AUSTRALIA'S DEBT:

AN HONEST DEBATE

DICK SMITH FAIR GO

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Dear Reader

Before the 1996 election, John Howard’s famous debt truck appeared. At that time, Mr Howard said to the nation:

“We now owe the rest of the world $180 billion. Nothing, my friends, symbolises absolutely and comprehensively more than that disgraceful figure the total failure of Labor’s economic management over the last thirteen years.”
- John Howard

Now, eighteen years later, the figure has gone up 5.5 times to roughly a trillion dollars and no one appears to be complaining.

Before the 2013 election, Mr Howard’s protégé, Tony Abbott, made the then Labor government’s “debt and deficit disaster” the centrepiece of his campaign – after all, by the time they lost the election in November 2007, Labor had racked up $212 billion dollars, blowing the national debt out to $270 billion.

In those days, Scott Morrison told parliament that the borrowing of $100 million a day was something that “outraged” his constituents.

Fast forward to 2016 and Australia’s federal government debt has exceeded $500 billion (more than double the debt Labor added during the Global Financial Crisis, but much quicker), and we find Mr Morrison, now treasurer, borrowing almost 40% more. But now he argues that “… we are raising the gross debt to build airports, to build railways, to build infrastructure, to build submarines”.

Well, that sounds OK doesn’t it? But what happened to the claims of the failures of economic management and debt and deficit disasters?

Did something change? Or is this just the way our politicians talk as they act on the national stage?

I, like many others, want to know if the debt situation is a real problem or not.

What are the different kinds of debt? Which ones matter and why? What is Australia’s real situation, what do we need to do about it, and how does all this relate to what we’re told by our political leaders? How does the federal government’s mass immigration program affect Australia’s debt levels?

I hope this report sheds some light on a complex matter for the typical Australian, and helps us all see through the spin.

Regards

DICK SMITH

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THE NATIONAL DEBT

Around $170,000 for every individual man, woman, and child in Australia

The most important thing to say initially is that the 'national debt' shouldn't be confused with the 'government debt'.

The national debt is the total debt in the Australian economy – everything that Australian individuals, businesses *and* governments have borrowed combined.

It includes your own private credit card debt, home loans, the loan that the café down the road borrowed from the bank to buy a new coffee machine, the money that the government borrowed to build a new highway and the money Rio Tinto borrows to build their mining infrastructure.

It is money that is owed by Australians to other Australians, as well as by Australians to foreigners.

As at 30 June 2017, Australia's national debt was: $4,203,208,000,000[1]. That's four trillion, two hundred and three billion, two hundred and eight million dollars. That's about $170,000 for each of the 24.7 million men, women and children in Australia or around $692,000 for each of the 6.07 million family units.

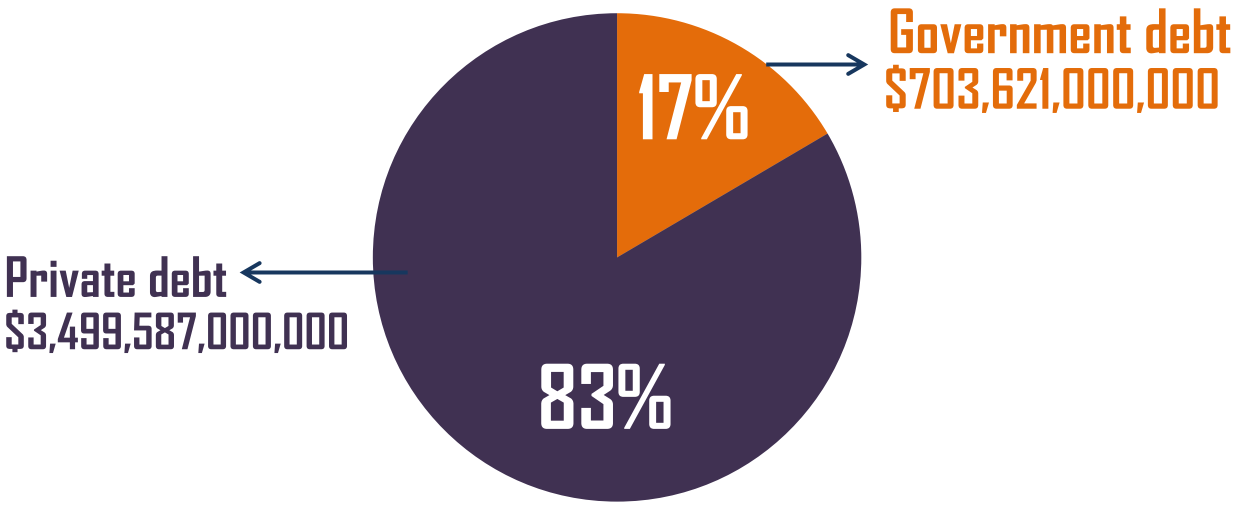
Sounds scary, right? But the truth is that most experts say this figure doesn't really mean very much and is not particularly useful for anything.

That's because the different components that make up this mountain of debt are all quite varied and different rules apply to each component when it comes to working out whether the debt matters or not.

So let's have a look at each part separately.

1. Bank for International Settlements - credit to non-financial sector from all sectors at market value. BIS has total general government debt at $703.621 billion and non-financial sector debt at $3,499.587 billion.

Proportion of the National Debt Owed by the Public and Private Sectors Respectively



THE FOREIGN DEBT

First up, let’s look at the foreign debt, considering Mr Howard thought it was so important back in the 90s.

The nation's net foreign debt is all the money Australian businesses and governments (and any other Aussies) owe to foreigners, less what they owe us.

Of the national debt from the previous page, we owe just under net $1 trillion dollars’ worth to foreigners.

It’s about 24% of the total – or about $40,000 per head for each Australian.

The rest, we owe to fellow Australians.

Of the nearly $1 trillion that all of Australia owes to foreigners, just over a quarter of it is owed by government.

It’s the foreign component of the whole national debt that John Howard’s 1995 “debt truck” referred to – not just the government’s share of the foreign debt, but what the country as a whole – governments, individuals and corporations – had borrowed from foreigners. “$10,000 for every man, woman and child” was the Howard slogan.

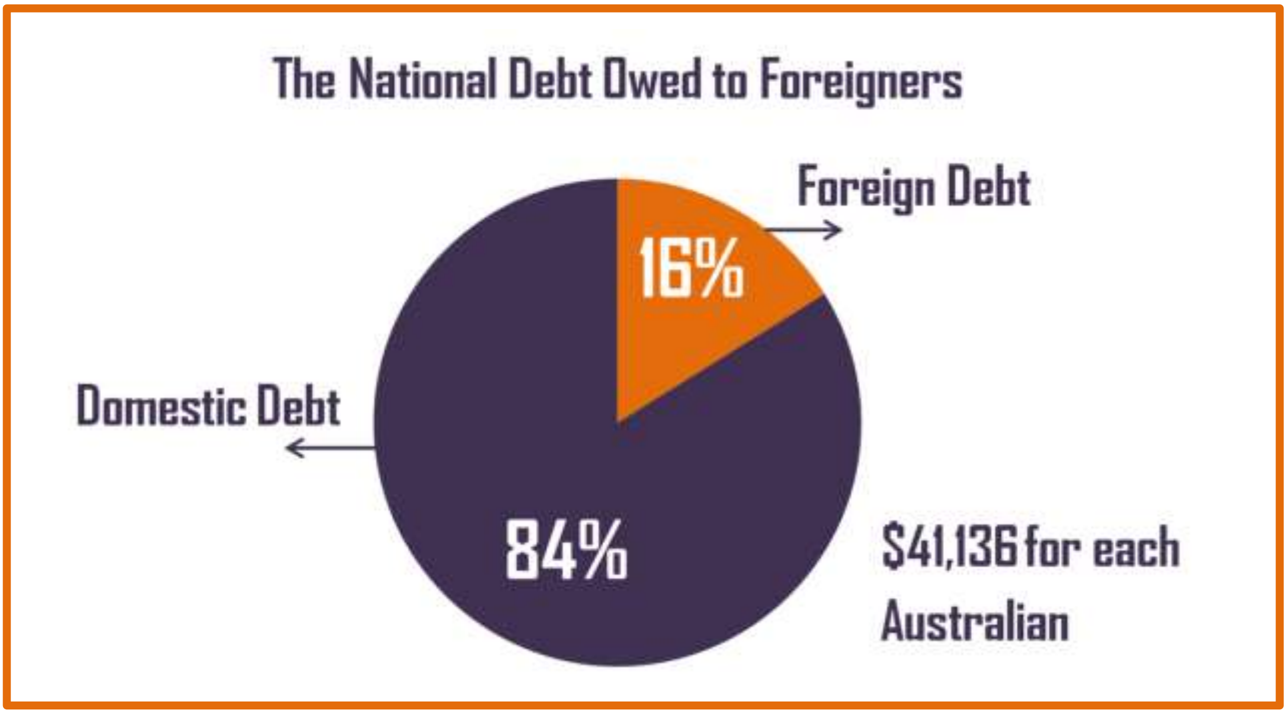
As the economy grows over time and inflation occurs, you don’t get a good idea of how the foreign debt situation is tracking by simply looking at what it is now compared to 1995.

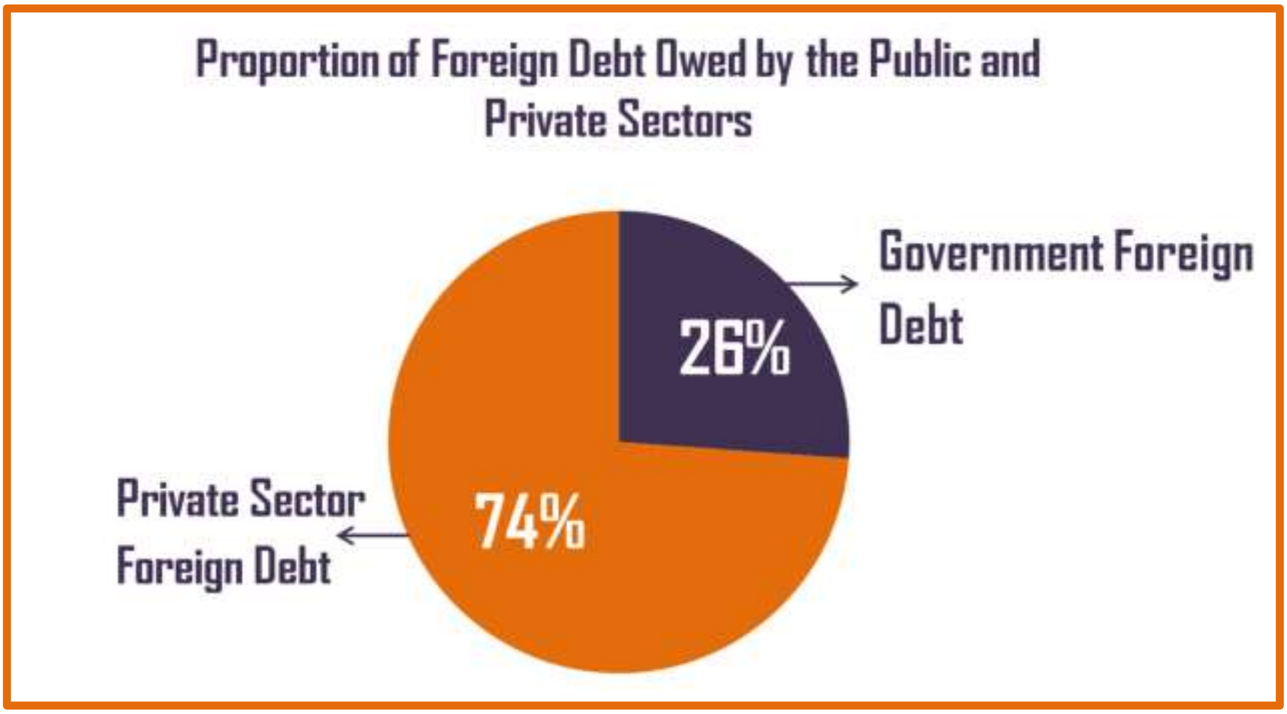
The important measure, is the size of the debt relative to the size of the economy. It would be possible for a much bigger number to actually be far less significant relative to the size of the economy, if the economy has grown considerably in the meantime. A bigger economy has a greater capacity to service and repay any debt. This is one of the reasons why politicians always want to ‘go for growth’ – they can reduce the debt burden without having to offend voters with harsh cuts or higher taxes.[2]

2. But they fail to mention that ‘growth’ via increasing the population also raises debt through all of the extra borrowings to fund infrastructure and housing, as well as all the extra imports.

Unfortunately, in Australia's case neither of these considerations make Australia's situation look any better – when Mr Howard rolled out his debt truck, the foreign debt was 37% of GDP. It's now 56% of GDP.

It's worse whichever way you look at it.





Alan Moir, Sydney Morning Herald.

Cartoon by Nicholson from "The Australian" newspaper: www.nicholsoncartoons.com.au

So how did we rack up so much foreign debt?

In Australia, we usually buy more goods from other countries (electronics, cars etc.) than we sell to them (food, minerals etc.). This gives us what we call a 'trade deficit'.

The difference between the value of what we buy and sell in the global market has to be paid for by borrowing from foreigners.

We've been running trade deficits for a long time now and that's how we've racked up all the foreign debt.

Of course, when we borrow from foreigners, we have to pay interest on that debt. When foreigners own stakes in Australian businesses, the dividends they receive go overseas too.

Does Australia's foreign debt matter?

You wouldn't think so by listening to our politicians today.

If the situation was so serious in 1996 that it showed "… *total failure of Labor's economic management over the last thirteen years*", why isn't the fact that debt has increased so much in real terms not even mentioned now?

The Sydney Morning Herald's economic editor, Ross Gittins, has a theory: *"Short answer: the politicians don't want to talk about our 'external sector' because it sounds bad. The economists don't want to talk about it because they know it isn't bad."*

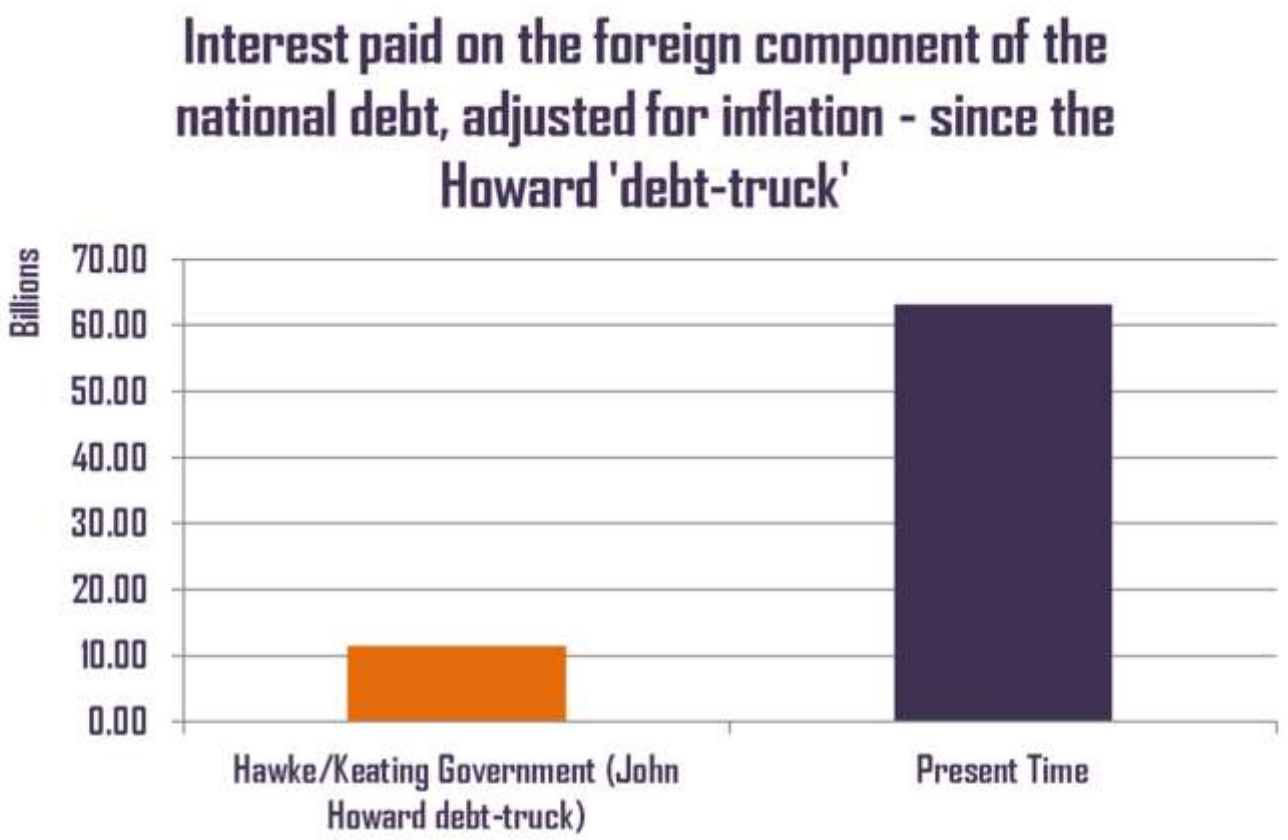
Very high foreign debt is generally believed to be harmful for the economy.

According to the International Monetary Fund (IMF) and the World Bank, *"a sustainable debt is the level of debt which allows a debtor country to meet its current and future debt service obligations in full, without recourse to further debt relief or rescheduling, avoiding accumulation of arrears, while allowing an acceptable level of economic growth".*

According to these two institutions, foreign debt of about 150% of a country's exports or 250% of its GDP is about the point where it becomes harmful to the economy.

With our foreign debt at about 60% of GDP, Australia would seem to be in the safe zone by that measure. Further, the debt is not currently growing faster than our GDP is growing, so on that basis it is claimed we should face no difficulty affording the interest payments.

It is not that simple. As I will explain later, while some of the foreign debt represents borrowing that is productively invested in helping us to develop our economy faster than we otherwise could, a very large part of it is borrowed by Australia's banking sector to fuel Australia's non-productive housing bubble, which creates its own unique set of risks for Australia.



THE GOVERNMENT DEBT

Government debt has been on the rise since the Global Financial Crisis in 2008, when the Rudd Government decided to borrow a great deal in order to pay for the economic stimulus package.

The plan was to keep Australia out of recession.

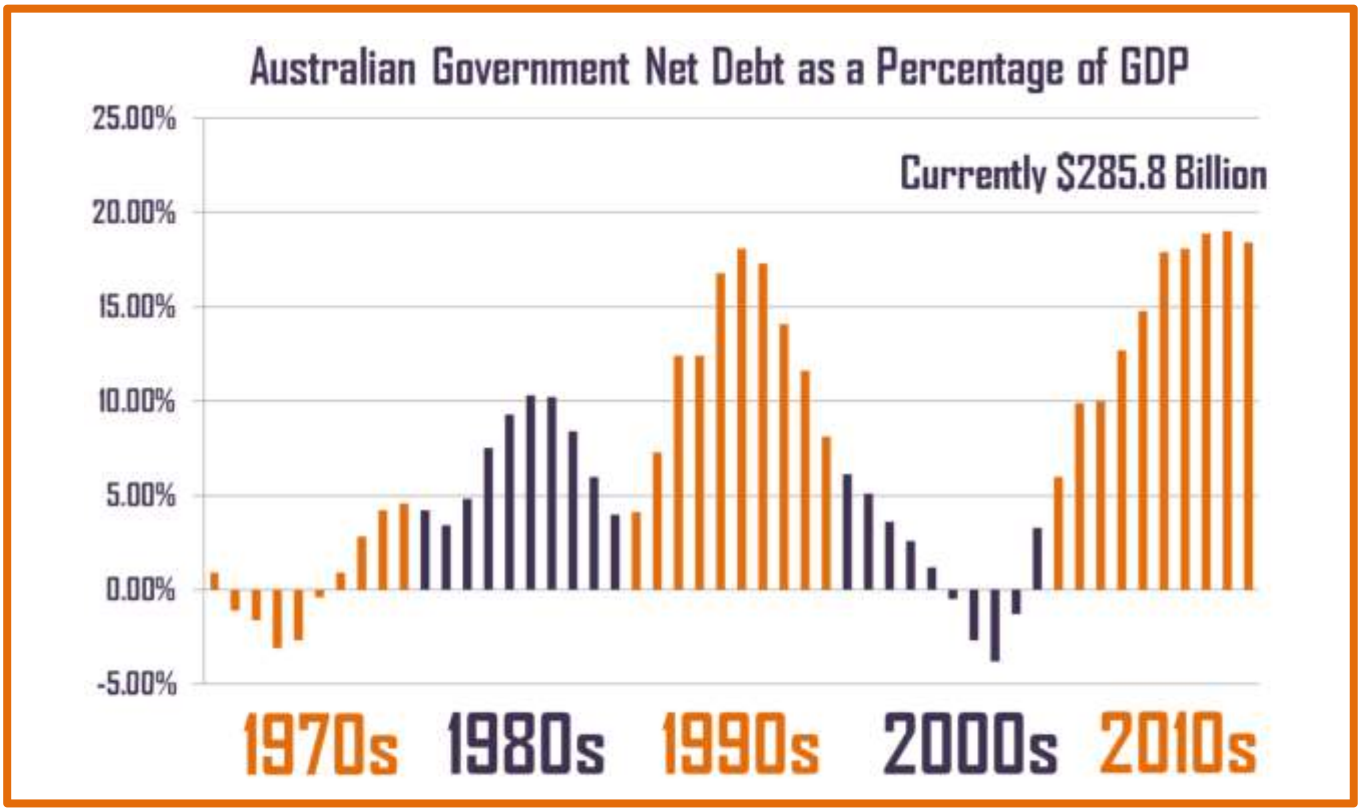
When government debt exists, we have to pay interest on that debt. This requires taking money away from other important government expenditure.

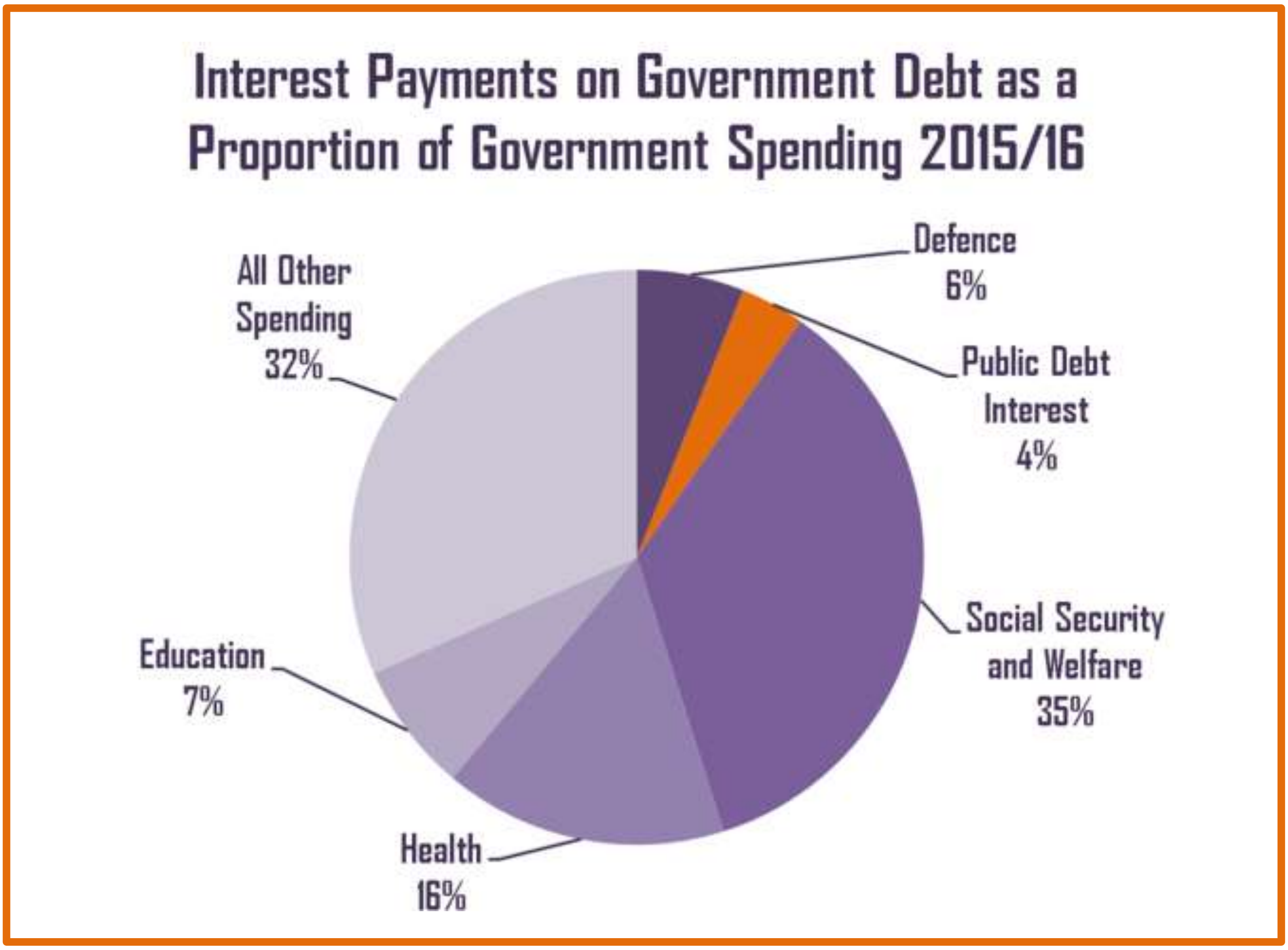
In 2015/16, out of a total budget spend of about $434.47 billion, we spent $15.6 billion on interest – about half of what we spend on education in a year.

According to an International Monetary Fund (IMF) report, the point at which government debt becomes unsustainable is when a government is borrowing just to pay interest on the debt.

Realistically, we should be worrying a fair while before that point. The United States is expected to cross that threshold in 2019 when the federal government will borrow $722 billion and its net interest expense will also be $722 billion.

Fortunately, Australia's government debt is nowhere near that point.


Australian Government Net Debt as a Percentage of GDP
Currently $285.8 Billion
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
-5.00%
1970s
1980s
1990s
2000s
2010s


Interest Payments on Government Debt as a Proportion of Government Spending 2015/16
Defence 6%
Public Debt Interest 4%
Social Security and Welfare 35%
Health 16%
Education 7%
All Other Spending 32%

The deficit

In the same 2015/2016 financial year that the government spent about $434.47 billion, the government only raised an income of $397.98 billion.

This income primarily came from the taxes we paid.

That’s a shortfall of $36.69 billion – or $1,542 per head of every Australian.

We call this the ‘deficit’.

The government has to borrow to make up the difference.

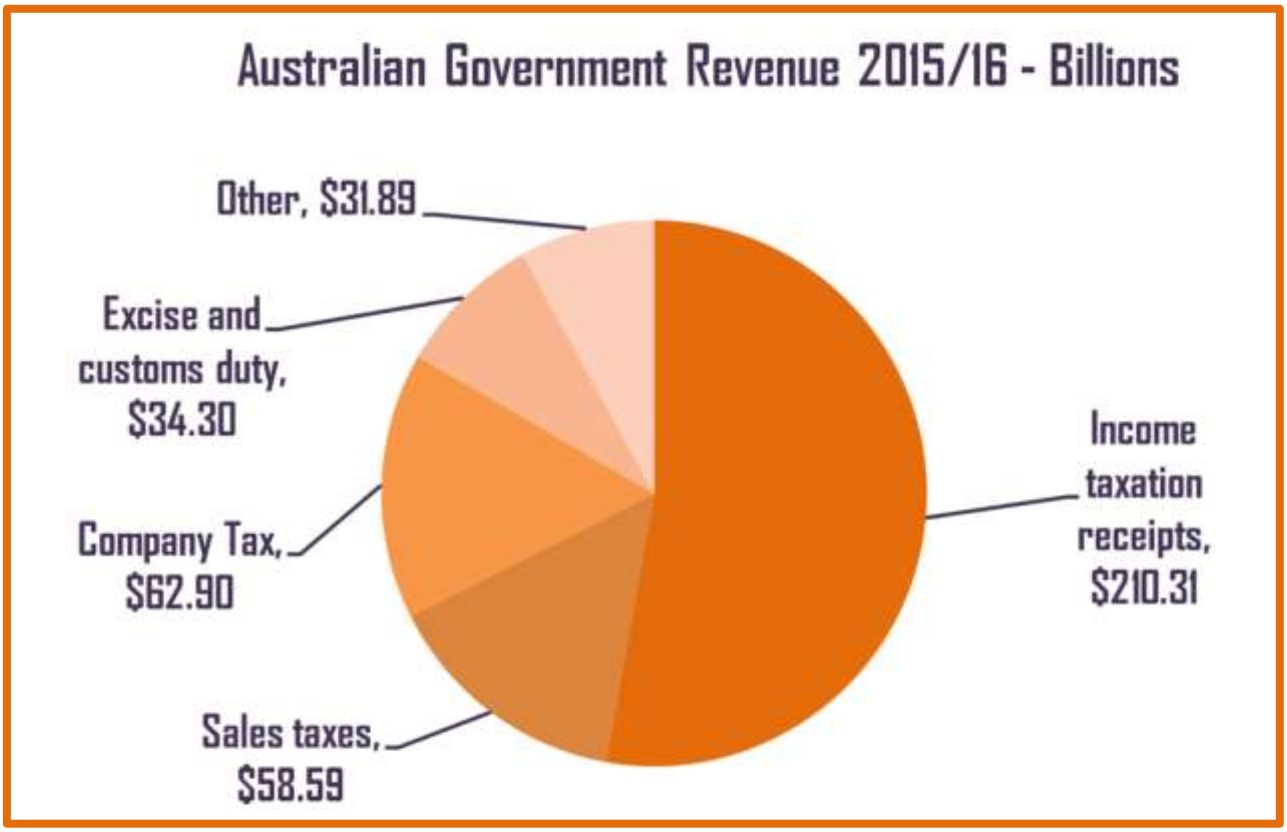
That borrowing, the deficit, is added to the government debt pile each year. This year it has piled up to half a trillion dollars’ worth – that’s over $20,000 per person.

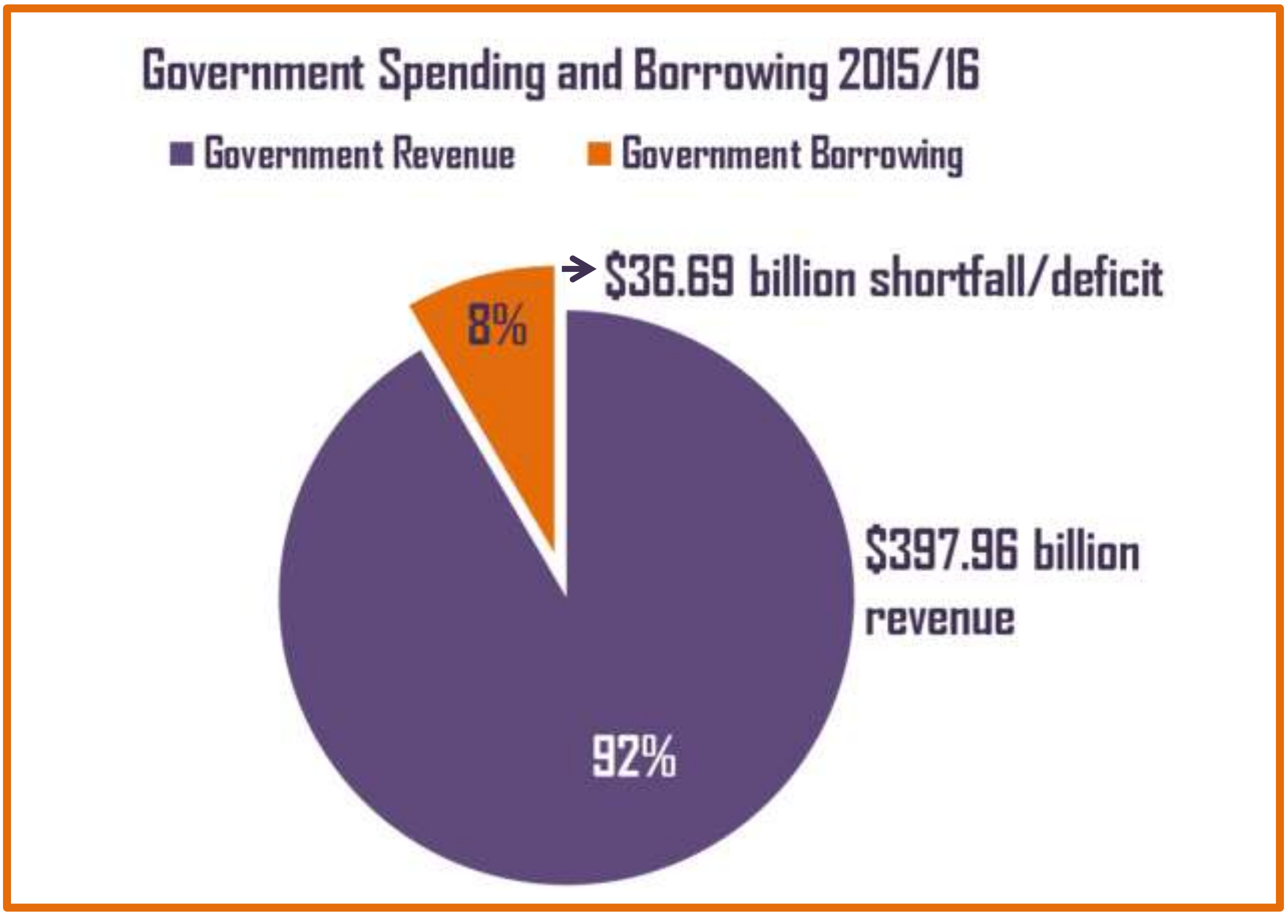
When the government talks about reducing the deficit, they’re just talking about reducing the amount that they have to borrow each year to cover the shortfall in revenue.

Before they can even begin to repay the actual government debt, the budget needs to be in ‘surplus’.

To be in surplus, the government has to raise more money than it spends.

The last time that the federal government’s budget was in surplus was over seven years ago in 2008/2009, before the Global Financial Crisis hit.


Australian Government Revenue 2015/16 - Billions
Other, $31.89
Excise and customs duty, $34.30
Company Tax, $62.90
Sales taxes, $58.59
Income taxation receipts, $210.31


Government Spending and Borrowing 2015/16
Government Revenue
Government Borrowing
$36.69 billion shortfall/deficit
8%
$397.96 billion revenue
92%

Good debt/bad debt: does government debt matter

"…the rising levels of debt actually reveal just how little it matters. When we reached $500bn worth of gross debt no one sitting at home felt a chill go down their spine. No one came home with the sad news that they had lost their job because the government now had half a trillion dollars' worth of debt on its books; no one got a letter from their bank telling them that, due to the government's debt, interest rates were going up. We currently have record levels of debt and yet also record low interest rates. Unemployment has fallen and even full-time employment – that most elusive thing of the past few years – also appears to be growing more solidly. Debt is apparently not the economic evil the conservatives would have had us believe it was."
- Greg Jericho, Sunday 18 June 2017

While there is some truth to Jericho's comments, government debt *can* matter.

Of course, if the debt pile becomes so large that the country is borrowing just to pay the interest, eventually services have to be cut or taxes have to be raised to very high levels, lest the government default or the mountain of debt compounds to such an extent that interest payments alone absorb all the government can raise.

However, whether or not a debt is bad news for the economy depends what the borrowed money is being used for.

If debt is used to fund productive ventures that save costs over time, like a bridge or a highway, then a higher level of debt can be acceptable and obeys the 'golden rule' of public finance: *"over the economic cycle, the government should borrow only to invest and not to fund current spending."*[3]

3. www.publicfinance.co.uk/2005/09/labour-liabilities-george-osborne

‘Current’, ‘recurrent’, or ‘structural’ spending are all terms that refer to the kinds of things that the government has to fund over and over again every year and doesn’t get a return on directly, such as welfare payments and the pension.

To borrow to help pay for ‘recurrent’ spending places an extra burden on the future incomes of the country, without providing any extra assets or future income to help pay for it.

If we pass on debt that has paid for a bridge, it is acceptable that future generations who will benefit from its use contribute to its cost.

Passing on debt that we have used for recurrent spending today is tantamount to stealing from our children and grandchildren, as they will eventually have to cop higher taxes or reduced services to pay off the debt.

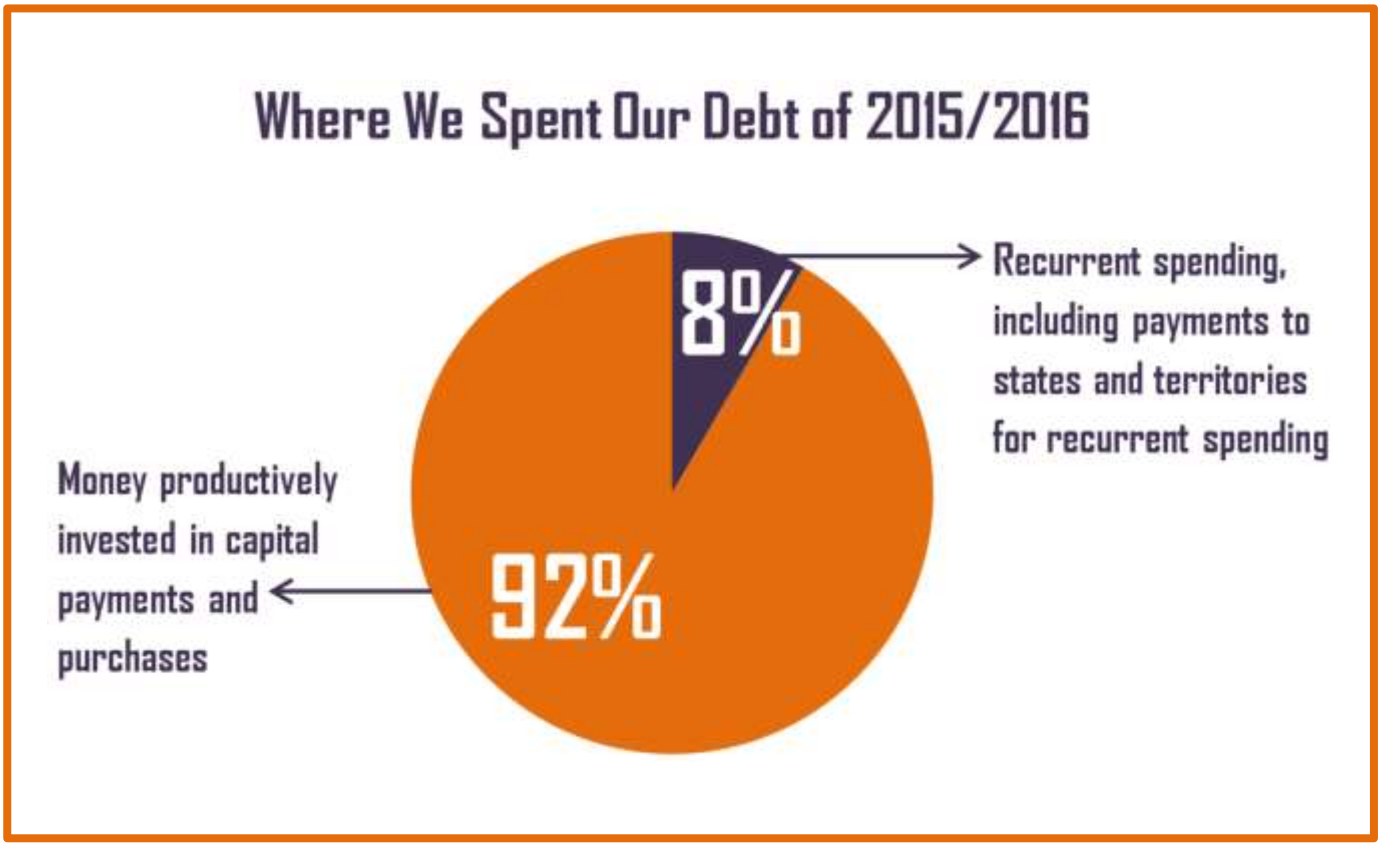
To illustrate, imagine you’re a farmer and you’ve decided to borrow $30,000 to purchase a machine that will improve the productivity of the farm for the next 20 years. With an astute farmer, the cost of the machine and the interest would be repaid by the extra income received, with some spare to improve overall wellbeing. This is considered sensible borrowing.

Now imagine if you’re the same farmer and you decide to borrow the same amount of money so you can take your family on a luxury holiday around the world. It’s obvious that this is a completely different form of borrowing and that’s what we have to consider as a country.

Since the GFC in 2008, the Australian Government has racked up $129 billion worth of debt (more than $5000 per head) that has been used to pay for recurrent spending – that is clearly bad government debt.

The government's first priority should therefore be to raise enough extra revenue or cut spending to the value of around $36.69 billion to avoid further deficits.

It then needs to raise revenue or cut spending further to begin paying down the $129 billion worth of unproductive debt.



PRIVATE DEBT

Australia's government debt does need to be reduced, however it appears to be far from the danger zone and far less than many other developed countries.

Australia's bigger problem is private debt.

The theory goes that when the private sector takes on debt, there's nothing to worry about because, motivated by the profit incentive, the private sector will always make choices that are ultimately productive.

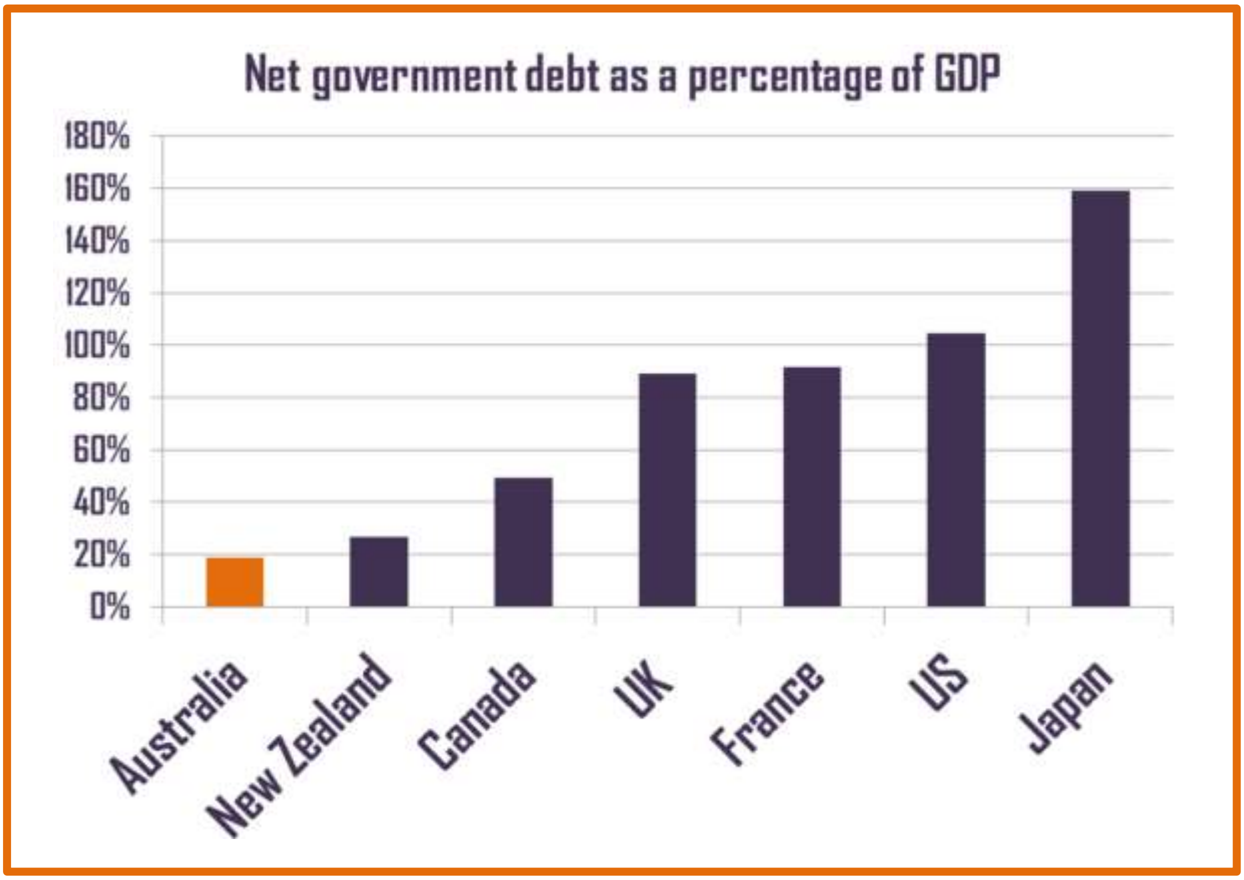
This may be true in the case of big operators like the mining industry; they borrow billions and the profits that result from all this borrowing more than takes care of the debt burden.

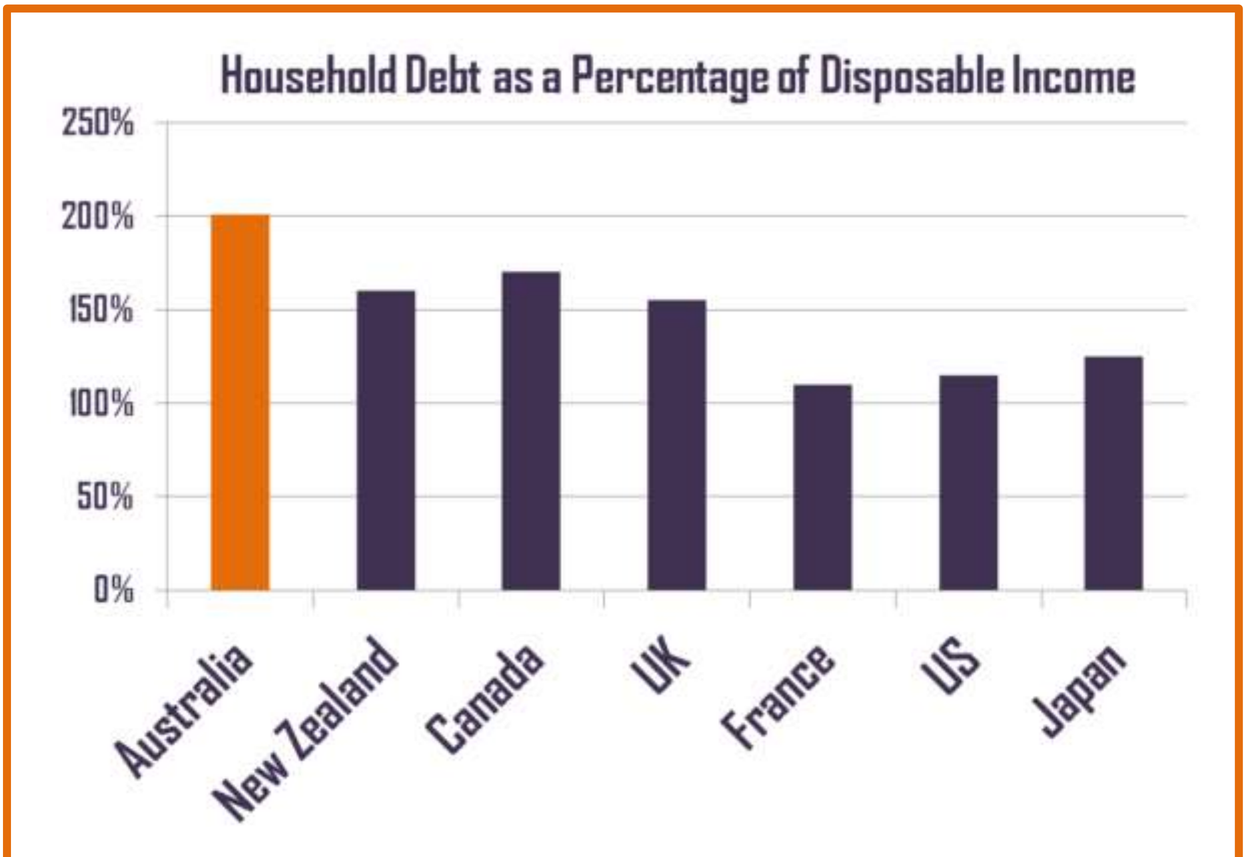
But that isn't always the case with smaller businesses, investors or especially, individuals.

When it comes to household debt – which includes people's mortgages, credit cards, overdraft and personal loans – Australian households are the second most indebted in the world (after Switzerland) when measured against the size of the economy or Gross Domestic Product (GDP).

In 1990, overall household debt accounted for about 70% of household disposable income. The Reserve Bank's data on household debt shows that it has since risen to 200% of annual household disposable income in 2017. This ratio is the highest it has ever been since the commencement of official data (dating back to 1988) and almost 50% higher than it was in the US ahead of the sub-prime mortgage crash of 2008 that caused the Global Financial Crisis.

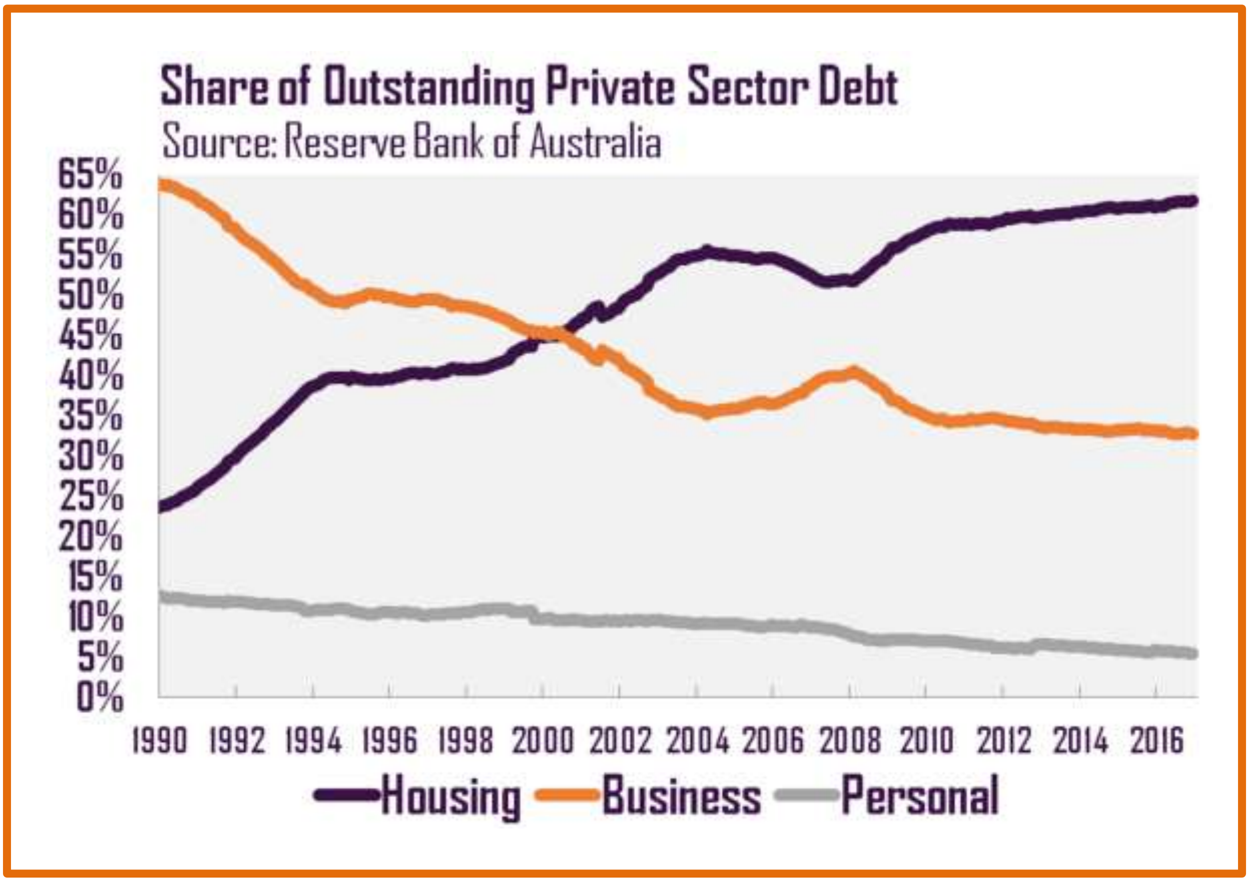
Like America, Australia's private debt levels are mostly because of home loans. Ever since the stock market collapse in 1987, when many business got into financial difficulties, Australian banks have shifted their focus to lending to invest in property and pumped money into home loans.


Net government debt as a percentage of GDP
180%
160%
140%
120%
100%
80%
60%
40%
20%
0%
Australia
New Zealand
Canada
UK
France
US
Japan


Household Debt as a Percentage of Disposable Income
250%
200%
150%
100%
50%
0%
Australia
New Zealand
Canada
UK
France
US
Japan

This was turbocharged after the Global Financial Crisis when interest rates were driven to historical lows in an attempt to spur 'economic growth' by making it very cheap for people to borrow to invest.

In fact, the share of total lending going to housing has increased from roughly 25% in 1990 to more than 60% currently, which has come at the expense of productive business lending.

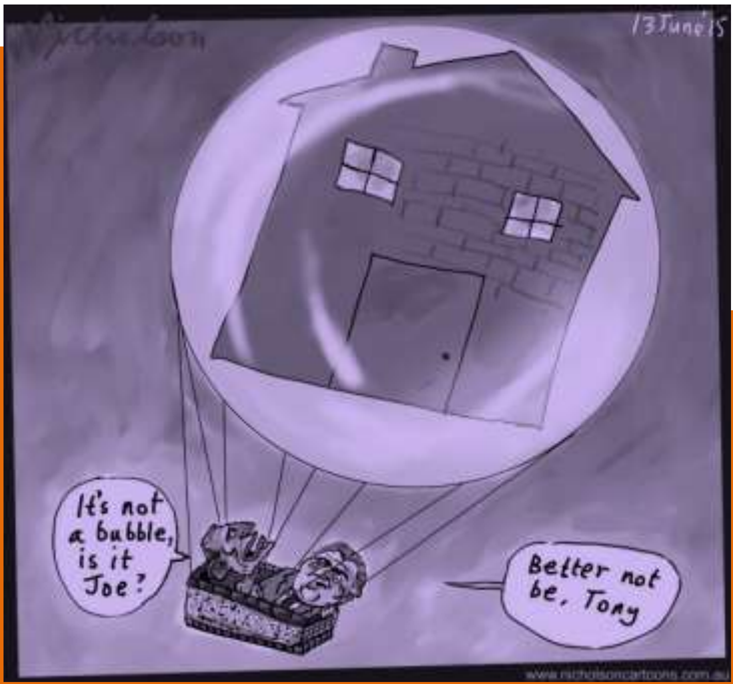


The more money the banks pumped in, the higher real estate prices rose to meet the increased spending power of buyers. The higher the prices, the more that was needed in loans. This is a business model that some would call a type of Ponzi scheme – which is illegal in Australia.

Aided and abetted by negative gearing and the discount on the capital gains tax, it was very profitable for all involved – for more information about this see our other publication: *'The Aussie Housing Affordability Crisis: An Honest Debate'*.

As a result, we now have some of the most inflated house prices in the world and Australian home loan borrowers are among the world's most indebted, with an eye watering $1.7 trillion owing on their houses.

There are three big hidden threats to our whole economy lurking behind all this:



Cartoon by Nicholson from "The Australian" newspaper: www.nicholsoncartoons.com.au

Cartoon by Nicholson from "The Australian" newspaper: www.nicholsoncartoons.com.au

Unproductive debt, offshore borrowings and interest rates

Substantial amounts of the money that Australians are borrowing from our big banks to buy these houses were originally borrowed by the big banks from overseas, which contributes to our national debt.

Selling the same house half a dozen times produces very little in terms of expanding the economy, or creating any new jobs. More than 90% of this lending for property investment was for existing houses, not even to build new ones that would help boost supply.

Borrowing money from overseas and investing in unproductive assets that don't help us to pay it back, like housing, sounds like a recipe to damage the economy to me.

That is one reason why politicians are being disingenuous when they crow about the government debt, but ignore the level of household debt, which would appear to be a far bigger threat to our economy.

The reality is that Australia's government debt and private (mainly housing) debt are inter-related.

Most of Australia's $1 trillion dollars in net foreign debt has been borrowed through the banking system and used to increase home lending.

As at June 2017, the banking sector had borrowed some $850 billion from offshore, equating to 49% of Australia's GDP.

Australia's banks would never have experienced anywhere near the same degree of asset (loan) growth without this tapping of offshore funding markets. Accordingly, the total value of Australian home loan debt would never have grown so strongly and Australian house prices would be materially lower as a result.

Australia's banking system is also now so large that it is considered 'too-big-to-fail' by the ratings agencies, which means that the federal government (read taxpayers) would be required to bail the banks out in the event that there was a banking crisis. Accordingly, the major banks' credit ratings are now inextricably linked to Australia's sovereign AAA credit-rating.

The higher the rating, the safer bet you're seen to be by lenders who will be willing to extend larger amounts at a cheaper rate of interest.

The key risk is that the banking system's ability to continue borrowing from offshore rests with foreigners' willingness to continue extending credit to them. This willingness will be tested in the event that Australia's AAA sovereign credit rating is downgraded (automatically downgrading the banks' credit ratings), if there is another global shock, or a sharp deterioration in the Australian economy (raising Australia's riskiness as a borrower).

While Australia's government debt is currently low, the Federal Budget is hostage to the banks' offshore borrowing excess as it cannot borrow to spend on infrastructure or other initiatives for fear that Australia will lose its AAA credit rating, automatically downgrading the banks' credit ratings and causing an unravelling of the private debt bubble created by the banks.

Indeed, credit ratings agency, Moody's, last year noted that *"A key issue for the Australian sovereign and the country's banking sector is their reliance on overseas funding… This means a relatively greater vulnerability to 'event risk' than most other AAA-rated sovereigns"*.

In a similar vein, the Murray Financial System Inquiry warned that *"Australia's banking system is highly concentrated, with the four major banks using broadly similar business models and having large offshore funding exposures… Australia is susceptible to the dislocation of international funding markets or a sudden change in international sentiment towards Australia, which would reduce access to, and increase the cost of, foreign funding* [and] *a severe disruption via one of these channels would have broad economic and financial consequences for Australia".*

Domestically, the build-up in private debt has been sustainable while interest rates have been at record lows.

However, loans run for 25 to 30 years. Anyone who thinks rates will stay at record lows for that length of time has their head in the sand.

There are plenty of people who've bought into the frenzy, borrowed to the hilt, and given themselves little room to move in the event of a rise in interest rates.

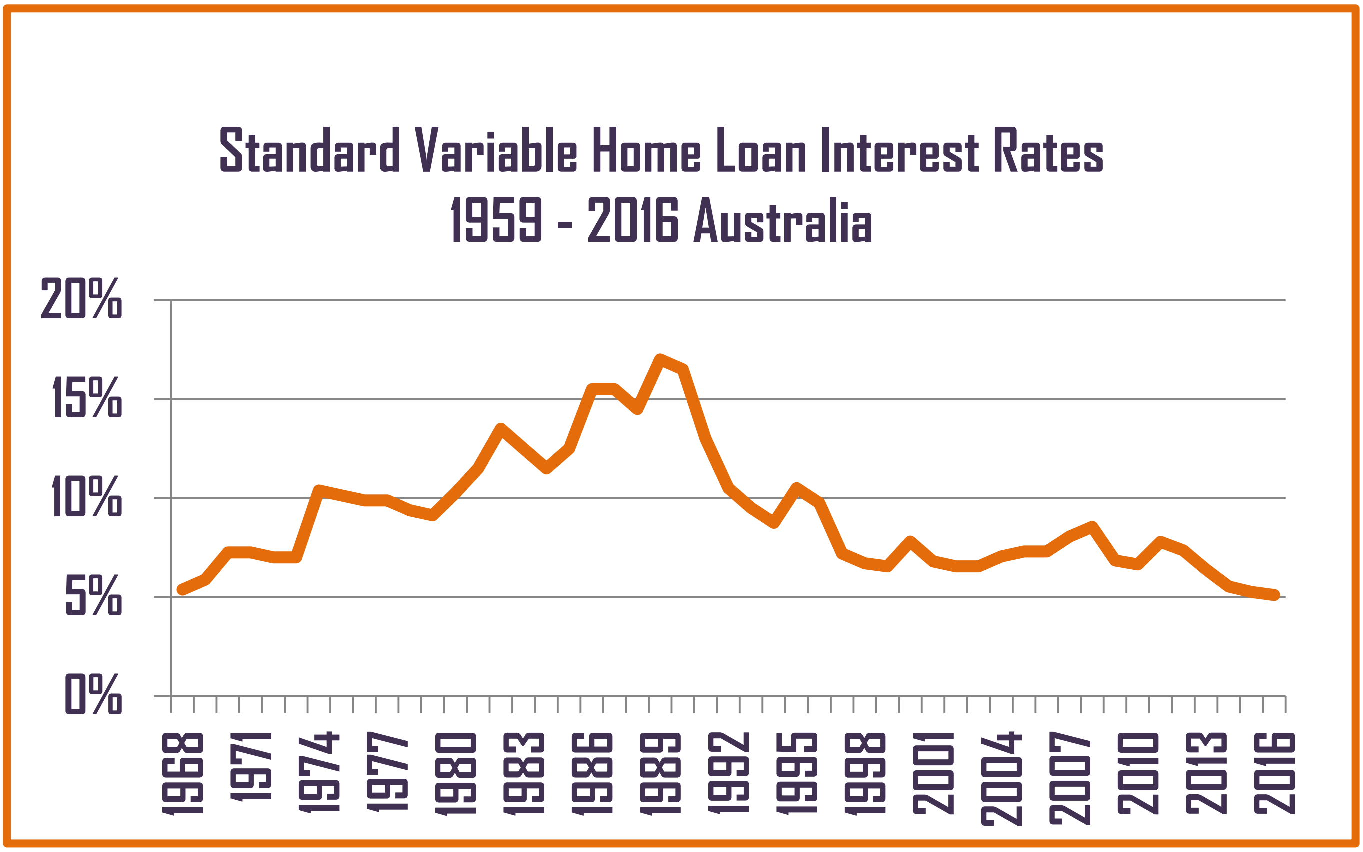
In the 1990s when mortgage interest rates peaked at 17%, lots of typical Australians lost everything[4]. It could happen again, and interest rates don't need to go anywhere near as high to start causing financial strife.

Work by the Grattan Institute shows that if interest rates went up just 2 percentage points, stress levels would be the highest on record but for that 1990s 17% squeeze.

If this were to happen while wages growth remains as flat as it's been, borrowers might not be able to afford their loan repayments. When this happens en-mass it puts our banks in dire straits.

Higher loan costs would lead to less spending, which would affect employment rates, hit the government's budget, and plunge us into a recession.

4. In fact, some of my friends, like Queensland developer Keith Williams, were forced to pay interest rates as high as 26%.


Standard Variable Home Loan Interest Rates
1959 - 2016 Australia
20%
15%
10%
5%
0%
1968
1971
1974
1977
1980
1983
1986
1989
1992
1995
1998
2001
2004
2007
2010
2013
2016


nab
nab
CommonwealthBank
ANZ

THE LINK BETWEEN POPULATION GROWTH AND DEBT

There is one final aspect of Australia's debt debate that is rarely discussed and not widely understood: the link between the federal government's 200,000 strong 'Big Australia' immigration program and private debt.

The lion's share of Australia's export revenue comes from commodities and from Western Australia and Queensland. But the majority of Australia's imports and indeed private debt flows to our biggest states (and cities), New South Wales (Sydney) and Victoria (Melbourne). Sydney and Melbourne also happen to be the key magnets for migrants.

Increasing the number of people via mass immigration does not materially boost Australia's exports but does significantly increase imports (think flat screen TVs, imported cars, etc.). These imports must be paid for – either by accumulating foreign debt, or by selling-off the nation's assets. We've been doing both.

So, basically, high immigration is affecting the trade balance via more people coming in each year (mostly to Sydney and Melbourne) because of the additional imports purchased, as well as driving Australia's external vulnerability via the build-up of non-productive private debt.

CONCLUSION

So, where does all this leave us?

After the claims propagated by the Howard debt truck of 1996, the country’s debt load is now the highest it has ever been.

When they are in opposition the major political parties are keen to simplify and weaponise the idea of debt in the political battle against their opponents – but when they’re in power there’s suddenly a difference between good debt and bad debt.

While it may be more politically astute to focus on the government debt (because they can more easily blame their opponents for it), it will be better for the country if the Australian people, the voters, are informed that it’s private and household debt that is most likely to cause major problems in the future and that our record high immigration-fuelled population growth is making the problem worse.

To put it simply, we need to live within our means!

Prepared by Dick Smith – 31 January 2018
With assistance from Zann Maxwell and Leith van Onselen.
Special thanks to Peter Nicholson and Alan Moir.

Cartoon by Nicholson from "[The Australian]" newspaper: [www.nicholsoncartoons.com.au]

Cartoon by Nicholson from "[The Australian]" newspaper: [www.nicholsoncartoons.com.au]

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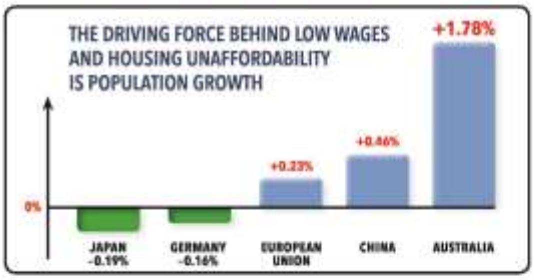
EXPLAINS HOUSING AFFORDABILITY

Housing supply, interest rates, and tax breaks are only part of the story...



The Coalition, Labor, and The Greens are 'Big Australia' allies in a code-of-silence on the prime driver of unaffordable houses ... our extraordinary population growth!

Australia has the highest immigration rate in the Western world. The population pressure-cooker means more demand for the limited supply of land and housing, which pushes up prices.

Big Business loves big population growth because they get more customers, and extra workers competing for jobs keeps wages down. The politicians like it too because big population growth keeps GDP numbers artificially inflated, which makes them look like better economic managers than they really are. But in the meantime the per capita share is going down and urban sprawl, jammed roads and unaffordable housing is destroying our Australian way of life.

If we return our immigration levels to the long term average of 70,000 per annum rather than the 200,000 per annum of the present time, house prices would be more affordable and wages would again improve.

One day we will have to stop endless growth and live in balance. Let's do it now.

THUMBS UP TO THOSE WHO GET IT, AND SPEAK OUT:

• Mark Latham, former Labor leader • **Judith Sloan, *The Australian*** • Tony Abbott, former Liberal Prime Minister • **Kelvin Thomson, former Labor Member for Wills** • Ross Gittins, economics editor, *Sydney Morning Herald* • **William Bourke, Sustainable Australia Party** • Philip Lowe, Governor of the Reserve Bank of Australia • **Pauline Hanson, One Nation** • Bob Carr, former Premier of NSW • **Carrington Clarke, ABC** • Leith van Onselen, *Macrobusiness* • **Rob Burgess, *The New Daily*** • Richard Denniss, The Australia Institute

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Overpopulation will destroy Australia

Every Aussie family has a population plan. They can have up to 20 children but they don't. Instead they have the number they can give a good life to.

Yet our major political parties have no similar plan for our country!

New Zealand has had a change of Government driven by voter concern about the unsustainably high immigration rates that only benefit the wealthy.

Just about every problem we have in the world today is harder to fix with more people. With automation and robotics, there will be less jobs available in the future.

Do we want an Australia where our children and grandchildren will never have a proper full time career? Of course we don't. Or an Australia where they will never be able to afford a house with a backyard – instead living in a world of endless traffic gridlock?

Eight out of ten Australians want a population plan.

VOTERS

Ask your state and federal politicians to come up with a plan – otherwise, tell them you will be voting for the Sustainable Australia Party...or Pauline!

Don't let the wealthy donors to political parties destroy Australia as we know it today.

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