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Debt phobia 'hobbling chance to borrow and build'

ADAM CREIGHTON

ECONOMICS CORRESPONDENT

THE government's "obsession" with a surplus is causing it to waste an unprecedented opportunity to borrow at cheap rates and build infrastructure, top economists say.

Speaking at a Finsia conference in Sydney yesterday, Justin Fabo, ANZ's senior economist, said there was little good reason why the government should not take advantage of historically low yields on government securities to fill Australia's infrastructure gap.

"If the government can promise the investment is productive then there's nothing wrong with borrowing to invest," Mr Fabo said, suggesting political constraints were the only impediment.

"The returns on infrastructure spending are very likely to be higher than whatever interest rate the government would be paying on the debt," he said. He pointed to the slump in construction employment in order to dismiss the argument that the resources boom was sucking up available workers.

Doubts about the long-term creditworthiness of governments in Europe and the US has increased global demand for Australian dollars and specifically Australian government debt, pushing interest rates on long-term government borrowings near 3 per cent. Bill Evans, Westpac's chief economist, said the Infrastructure NSW report released last week was a reminder of "very worthy projects that would add to substantially to productivity". He said, however, that state government debt ratios were skirting perilously close to prompting downgrades from ratings agencies, curbing state governments' ability to borrow even at low interest rates.

"Rather than sitting on our hands, borrowing should be done through the commonwealth government," he said.

Saul Eslake, chief economist of Bank of America Merrill Lynch, agreed, suggesting the Gillard government use the same "loophole" it had used to finance the National Broadband Network to finance state government infrastructure investment.

"The commonwealth could simply borrow to buy state government debt, which would not contribute to the underlying budget deficit," he said.

Each economist said Australia's "debt phobia" was hobbling sensible government investment.

Mr Eslake played down concerns that the government's projected surplus would impede economic growth.

"Two thirds of the supposed tightening of fiscal policy will not be a drag on growth because it consists of artificial changes to the timing of spending, and reductions in spending overseas," he said.

Mr Evans said growth prospects in Europe were dimmer given that the voting populations seemed to have little interest in reform. "France now appears to be enacting policies that would top a list of what not to do to encourage economic growth," he said. "And they are proving popular."

DAN HIMBRECHTS

Saul Eslake, left, Bill Evans, Justin Fabo and Adam Creighton