

Australia came back from a downgrading twice – better and stronger



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The immediate cause of last week's stockmarket gyration was the downgrade of the US credit rating. Standard and Poor's announced it would lower its rating of long-term US sovereign debt because the agreed plan to lift the debt ceiling would not stabilise US government debt and, in its view, the deep divisions in Washington are going to make it harder to find a plan that will.

President Barack Obama was furious. "No matter what some agency

may say, we have always been and always will be a AAA country," he said. I know how he feels. As treasurer, I would get an annual visit from the various ratings agencies. Their analysts were neither original nor especially bright. After a perfunctory review they would give a credit rating – a kind of exam mark – for the economy. There was little scrutiny of the people who were doing the review. They have extraordinary power but very little accountability.

However, on this occasion, the rating agency has done the US a favour. The US has a problem. It is living beyond its means. If interest rates return to normal, then debt servicing obligations will cripple the US budget. And it has unsustainable entitlement programs. No one of any seriousness in Washington needs to be told there is a problem. But they do need the public to appreciate how serious it is. They need

the public to support the tough measures needed to fix it. And the fact that at least one rating agency has downgraded US government debt might be the catalyst.

The President can fight the announcement or use it. Fighting it will make no difference.

Australia went through this experience, only worse. In 1986 both Moody's and Standard and Poor's downgraded Australia's foreign currency sovereign rating. The country was shocked. The treasurer, Paul Keating, warned that Australia risked becoming a banana republic. It was colourful language but, to his credit, he did something about it.

Instead of running budget deficits – which was his policy – he changed direction and, after two years, delivered a surplus. It takes a lot to change direction. Back then it was not just the

government racking up debt. Households and business (aided and encouraged by the banks) joined in and the banks were racking up huge borrowings overseas. Australia was downgraded a second time in 1989.

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When interest rates increased sharply the economy went into a deep recession. Several banks, such as the State Bank of Victoria and the State Bank of South Australia, failed and several came close. This was Australia's banking and financial crisis. The budget went back into deep deficit.

Unemployment reached the kind of levels they are in the US today.

It would take eight years, after a change of policy and a change of government, to balance the budget again. But that did not get our credit rating back. We did not recover our AAA rating until 2003 – 17 years after that first downgrade. And that was after seven years – from 1996 – when we did not borrow a cent. We repaid nearly all our government debt.

And when we had proved that we didn't need it, the ratings agencies reclassified us as a "class A" borrower. It's a banker's joke – the only person qualified to borrow is the one that doesn't need to.

But it was worth it. When the Labor government began to borrow again in the midst of the financial crisis of 2008, we were able to do so at the most favourable rates.

It was hard work to get back into the international "A league". It meant sustained effort to restrain expenditure in every area apart from defence. More importantly, it meant resisting new spending programs.

The experience shows it can be a long way back from a credit downgrade. It is better to make sure it doesn't happen in the first place. Several Australian states that have faced the threat of a downgrade have used it to justify belt-tightening or efficiency improvements. It has helped them explain why unpopular measures must sometimes be taken.

The ratings can give an astute politician the lever to engineer good policy. Rightly used, it can be an opportunity rather than a setback.

Peter Costello is a former Liberal treasurer.