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Problem is we're not borrowing from the future, but taking from it

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As the deficits being incurred by Australian governments continue to spiral, the claim that we are “borrowing from the future” has become increasingly widespread.

The other day the Reserve Bank governor said that it makes sense “for the government to borrow from the future, especially at today’s record low interest rates, to cushion the damage to the economy and jobs now”.

Presumably, the governor’s statement was intended to be reassuring. We are, it implies, behaving much like a household whose income has taken a purely temporary hit: by borrowing, we tide over the bad patch, repaying the loan once the good times return. We are less badly off than we would otherwise have been — and the fact that we borrowed from willing lenders means that ultimately they gain too. But that isn’t an accurate description of what is happening today. To understand why, the first step is to switch from fiscal accounts, with their ledger of credits and debits, to the real economy; that is, to the production and use of goods and services.

The inescapable fact is that the real economy has shrunk, with GDP (the broadest measure of the goods and services produced in a year) falling by 10 per cent or more despite the massive increase in public spending.

Now, if we held huge stocks — like Pharaoh’s granaries — we could, much as Joseph did, run

them down, adding to the goods and services available for current use. We live, however, in a just-in-time economy, and there is little scope to expand consumption and investment by reducing inventories.

Equally, we could use more than we produce by diverting goods and services from other countries — that is, by running a current account deficit. However, GDP is also shrinking overseas, making that hard to achieve, other than on a small scale.

What this implies is that our use of goods and services must shrink by about as much as the fall in GDP. There is, in other words, what economists call a “material balance” constraint, which dictates that, in total, consumption, investment and net exports cannot “absorb” more than the goods and services that are actually available.

And since that quantum has fallen, we are poorer, in ways that invoking posterity does nothing to change. The future cannot send us food parcels, any more than it can “lend” us a vaccine that has not yet been invented.

What then are the roles of budget deficits and public debt, if not to enable borrowing from the future? They do provide some economic stimulus, limited, however, because economic activity is constrained more on the supply side — by the restrictions, lockdowns, distancing requirements and supply chain disruptions imposed on production — than by a Keynesian deficiency of aggregate demand. Other than that, their main purpose is to redistribute the pain.

In simple terms, the extraordinary welfare payments allow some households and businesses to use a greater share of GDP than they otherwise would. And because the material balance constraint must still be met, other uses must fall.

In practice, a large part of that fall is likely to be in investment, reducing the capital stock available to future generations and decreasing the income they will obtain.

And those future generations — or at least the taxpayers among them — will also inherit the increased debt we leave behind. Ultimately, that will translate into a greater tax burden than

there would otherwise have been, with the economic losses from higher taxes further reducing their incomes.

All that may be unavoidable and to some extent desirable; but we shouldn't allow catchphrases to paper over realities. We aren't borrowing from the future: we are taking from it. And once we recognise that, doing what we reasonably can to minimise the harm becomes not only good sense but a moral responsibility.

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