time*, January 30.

"The rise makes it more expensive for consumers and businesses to buy or build with borrowed cash", *Time* explains. "It could put an end to the housing boom by causing savers to pull their money out of savings banks — the prime source of mortgage loans — and instead buy Treasury bills or bonds to get the higher interest rates that they offer."

US domestic inflation is now picking up again, averaging 7.25 per cent over the last four months of last year. While this may sound good by Australian standards, it, in fact, represents a serious reverse: inflation in the US is now higher than it was two years ago and is predicted to go higher still. It

seems that even the most powerful economy in the world cannot begin to recover without setting off new inflationary pressures that must, by the nature of things, flow through to other, dependent economies.

Another source of instability

While US domestic developments are one source of instability for the international monetary system, another, perhaps more intractable, problem involves the under-developed countries.

According to the OECD those developing countries which import oil saw their overseas debt rise from \$90 billion at the end of 1973 to \$170 billion at the end of 1976. At the same time, the interest they had to pay on these loans went from \$13 billion each year to over \$25 billion. US Senator Javits predicts these debts will reach \$380 billion in five years and \$540 billion in ten years.

"This will break the back of any system, including this system", Senator Javits said, referring to the institutions that regulate international finance.

While the under-developed countries are more and more heavily in debt to other countries and to international agencies, the really dramatic growth has been in their debts to international banks.

As the OECD puts it: "The international banking community has so far shown a remarkable willingness and ability to act as financial intermediary between the surpluses of the petroleum exporting countries and the borrowing needs of the developing (and some developed) countries."

These oil surpluses — currently running at about \$40 billion a year — are the amounts the oil producing countries receive for their oil over and above what they are able to spend on imports. Due to their small populations and backward social systems, these countries only import a limited quantity of goods. The rest of the money they make out of oil is merely deposited in US and European private banks.

This money is then re-lent. Because of the world recession, the banks' main customers, the big corporations, have not needed funds for expansion. The banks, therefore, have been falling over themselves to lend their surpluses to other borrowers and in

particular to non-oil producing under-developed countries who desperately need funds to pay for imports — especially oil, for which they, too, have to pay higher prices.

Thus, while commercial and industrial loans of the eight largest New York banks increased only 1.8 per cent to \$33.8 billion during the year to June 1977, foreign lending jumped 26.1 per cent to \$71.2 billion in the same period.

In 1960, private "hard" loans - in other words, loans at market rates of interest to private banks - made up only 16.7 per cent of the debt of developing countries. Now the proportion is 36.2 per cent. Interest payable to private banks has gone up even faster, now constituting 42.8 per cent of these countries' massive debt service charges.

For many of them, interest payments take over a quarter of all export earnings and for some much more: Brazil, for example, will have to spend 44 per cent of all its export earnings this year, just to pay interest on its debts.

The private multinational banks, of course, are in it for the money. While the proportion of their total funds that they lend to under-developed countries varies between Chase Manhattan's 12 per cent and Citicorp's 22 per cent, the proportion of their profits which they derive from this source is much greater. Foreign earnings of the thirteen US commercial banks have increased from 34 per cent of total earnings in 1973 to nearly 50 per cent in 1975. Later figures are no doubt higher.

But how long can it go on?

A study by American Express says that one out of every two dollars borrowed by the under-developed countries in 1980 will have to be spent just paying interest on old loans. A US Senate study on "International Debt, the Banks and US Foreign Policy" predicts that these countries "will find it more in their interest to simply default or repudiate their external debts rather than to have to continue borrowing just to repay old loans".

"And if this happens", the study goes on, "a domino effect could take place in which other debtor countries follow suit, the banks panic and start calling in their international loans, the stock market falls precipitously and the international capital market collapses.

"This doomsday scenario may be extreme in its pessimism, but it is being taken seriously enough by responsible officials that a concerted international effort is now under way to prevent that first domino from falling."

Part of this "international effort" consists of forcing under-developed countries borrowing from private banks to fulfill the sorts of stringent conditions the International Monetary Fund lays down before it will give official loans.

The IMF has been able to force recipient countries to cut back social services, hold down living standards and impose other austerity measures as conditions for official loans. As the OECD points out, one reason under-developed countries prefer private loans even before they have exhausted their credit facilities with the IMF is that the banks up till now haven't imposed such conditions.

But this has to change, the OECD argues: "Debt relief should be accompanied by an effective stabilisation program on the part of the debtor country, preferably in the context of an IMF standby undertaking." In other words, the IMF will bail out the private banks if the banks in turn impose the same austerity measures as conditions for future loans.

The banks, however, are caught in a trap. If they reverse their liberal, profit-hungry criteria for future loans they might trigger off a series of defaults. Once this has happened where will it end? Better, perhaps, to keep lending.

This instability in the international monetary system has persisted through the recession and could well upset any recovery in world production or trade. The US experience suggests any upturn will be at the cost of future inflation. If this inflation is immediately transmitted through the system, future prospects for places like Australia are not nearly as bright as our own recent inflation history suggests.

We may, in fact, be taken for another inflation ride before we recover from the present one.