Resolving the RBA dilemma: Save the economy not banks!

The Reserve Bank of Australia is in a bind. It is desperate to protect the big banks by preventing a collapse of the Australian housing bubble, but has only limited means at its disposal. With interest rates at a record low of 1 per cent there is little in the way of monetarist policy space left to manoeuvre. Head honcho Philip Lowe has therefore called on the government to contribute to the task at hand using fiscal policy.

In addition to lower rates, the RBA is talking quantitative easing (QE)—creating money to buy assets from banks, thus injecting money into the system—while prominent bankers and economists have called for extreme QE measures including government cash handouts to households, a.k.a. helicopter money.

In a 20 June Adelaide speech, Lowe suggested the government spend money on infrastructure, to help stimulate credit flow. In a Darwin speech on 2 July following the second rate cut in two months, Lowe foreshadowed a further cut, but called for all of the "various arms of public policy" to be pointed in the same direction—at stimulating the economy. Monetary policy alone cannot achieve the task ahead, he said. Fiscal support, including through infrastructure spending, would be appropriate, he restated, along with structural polices to aid business expansion.

Treasurer Josh Frydenberg responds to the RBA call for fiscal stimulus.

Treasurer Josh Frydenberg on 9 July, however, declined to jeopardise the government's budget surplus with extra spending, saying the government was already stimulating the economy with its tax cuts—part of the suite of fiscal policies at its disposal. This is teamed with interest rate cuts and a loosening of bank lending standards, he said, choosing to emphasise Lowe's reference to structural reforms such as industrial relations reform instead of increased government spending. The government's measures encompass Assistant Treasurer Michael Sukkar's strategy to bring regulators ASIC and APRA and the banks together to get more credit flowing to home buyers, and state government action to streamline construction approvals, to boost the bubble.

The RBA has taken its script from the central bank of central banks, the Bank for International Settlements (BIS). Its 2019 Annual Economic Report stated that "there are diminishing returns and costs in relying too much on monetary policy. Such an overburdening can contribute to the reemergence of financial vulnerabilities and reduce the room for policy manoeuvre. It becomes natural to ask where the limits to this approach are. Ostensibly, monetary policy cannot be the engine of higher sustainable economic growth." BIS general manager Agustín Carstens warned that further loosening in countries with ultra low rates would have little impact: "I mean how much more stimulus will you get if interest rates are reduced in the margin another 25 basis points? It is difficult to see how that will generate a lot of bang for the buck", reported the 30 June London *Telegraph*.

The BIS report concluded that "targeted fiscal expansions may usefully support the economy if the need arises", particularly with well chosen infrastructure investments and fiscal measures of a structural nature.

A capital budget

Infrastructure is an urgent necessity for Australia and a crucial way to unleash economic growth to benefit all, but it is not a means to prop up a collapsing financial system. The CEC's proposal for a national credit bank is the best way to initiate a large-scale development program with the scale and urgency of a war mobilisation. Another worthy proposal is the use of a "capital budget", as suggested on 4 July by former Liberal opposition leader and economist Dr John Hewson. Hewson denounced the idea that "all debt is bad", stating that for the government the "budget surplus has become an end in itself, rather than a deficit being a means to an end". If productively employed, debt can be very beneficial. Hewson suggested the government issue an Australian Infrastructure Bond to underwrite "an infrastructure revolution", which would be very attractive to central banks, sovereign wealth funds, pensions and super funds, etc. The debt accrued would not be counted in the regular operating budget, but function as a separate capital budget.

In the 2017-18 budget even then-Treasurer Scott Morrison distinguished between “good” and “bad” debt, suggesting productive investment be thought about “in a different way to recurrent spending”. He said, “It can be very wise for Governments to borrow, especially while rates are low, to lock in longer term financing and invest in major growth-producing infrastructure assets, such as transport or energy infrastructure”.

In 2014, billionaire businessman Frank Lowy proposed “a separate balance sheet for capital projects”. In 2016, former Reserve Bank governor Glenn Stevens called for an increase of spending on “long-lived investment assets that yield an economic return”, the debt for which is held against assets. He said that monetary policy—specifically lowering interest rates—was running out of puff. In April this year, top Treasury and OECD economist Peter Downes and former RBA board member Prof. Warwick McKibbin called for greater capital spending on infrastructure, separate from the regular budget.

The CEC has long advocated the merits of a capital works budget, funded with credit from a government-owned national bank in which the public can invest. “[B]acked by the entire wealth and credit of the whole of Australia”, as original Commonwealth Bank governor Denison Miller put it when the public bank opened its doors in January 1913, such a system is unassailable. A credit system is a leap beyond a capital budget, truly putting the nation’s future in the hands of the nation. Together, bank and budget can unleash a self-perpetuating potential for growth, by generating new jobs and technical capabilities, productivity-improving high technologies, new platforms of infrastructure opening up new economic potentials, expanding industry in all fields and creating new markets, enlarging the economy as a whole.

With the gains of an expanded economy, the long-term credit created by a national bank can easily be repaid over 25-plus years. “The new infrastructure acts like healthy arteries facilitating growth of the productive economy, massively increasing economic output of real physical goods. Real wealth”, as CEC leader Craig Isherwood explained in March 2016.

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