



CORPORATE FOREIGN DEBT AND THE CURRENT ACCOUNT

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Current political debate over the costs of Australia's foreign debt echoes a debate carried on amongst economists over the past decade. Liberal leader John Howard says that Australians pay higher interest rates as a result of the high levels of foreign debt, and the consequent large current account deficit. His suggestion is that macroeconomic mismanagement by Labor has generated a cost for all borrowers in Australia (Howard 1995: 13). Prime Minister Paul Keating has responded, variously: that asset rich Australia can afford its debt; that the largely private foreign debt is a burden only on private borrowers; and that there is no real link between foreign debt and interest rates (Keating 1995: 13).

In this paper I argue that Howard is right in identifying the general problem, but that he has missed the central feature of the problem: that higher interest rates are one of the current costs of the normal activity of private (generally corporate) capital. The federal government has a responsibility to find ways to hold this private capital accountable.

This paper will argue:

- that Australia's foreign debt does matter, as it imposes public costs;
- most of these costs are caused by private, corporate borrowings;
- one important public cost of private borrowings is their impact on the level of domestic interest rates, through the institution of the current account;
- such a public cost is a measurable burden on home-buyers, small business, wage-earners and the community in general; and
- such costs demand a greater public accountability of private capital.

Does Australia's Foreign Debt Matter?

A debate developed in the late 1980s around the effects of the foreign debt. Foreign debt, as opposed to domestic debt, has been seen to impact on some of the central institutions of the Australian economy, notably the current account deficit, the currency and interest rate policy. In the past it has been suggested vaguely, but rarely with much elaboration, that we all bear some burden of this debt, despite the fact that private debt was between 54% and 59% of the total Australian foreign debt between 1990 and 1994 (ABS 5306.0).

Some, notably John Pitchford, have argued that the foreign debt doesn't matter; that the ebb and flow of international private financial transactions should not impact on public policy (Pitchford 1990). Others go further, arguing that foreign debt doesn't matter in practice or in principle: with open market reforms the current account deficit will stabilise and fall; and in any case the current account is only a "residual", an indicator of the healthy process of private investment and growth (Harper 1995). This is in line with what has been called the "new view": that the current account should not be a matter of concern, as it may have been (in the "old view") when there were fixed interest rates and less international capital mobility. The "new view" says that, with flexible capital markets, debt and current account profiles simply reflect a range of optimal savings and investment decisions (Corden 1991: 2-5).

The more common view amongst public commentators is that the foreign debt does matter, and that prudent public policy must seek to contain external liabilities (both public and private) within the bounds of the economy's capacity to pay (Abelson & Maynard 1989: 21). Fred Gruen agrees, arguing that high current account deficits raise the risk of a currency crisis and an investment collapse (Gruen 1995).

Pitchford's argument, and that of the "new view", is that public policy is distorted by focussing on the current account. Mark a clear line, Pitchford says, between public and private responsibilities. Don't force this public responsibility for private economic activity and let private financial markets take care of themselves (Pitchford 1990: 87). The more traditional argument of Gruen, and Abelson & Maynard, is that public

policy must guarantee a stable economic environment for private activity, and that the currency (albeit floated since 1983) and interest rates (although said to be set by a 'deregulated' finance sector) must be carefully managed on prudential grounds.

In 1990 Reserve Bank Governor Bernie Fraser acknowledged that foreign debt was a concern, as debt service payments consumed four times more of the foreign currency earned by exports than they had at the beginning of the 1980s. This meant that Australia was:

much more vulnerable to shocks than in earlier times ... our freedom of action would be severely limited in the event of a sharp slump in export income or a sudden loss of confidence on the part of foreign investors ... This vulnerability was made worse by a [volatile] foreign exchange market ... the floating exchange rate regime automatically clears the foreign exchange market but this does not automatically deliver external balance in any more fundamental sense (Fraser 1990: 12).

Any fall in the exchange rate, such as would be occasioned by lessened inflows of capital following a fall in interest rates, would have substantial implications for repayments on any foreign debt denominated in foreign currency. In these circumstances, the repayment burden on Australian borrowers would worsen and the current account deficit would rise.

I disagree with Pitchford's attempt to disengage the private and public economies. I also disagree with the mainstream view that public policy must adjust for the vagaries of private transactions, *without* recognising the public costs of this process. I suggest that there are specific and quantifiable public costs which may be linked to particular corporate financial activities. While socialising the costs of private economic activity may be a traditional field of public policy, these costs must be more clearly identified and set against the more commonly suggested benefits of private borrowings, so that a full public accounting can be made. I attempt here to focus on the largely ignored cost side of this equation, and to illustrate how we may begin to impute the public cost of private foreign debt, through its impact on the current account.

Foreign Debt and Interest Rates

In support of his argument that we all pay for aggregate foreign debt, John Howard cites the ratings company Standard and Poor's, which concluded that Australia's foreign debt and current account deficit

stand out as unfavourable features of Australia's creditworthiness [and] place Australia in a position where it is much more susceptible to international trends and preferences, and they restrict flexibility in economic management (Howard 1995: 13).

Similarly, Vince Fitzgerald, the federal government's adviser on savings policy, spoke of a "risk premium" attached to the foreign debt, which could raise rates between a quarter and half a percent (in Gordon & Henderson 1995). Howard suggests such a risk loading as the "narrowest indicator" of the impact of foreign debt on interest rates.

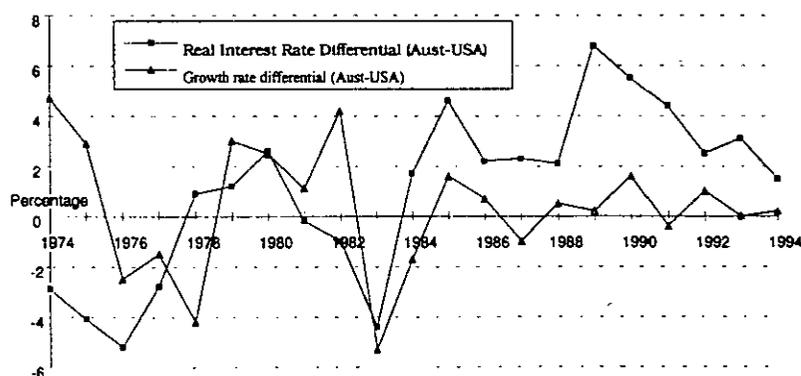
Bernie Fraser has given several explanations of the reasons behind the Reserve Bank's interest rate policy. He has linked interest rate movements to the pace of economic growth, wage pressures and pressures on import prices (Davies & Allard 1995). Later, while calling a fall in US rates a "relevant overseas development", Fraser added the local growth outlook, inflation pressures and the current account problem as important considerations (Davies 1995). However when the political debate over foreign debt and rates was raised he appeared to contradict Howard's argument, saying

debt has some connection with interest rates [but it] is not a major issue ... [and while the bank had lowered rates 15 times and raised them 3 in the past four years] I can't remember mentioning in any one of those 18 instances any reference to foreign debt (in Henderson, Gordon & Ramsey 1995).

This latter comment is less than a denial of the significance of debt and the current account deficit to interest rate policy. The current account may well be subsumed in considerations of sustaining the value of the currency and keeping rates above those in other key countries, such as the USA. Despite the varying emphases of Fraser's public comments, the

Reserve Bank Governor has consistently suggested that, while monetary policy is focussed primarily on internal balance — in counter-cyclical demand management and by helping lower inflation — it is also directed to influence the external accounts. High interest rates push up the exchange rate and (even though this may encourage imports by making them cheaper) the "net effect" of this deflationary monetary policy (by reducing disposable incomes and tightening credit) was to reduce imports. For these reasons, he claims, "monetary policy has clearly improved the current account deficit" (Fraser 1990: 14-15).

Figure 1: Real Interest & Growth Rate Differentials, Australia and USA, 1974-1994



Source: Foster & Stewart 1991, Reserve Bank Bulletin, OECD Monthly Estimates

In the political arena, Prime Minister Paul Keating has attempted to deflect attention from the relationship between debt-generated current account problems and the level of interest rates. He suggested that Australian interest rates in 1995 were higher than those in the USA because the demand for money in Australia was higher, based on a higher Australian rate of growth (Keating 1995). However, this explanation does not stand up to critical scrutiny. US growth rates for half the years between 1984 and 1994 were equal to or higher than those in Australia, yet Australian interest rates were substantially higher in every one of those ten years (Figure 1) (and higher still in the latter half

of that period, corresponding with a period of a more stable and more highly valued Australian dollar). Keating is therefore wrong to suggest that higher growth rates can explain Australia's higher real interest rates.

Counting the Current Costs of Private Foreign Debt

There are two broad categories of the social costs of private foreign debt: costs of collapse and current costs. By costs of collapse I mean governments actually paying or subsidising creditors, in the event of default or bankruptcy, due to the companies' high levels of debt. Such a situation may involve a mixture of domestic and foreign debt. It also may involve the government guarantee to registered banks being extended to private finance companies which are subsidiaries of those banks, as Quiggin has pointed out (1992: 56). In recent years state governments have bailed out Western Australia's Rothwells Merchant Bank and Victoria's Pyramid Building Society. Neither company was subject to the formal guarantees given to (nor the prudential controls exercised over) registered banks, but in both cases state governments felt politically obliged to intervene, given the large number of investors or account holders.

My concern in this paper is only with the *current costs* of foreign debt. These can be seen in two related ways: the 'risk premium' idea, suggested by Vince Fitzgerald and others (Gordon & Henderson 1995), and the 'current account plug' idea, which I will develop below. The 'risk premium' idea suggests a risk to overseas lenders, because of possible institutional instability in a highly geared economy (that is, one with a high ratio of debt to equity, as a means of funding investment). A premium is then imposed for this added uncertainty. For example, ratings agencies routinely impose lower ratings (which in turn attract higher loan rates) on companies and state governments with high and unsecured financial gearing (Standard & Poor's 1992). However, if we accept that the risk premium is socialised in the form of higher interest rates, then we are confronted with a broader concept of 'risk': the risk to the public of higher interest rates because of the highly-g geared private activity. This is a concept of risk largely ignored by orthodox economics.

'Risk' as an issue in private finance is generally defined as a phenomenon impacting on the parties involved, and it is generally accepted in finance circles that

higher gearing or leverage has the potential to earn higher returns on shareholders funds; however ... this exposes the firm to higher financial risk and reduced ability to service debt (Moore et al 1988: 98).

Greater returns are often acknowledged as the reward for greater risk taking. The impact of macroeconomic conditions within the institutions of a national economy are also often seen to impact on private risk (Fraser 1987: 61). However, the reverse — the social impact of economic conditions generated by private activity — is rarely admitted in the orthodox literature. One can search macroeconomic or microeconomic economic textbooks and, although 'risk' is repeatedly defined as a consideration for investors, the feedback of risk onto the public economy is ignored (eg. Samuelson *et al* 1992: 296, 327), with the exception of concern implicit in the Reserve Bank's general prudential monitoring of the banks' spread of their risks (McTaggart *et al* 1992: 267). Keynes in his *General Theory* did mention the social cost implicit in borrowing, but only as an aggregated cost to investors as a whole (Keynes 1936: 144), not as a cost to *borrowers*.

Although private economic activity is seen as producing 'flow on' or 'trickle down' *benefits* to the wider community, it is common to portray the costs as implicitly privatised. That is, the community may benefit from the productive activity of a private company, but any costs are born exclusively by that company. This general trend has been challenged in the field of environmental costs (eg. Kapp 1950). Environmental costs, such as pollution and natural resource depletion, have been defined as "externalities": public costs outside an internally efficient and primary market system (Pearce 1976: 24). Alternatively it has been suggested that the costs be "marketised" through fines, licenses and the like. Attempts to marketise environmental "externalities", however, have come in for substantial and justifiable criticism (Jacobs 1989: 232). Less attention has been paid to economic "externalities", though Corden has suggested a "contamination effect" externality, whereby borrowers pass on a risk

from their highly leveraged activity. This seems similar to Fitzgerald's 'risk premium' idea, although Corden posits it as a qualification which does not "seriously dent" the new or benign view, that the current account doesn't matter (Corden 1991: 8-18). However the costs referred to in this paper are best regarded as inbuilt and essential institutional costs of private activity. They are costs truly "internal" to any economy with such institutions.

To illustrate the scale of such costs, take the example of the foreign debt of a very large Australian company, News Corporation. As at June 1995, News Corporation had overseas currency denominated debts of US\$7,504 million and Yen 363 million. Two years earlier the large scale of News Corporation's borrowings had led to a "BB+" credit rating, which suggested a "less [than] adequate capacity to pay interest and repay principal in a timely manner" (Standard & Poor's 1993: 28). Interest payable on the News Corporation loans — which were mostly unsecured and carried maturity dates from 1996 to 2034 — ranged from 7.5% to 9.5% (News Corporation 1995: 31). News Corporation has to service these loans in foreign currency, a process which places upwards pressure on interest rates. This cost has to be set against any equivalent benefits: that is, any earnings of foreign currency by the company's overseas investments or loans.

In looking for such benefits we have to consider two things. Firstly, the nature of each loan: might they have related to such things as preference shares, hybrid securities or back to back share swaps (Dixon 1989)? If there are such offsetting factors, which reduce the company's foreign liabilities, some discounting is required. Secondly, we must consider the capital income that flows back into Australia from companies' investments overseas. That is, to what extent does the foreign currency earned by the company's investments abroad offset its drawing on foreign currency to pay its foreign debt? Such calculations are generally not possible from Australian companies' annual reports, which often detail financial assets and liabilities but do not break down revenues to this degree of detail (News Corporation 1995). Nor is this information available from the major Australian ratings company which, while concerned with gearing and debt, relies on data from annual reports

supplemented by additional data on the security of loans (Standard and Poor's 1995).

Table 1: Current Account Impact of Hypothetical Large Corporation

	Stock \$A Equiv Million	Flow \$A Equiv Million
Total borrowings in foreign currency	8,000	
Servicing payments to overseas (av. 8.5%)		680
Total foreign investments	1,765	
Revenue from overseas		150
Net Outflow		530

Nevertheless, it is possible to estimate the impact on financial flows arising when a company borrows overseas on the scale of News Corporation's foreign borrowings. Table 1 shows a Hypothetical Large Company (HLC) and imputes a foreign exchange revenue based on the aggregate ratio of capital income receivable to that payable, which averaged 22% over the years 1990 to 1994 (ABS 5301.0, 5302.0 & 5306.0). In such a hypothetical example we can identify one company's net impact on the current account, in this case a net outflow of \$530 million. These are foreign currency costs, counted in terms of equivalent Australian dollars.

The issue of how to count the use to which foreign borrowings are put is problematic. That is, should funds for productive purposes (investment in new capital plant) be credited differently to those for property or speculative transactions? In the short term such funds impose the same cost across the current account; in the longer term they may generate export earnings or other domestic benefits. In a full model of the public costs and benefits of private financial transactions, one option would be to give some credited weighting to borrowings taken out for demonstrably productive purposes. Alternatively, if the foreign exchange costs and benefits are to be separated from other costs and benefits, the

instant impact on the current account would be considered, with longer term benefits credited only when they appeared.

The balance between borrowings from overseas and from foreign investment shown in Table 1 reflects general trends. Australian corporate investment abroad has increased in recent years, but it has not matched the size of foreign investment in Australia. Between 1990 and 1994 Australian investment abroad ranged from 17% to 92% (average: 42%) that of foreign investment in Australia. However, given the much larger foreign debt stock in Australia, income *receivable* on Australian investment abroad was 16-28% (average: 22%) of that payable to foreign creditors, in the same period (ABS 5301.0, 5302.0 & 5306.0). The net capital servicing deficit is still large and by far the biggest component of the current account deficit. Between 1990 and 1994, net income payable ranged from 80% to 137% of the current account deficit (ABS 5301.0 & 5302.0). In other words, the current account problem is overwhelmingly a capital servicing problem, rather than a trade deficit problem.

Corporate borrowings, such as those illustrated by the Hypothetical Large Company can have a wide range of public costs and benefits, through the various consequences (currency impacts, influence on fiscal policy, environmental impact, impact on wages) flowing from private and apparently normal corporate activity. The rest of this paper focuses only on the likely impact of foreign corporate debt on interest rates, through the institution of the current account.

Foreign Debt and Interest Rate Policy

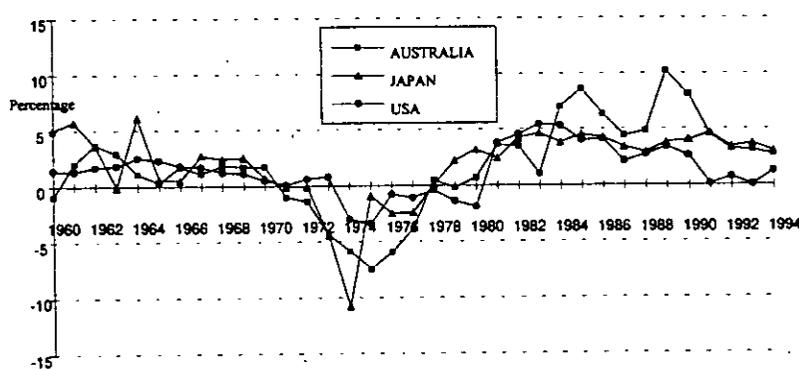
As Bernie Fraser has explained, official interest rate policy incorporates a range of considerations: the strength of aggregate demand, inflationary pressures, wage pressures, the exchange rate and import prices, overseas interest rates and the current account deficit (Fraser 1990; Davies 1995 & Henderson *et al* 1995). However, it must incorporate these considerations in different ways. Some factors are relatively constant and others vary from time to time. Factors which may vary on a monthly or quarterly basis, such as demand, inflation and import prices, may appear the more dynamic because they must be reconsidered periodically. For

this reason I call these factors 'discretionary'. Any more constant factor, such as Australia's chronic current account deficit, will carry similar weight from year to year; it will become a 'background' factor which must be considered, but less frequently reconsidered. Its importance may be understated, and not even "mentioned" at policy meetings (Fraser in Henderson *et al* 1995). However this need not mean that its import is lost. It must remain significant as a background consideration, or a 'non-discretionary' factor.

The non-discretionary root of interest rate policy in Australia, then, may be understood as a traditional bandaid covering — as opposed to seriously addressing — the chronic structural deficit on current account, caused mainly by an outflow of capital servicing funds. Higher interest rates draw in more foreign capital, counterbalancing the current account deficit by an increase in the capital account surplus. This is only a temporary 'solution', of course, as the new capital proceeds to increase the longer term servicing obligation, and to aggravate the current account weakness.

For this purpose, interest rates in Australia must generally be higher than those in countries which are the sources of foreign capital and the rival strong fields of investment, notably the USA and Japan. Figure 2 shows the longer term trends in short term real interest rates: it demonstrates that rates in Australia have mostly been kept well above those of the USA since the late 1970s, notably since the early 1980s and the Australian current account crisis of the mid-1980s. A similar differential applies to Australian-Japanese interest rates since the early 1980s, though not in the early 1990s, where (in this latter period) deflationary policy has contributed to higher rates (Foster & Stewart 1991; RBA 1984-94). The widening of these differentials broadly corresponds to the mid-1970s growth of the Eurodollar market (the rise of stateless capital), the rise of rates in general and the Australian deregulation of capital controls in the early 1980s. More generally, the widening of this differential corresponds to the Australian deregulation of capital and the associated growth in foreign debt and the current account deficit from the early 1980s onwards.

**Figure 2: Short Term Real Interest Rates (Australia, Japan & USA)
1960-1994**



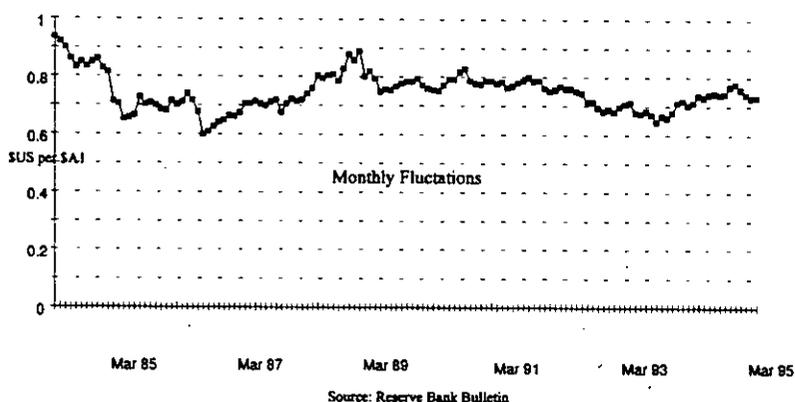
Source: Foster & Stewart 1991, Reserve Bank Bulletin, ABS 1350.0

There are some exceptions to this broad trend. The dip in the ratio of Australian to US rates in the early 1980s can perhaps be explained by the enormous growth rate differential (Figure 1). In 1983 the Australian economy was contracting by 1.4% as the US economy grew strongly at 3.9% (RBA 1984-94 & ABS 1350.0). Exchange rate volatility between 1984 and 1988 (see Figure 3) — after the Australian float in December 1983 and before the high interest rates of the late 1980s — combined with an appreciating US dollar, help explain the far higher Australian interest rates in the mid 1980s. It may be that the unusually strong US dollar in the mid 1980s explains a fair amount of the large gap in 1984-87, while the high Australian discretionary rates of the late 1980s explain much of the gap in 1989-90. Finally, similar recessions and gradual recovery paths explain the flattened but still significant Australian-US differentials in the early 1990s. Japanese deflationary policy (like Australian policy in the late 1980s) held up Japanese real interest rates in the early 1990s.

Notice also that the period since the mid 1970s corresponds to a rise in the importance of interest rate policy as a counter-cyclical instrument. With the decline of fiscal policy as a discretionary tool, discretionary interest rate policy is now more openly used to dampen demand and thus

control inflation. It is also used to dampen imports, though interest rates are an extremely crude and brutal instrument for such a purpose. Higher interest rates have a range of adverse effects, including those on trade. By helping push up the demand for Australian dollar-denominated assets, higher rates help hold up the value of the currency, helping debt servicing but making Australian exports less attractive and imports more affordable. In this way the efficacy of higher rates to repress demand and slow imports is dubious.

Figure 3: Exchange Rate: Australian dollar to US dollar, 1984-1995



In broad terms then, the widening international interest rate differential should be seen as the outcome of two broad forces:

- a groundswell of non-discretionary interest rate policy responding to the current account deficit, which is in turn caused by mounting, largely uncontrolled capital servicing requirements, and
- the increased reliance on discretionary policy to target inflation, through repressing perceived excess demand.

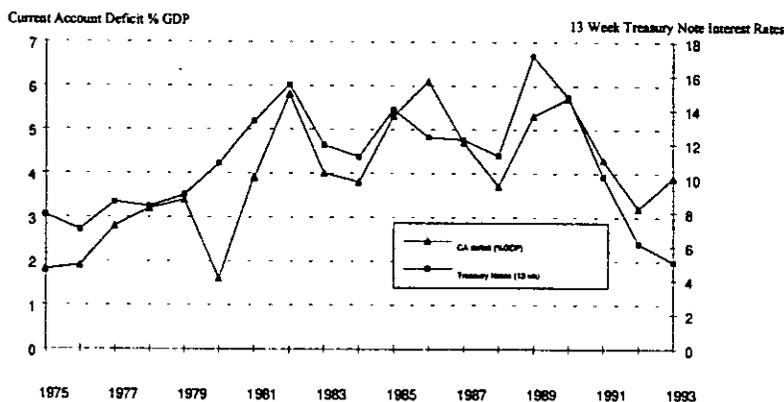
From the first proposition, we should see a quantifiable increase in interest rates — through non-discretionary policy — brought about by any given rise in the capital servicing component ('net income') of the current account. If, for example, there is an unforeseen addition of \$1

billion to the net income outflow, raising the current account deficit, say from minus 15 billion to minus 16 billion, then the Reserve Bank can be expected to tighten interest rates in an attempt to draw in more foreign capital, to plug the gap and sustain the currency. How far will rates rise? This depends on the strength of the relationship between official interest rates and the current account deficit.

Figure 4 shows a close and positive correlation between current account deficits (as a percentage of GDP) and official interest rates between 1975 and 1993 (Foster & Stewart 1991: 1.1 & 3.22). The correlation coefficient for this series is in the 'strong or marked' range, at 0.70. Statistically, the square of the correlation coefficient (ie. 0.7×0.7) tells us the degree to which we can expect one variable to be explained by the other, and in this case that is 0.49. This is a strong correlation, and it is not apparent that there is any other consistent factor involved in the relationship over this period of time. One must strongly influence the other, but is there a leading factor? There is logic both ways. On the one hand, a rise in interest rates will worsen the current account deficit in the longer term (that is, a lagged effect), by drawing in more foreign capital, which then adds to income payable overseas. On the other hand, a worsened current account deficit will require sustained high interest rates to draw in foreign capital, such that the capital account surplus 'plugs' the current account deficit. Both appear mutually reinforcing, but for the purpose of this argument we can say that a sustained, high current account deficit is likely to exert a strong force to hold up interest rates.

From this statistical relationship, about half the change in interest rates is linked to changes in the current account deficit, with the other half explained by other factors, such as the discretionary factors listed above. The scale in this series indicates a current account deficit change of 1% GDP is associated with a 0.39% change in interest rates. Thus it can be suggested that a current account deficit increase, of the equivalent of 1% GDP, is likely to induce an increase in official interest rates of 0.49×0.39 (the square of the correlation coefficient times the scale of the relationship), or 0.19%. That is, for every 1% of GDP increase in the current account deficit, there will be leverage of 0.19% on interest rates.

Figure 4: Current Account Deficit & Official Interest Rates, 1975-1993



Source: Foster & Stewart 1991 & ABS 1350.0

If this is the case, then the Hypothetical Large Company, with its net current account drain of \$530 million (or 0.14% GDP) would exert a leverage of 0.03% (0.14×0.19) on interest rates. What costs does this add? The ordinary private servicing of overseas borrowings, at this scale, would for instance:

- add \$24.48 per year to a home loan repayment of \$100,000 over 25 years, by raising the 1994 home loan rate from 8.75% to 8.78%,
- add \$8.88 per year to the repayments of small business with an overdraft of \$50,000 over 5 years, by raising the 1994 overdraft rate from 9.25% to 9.28%.

The aggregate effect is more substantial. Table 2 outlines the total interest bill for all Australian loans, and for the different sectors of those loans. It also demonstrates the impact of an increase of 1% on repayments on those loans, whereas the column second from the right shows the effect of the Hypothetical Large Company levering rates up 0.03%. In these terms, the HLC's net foreign currency drain of \$530 million has added approximately \$220 million to interest rate repayments on all domestic loans.

Table 2: Interest Paid on Total Australian Loans, January 1994

Sector	Total Loans (Sbn)	Int. Rate (av. %) Jan 1994	Annual Interest Bill Sbn			
			1994	If 1% rise	If 0.03% rise	If 0.35% rise
Housing	123	8.75	10.76	12.00	10.80	11.19
Government	44	9	3.96	4.40	4.09	4.11
Bank personal credit cards	5	14.5	0.73	0.78	0.73	0.74
Total overdrafts (personal & commercial)	14	9.25	1.30	1.44	1.30	1.34
Total fixed loans (personal & commercial)	66	13	8.58	9.24	8.60	8.81
Other loans (personal & commercial)	105	9	9.45	10.5	9.48	9.82
Total Loans	357,682		34.78	38.36	35.00	36.01

Source: Reserve Bank of Australia (1994) *Reserve Bank Bulletin*, Tables B3, D2 & D3

These are simply examples of the concrete costs of one large company's foreign borrowings in one year. The actual costs passed on will be the accumulated combination of all such private foreign borrowings. For example, in 1993-94 total private foreign debt was \$111 billion (ABS: 5306.0). If we once again use the average ratio of capital income receivable to income payable of 22%, then net debt to be serviced will be in the order of \$86 billion, or a net foreign currency servicing burden of \$7.36 billion at an average interest rate of 8.5%. In turn, \$7.36 billion is 1.82% of GDP. By the above argument, this would press interest rates up 0.35% (1.82×0.19). Total private foreign debt could thus be seen to:

- add \$286.92 per year to a home loan repayment of \$100,000 over 25 years, by raising the 1994 housing rate from 8.75% to 9.10%, and
- add \$102.60 per year to the repayments on a small business overdraft of \$50,000 over 5 years, by raising the 1994 overdraft rate from 9.25% to 9.60%. (rates: ABS 1350.0)

This aggregate effect is shown in the far right hand column of Table 2. The net private foreign currency debt servicing burden of \$7.36 billion per year, often said to be a burden only for the shareholders of the companies concerned, can be seen to lever up interest rates and impose a broader public cost of \$1.23 billion, through increased interest repayments on domestic loans.

These are tentative calculations, including some rough approximations, which are designed to illustrate one fundamental point: that the ordinary process of servicing private foreign debt imposes a clear and quantifiable public cost, through the current account, by leverage on domestic interest rates.

Such a rise in interest rates will also, of course, impose the wider costs of investment foregone and employment opportunities missed, as well as businesses closing through their inability to afford re-finance.

Towards a Full Accounting

There are other areas where we might seek to identify the socialised costs of ordinary private financial transactions. The impact of foreign and domestic borrowing on the exchange rate, tax scales and wages policy might usefully be investigated. The estimates in this paper relate only to the concrete costs of private financial activity on interest rates, conveyed through the current account deficit. Large scale corporate borrowings are seen to be mainly responsible for the net drains, through the institution of the current account, which in turn impose clear and measurable costs for domestic borrowers. These effects occur because of the pressure on the non-discretionary elements of interest rate policy - the need to sustain the currency and draw in foreign capital. Detailing these costs and proper accounting models to quantify them may provide the basis for a greater public accountability of private capital.

What means are available to deal with this problem? Fred Gruen says the risk to the public economy, flowing from current account problems, suggests the need for macroeconomic intervention (Gruen 1995). However, it is not clear exactly what contribution stabilisation policies or

fiscal adjustments may make. A focus of political debate in recent years has been savings policy, which attempts to obviate the need for overseas borrowings, by encouraging the development of a domestic pool of capital for investment. A federal government report on this issue proposed a national strategy of both public and private savings (Fitzgerald 1993). This issue certainly deserves consideration, but it tends to be linked to the strongly promoted demand for the removal of income tax on savings. This would mean that those who earn income from their labour should pay income tax, but those who earn income from savings deposits should not. There are obvious and serious equity problems with this demand. A second problem with any savings strategy is that it does not directly address the costs discussed in this paper.

Another possibility is for a tax on large foreign borrowings, to cover the immediate cost of impacts on the current account deficit. However, this would not address the issues of a wider cost-benefit accounting. It is also not clear how such a tax would compensate those domestic borrowers affected by higher rates, unless the tax was used to support other subsidised rates.

In looking at the broader problem of the public cost of private financial activity, John Quiggin has suggested we have a choice between a full deregulation of the financial sector, in which the public guarantee of bank deposits is removed, and an extension of "sufficient controls to make prudential regulation viable". A major problem with our current "partial financial deregulation" is that the government guarantee cannot be applied to depositors but not also to bondholders and shareholders (Quiggin 1992). That is, a form of public insurance designed to protect the savings of small depositors has the perhaps unintended but inevitable effect of also protecting and enhancing the profits of bank owners. Further, there is no way to stop the government guarantee from extending to the private subsidiaries of the registered banks. Quiggin's first option would appear the more reasonable: to extend the prudential regulation of banking and foreign borrowing, so as to better quarantine the 'contamination' of highly leveraged private risk-taking.

Whatever remedies may be proposed, there must be a recognition of the fact that new dilemmas are being posed for public economies by the

massive scale of today's private financial activity. New forms of public accountability must be devised to meet this challenge.

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