The Great Australian Ponzi Scheme, AKA 'Our Economy'

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Our economic reliance on natural resources for profit will, sooner or later, collapse, writes Ian McAuley.

Is the Australian corporate sector operating as a giant Ponzi scheme?

The classic Ponzi scheme is simple. With much hoopla the promoter spruiks some marvellous get-rich-quick idea, promising great returns. When the money has been rolling in for six or 12 months, some of the new contributions are used to pay dividends to the original investors, perhaps even higher than the original promised, thus confirming the promoter's credibility and attracting even more money.

Of course an enterprise cannot keep on paying dividends out of capital contributions, and eventually Ponzi schemes collapse, with tears all around – except for the promoter. But they can go on for a long time: Bernie Madoff kept his running for at least 20 years until the GFC brought him down.

By the letter of the law Australian investors are protected from Ponzi schemes by accounting standards which require a distinction between payouts from capital and from profits.

Telstra's recently-announced payout of $4.7 billion to investors, for example, identifies separate components of capital return and dividends.

Investors like big payouts, particularly capital returns. As rumours about a capital return spread, Telstra shares rose in the days leading to its results announcement.

So too did shares in BHP-Billiton, because there was a strong belief that they too would be returning capital, but they fell just as sharply when the company announced an organizational re-structure instead of a capital return.

Even though there has been little by way of capital returns, the last few weeks have pleased investors, stockbrokers and superannuation fund managers with a strong flow of dividends from Australia's public companies, generally exceeding brokers' expectations. As the profit reporting season runs its course, it is becoming clear that many companies have chosen to pay out high dividends, while keeping aside a smaller proportion of profits for re-investment.

Of course it is quite legal for firms to pay high dividends and to make capital returns, but in many ways the results resemble those of Ponzi schemes. Higher dividends, higher share prices, and capital returns all favour corporate managers, who receive much of their pay in stocks or stock options. It's not dissimilar to the early stages of a Ponzi scheme, where both the promoters and the investors do well.

Diversion of earnings to payouts means less investment in expansion, and, as William Lazonick of the University of Massachusetts Business School points out, that means fewer new jobs and a lesser share of wages in national income.

Note, for example, that our biggest telco is handing $4.7 billion back to shareholders even though our country has slipped a long way behind others in developing high speed Internet.

Last Wednesday Glenn Stephens, Governor of the Reserve Bank, appeared before the House of Representatives Standing Committee on Economics, and in the hearings he said "if reports are to believed, many businesses remain intent on sustaining a flow of dividends and returning capital to shareholders and are somewhat less focussed on implementing plans for growth".

It's a strong statement for a central banker.

The Reserve Bank can entice business with low interest rates, and the pipeline of superannuation contributions ensures there is no shortage of funds, but this corporate reluctance to invest is very much influenced by Government policies, on two counts.

First, it has wound back schemes of previous governments which had been designed to encourage industry adjustment, such as the National Broadband Network.

The most important schemes were carbon pricing and the renewable energy target (RET), both of which gave an incentive for firms in energy-intensive industries to invest in new technologies. But carbon pricing is dead, and there are strong indications that the Government is eager to get rid of the RET – a target legislated by the Howard Government, endorsed by the Rudd-Gillard Government, and used for many years as a basis for investment plans by renewable energy companies.

The problem with scrapping or modifying the RET is not only in terms of threatening the viability of projects already underway and scrapping planned investments (such as the now abandoned $420 million solar farm near Mildura), but also in terms of creating a climate of uncertainty around Australia's environment for investment in new industries.

Miles George, Chair of the Clean Energy Council and Managing Director of Infigen Energy*, a major wind energy company, has pointed out that a small group of "ideological opponents to renewable energy", both within Government and in advisory positions, through raising doubt about the RET, risk damaging Australia's sovereign risk profile.

That risk of capricious policy reversal, with no justification in evidence or reason, puts a dampener on all long-term investment plans, not just in the renewable energy industry.

In such an atmosphere the wisest decision for corporate boards may be to hand their profits back to shareholders to invest elsewhere, or to spend on consumption.

Second, the Government's attempts to frame a budget must be leaving many people wondering if it has any idea about economic management in a democracy.

Few would question the need to reduce the cash deficit, but to do it in the way this Government is proposing is irresponsible madness.

Whatever the motivations of senators, the best thing that could happen to this budget is to see it scrapped. A few compromises here and there won't overcome its basic faults – its failure to raise adequate revenue, its damage to tertiary education, its rewards to rent-seeking, its discouragement of productive investment, and its general unfairness.

Until our government displays some economic competence, we can expect to see a continuation of big payouts to shareholders and corporate executives, at the expense of investment, until one day, as in the real Ponzi schemes, there is nothing left to pay out.

But then, maybe our whole economy is a real Ponzi scheme. For two centuries we have been living off the proceeds of depleting natural resources. Is not that the essence of a Ponzi scheme – paying "dividends" out of capital?

* DECLARATION: Ian McAuley has shares in Infigen Energy through his superannuation scheme.