Artificial Guilt

For Howard Guille, the balance of payments controversy is much ado about nothing.

The government and the Reserve Bank are presently manipulating private sector interest rates with the express objectives of reducing the rate of economic activity, limiting imports and slowing the increase in overseas debt. These policies are deemed necessary to ensure that Australia lives within its means.

The only difference between government and Opposition on this score is the speed of adjustment; Labor is seeking a 'soft landing' without too great a reduction in living standards. The Coalition, on the other hand, wants an even tighter policy, and Senator Stone is calling for a Friedmanite 'short sharp shock'.

There is a clear logic in all this for the economic cognoscenti. The mechanical metaphors such as 'fine tuning' supposedly give comfort to the uninitiated and confirms that the men are in control. Yet even though it is clear that imports exceed exports, there are some nagging doubts. One doubt is about who has incurred the foreign debt; another is the ethics of slowing economic activity when unemployment is over six percent and public housing and facilities are deteriorating.

Yet another issue, hardly discussed, is who receives the high interest rates paid by those with mortgages, loans and overdrafts. Banks deny that they are the recipients, even though they have massively increased their profits. More pertinently, such questions are not asked, let alone answered, by the finance house economists trotting on to television each night with their charts and speculations. This could be because the answers are incommodious to their clients, some of whom are presumably the rentiers earning high interest rates. It might also be because economics and accounting training simply put such questions beyond contemplation.

Most prominence is being given to the balance of payments current account. In the December 1988 quarter (the most recent full quarter figure available) there was a \$4.1 billion current account deficit. The balance of payments measures transactions between people and organisations resident in Australia and those overseas. Conventionally, there are four components to the current account. For the December quarter 1988, these were:

merchandise trade . . .	- \$1.2b
services	- \$0.6b
income	- \$3.0b
transfers	+ \$0.6b

Merchandise trade covers imports and exports of goods. Services includes freight, travel, insurance and tourist expenditures. These two categories cover traded goods and services where an actual exchange occurs. They account for less than half of the current account deficit. The major component is the \$3 billion on the income account. This covers profits, dividends, interest and royalties paid into and from Australia. Note, this does not include borrowing and lending funds or the sale and purchase of property - which are all included in the capital account. The fourth component covers transfers of money made for pensions, foreign aid payments and funds brought by migrants. In the December 1988 quarter, funds brought to Australia by migrants made a positive contribution of \$649 million; this amount exceeded receipts from meat and gold exports.

Some suggested solutions for the current account deficit warrant discussion. For instance, the current account should be balanced if either rural exports or those of coal and minerals were doubled. However, a combination of agricultural protectionism and improved productivity elsewhere makes increases in rural exports unlikely. The greenhouse effect would also appear to reduce the prospects for coal and mineral exports.

Alternatively, manufacturing exports could be increased from the present \$1.5 billion to \$5.5 billion per quarter. Yet 'niche marketing' hardly seems likely to provide the necessary stimulus of capital equipment. Tourism is the other hot prospect; travel and passenger transport earnings totalled $1.4 billion in the December 1988 quarter. A four-fold increase in international tourist and travel receipts would be required to cover the deficit. Even with longer stays this would have immense social consequences; consider, for example, only three times as many planes landing at Sydney or Melbourne. Moreover, expansion would require imports, let alone the extra overseas expenditure as better-heeled Australian residents fled the tourist hordes.

The expansion of exports and tourist receipts is unlikely to close the deficit: a reduction of imports and overseas expenditure is clearly required. Import substitution needs promotion; the big expenditure is on transport equipment, computers, machinery and chemicals. This is evidence of the decline of capital equipment industries and failure to develop new industries in electronics and computers. More ordinary products are also imported, however: for example, in the December quarter 1988 when the deficit on merchandise trade was $1.2 billion, $0.6 billion was spent on importing food and beverages. This is a surprisingly high figure given our claimed status as a food producing nation. Assistance to and promotion of local industries are clearly justified. This should go to advanced and traditional sectors; cheese manufacture is just as important as computers.

There are some plausible reasons to balance overseas transactions for goods and services. However, the notion of an Australian balance of payments is more dubious. Goods and services are bought by individuals, not by countries. Financial deregulation has made national barriers irrelevant. For example, does 'Australia' *import* things when a multinational obtains a product from an affiliate which is based in another country? Just as importantly, the *price* at which such a transaction occurs reflects the corporate logic of the multinational. Yet that price is crucial to the calculation of the balance of payments. This is best shown by reference to the income and capital accounts. The balance of payments is calculated and presented so that the current account is balanced by changes in the capital account. A current account deficit means that capital liabilities and foreign debt increase; a current account surplus means a reduction in net foreign liabilities. However, the levels of foreign investment in Australia and, conversely, Australian investment overseas, are independent factors. Liabilities and assets build up both through buying and selling goods and services and by distinct movements of capital funds. The connection between the current and capital accounts made in the balance of payments is an accounting and not an actual relationship.

Changes in corporate and international finance have made the accounting assumption rather dubious. For example, the effect on the balance of payments would be different if an international company funded imports from Australian earnings or by borrowing from an overseas associate. In the first case, there would be a debit on the merchandise trade but no effect on the level of overseas investment. In the second case, where imports were funded by an overseas associate, interest payments on the 'loan' would be a continuing charge against current account receipts.

The balance of payments is an artificiality. Measurement of such national transactions is a product of the period of fixed national exchange rates, when a consistent surplus or deficit were grounds to alter the exchange rate. In essence, the balance of payments drove the exchange rate. In the current era of market rates the exchange rate almost drives the balance of payments. Furthermore, high interest rates encourage the inflow of speculative finance and create a further flow of overseas expenditure. It is misleading to combine individual and corporate transactions into some statement of national payment and debt. The question of whether 'Australia' can meet its foreign payments is actually a question of whether specific corporations can service their loans. There is a good argument for abolishing the balance of payments; this would not affect the real economy and would at least remove the artificial guilt we are expected to feel.

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