Can this Man Handle the Economy?

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Joe Hockey's shortcomings on economic policy were on show again last week. Why do the media give the Shadow Treasurer such an easy run on economic issues, asks Ian McAuley.

Joe Hockey has the unenviable task of selling the Coalition's economic policy. He has to defend Abbott's contradictory promises to extend welfare payments while cutting taxes, to pretend that we have crippling government debt, and to assert that balancing the budget is the be-all-and-end-all of economic management. It's like the burden of giving a kind reference to a dedicated but not particularly competent employee.

The only thing he has going for him is a media which, either through partisan bias or through laziness, gives the Coalition an easy run on economic issues — an easy run which has almost certainly contributed to the public perception that the Coalition is better placed than Labor to handle Australia's economy.

The Coalition's economic weakness was again revealed on Wednesday when Hockey delivered a speech on the economy to a business forum. Besides the usual promises about cutting spending he said that a Coalition government would be less reliant on fiscal policy (using government spending to boost or to slow demand in the economy) and more reliant on monetary policy (using interest rates to achieve the same ends).

It has been an article of faith among conservative economists that monetary policy is to be preferred over fiscal policy. They don't want governments engaged in direct decisions about spending. Rather, governments should take a back seat and let the "invisible hand" of the financial markets do the job. The only influence the government should exercise is through manipulating interest rates. Low interest rates stimulate business and domestic borrowing, and allow mortgagees to spend more, while high interest rates have a dampening effect.

The shortcoming of that theory is that while it is suitable for an Economics 1 exam question, it doesn't work in the more complex real world. It has long been known that decision-makers are very slow to react to changes in interest rates. It takes time for businesses to make plans for capital expansions, to get approvals and to arrange finance. Similarly, to take a domestic example, there are long time lags for households contemplating renovations.

Had Wayne Swan relied on monetary policy as a reaction to the global financial crisis (rather than going in quickly with cash grants and minor building programs) we would have entered a deep recession, and the monetary stimulus would have come too late. Also, monetary policy is two-edged, for while a lowering of interest rates helps borrowers, it reduces the incomes of lenders, including conservative superannuation investors who have holdings of cash and bonds, and it does nothing to help conservatively managed businesses holding little debt.

In fact, as the recent history of the USA shows, low interest rates were a major cause of the orgy of private borrowing that led to the housing boom and the subsequent financial crisis. The Coalition's focus on Australia's government debt (which is small by any international or historical standard) seems to have taken their eye off our high levels of private debt, particularly household debt. With our interest rates at around their historical levels, Australians are slowly paying down their household debt. Anything to stop this slow repair of our private balance sheets would be irresponsible.

And, as experience over the last few months shows, official interest rates have lost much of their clout. When Australia had a more closed economy, movements in official rates as set by the Reserve Bank were almost immediately reflected in market interest rates, but our financial markets are now much more dependent on global developments. To put it simply, there has been a huge loss of trust in the finance sector, and a consequent reluctance to by lenders to place their money anywhere except in the apparent safety of government bonds. So whatever means governments use to stimulate the money supply, that money comes back to government coffers, doing nothing to stimulate economic activity.

It's a problem in confidence, and in demonstrating that our alternative government is having difficulty in grasping the basics of economic management, Hockey is doing nothing to improve that situation.