

INDEXATION: WILL IT SPREAD TO THE CAPITAL MARKET?

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Even before Mr. Cameron's quarterly wage indexation conference, articles calling for an extension of cost of living adjustments began to appear in the Australian press. Indeed National Mutual, Australia's second largest insurance company, has attempted to extend indexation into lending business. If Mr. Crean's "mini budget" observation that over the last twelve months the ordinary man's savings have lost well over \$1,000 million in purchasing power is any indication, some members of the current government would seem to favour a means of extending indexation protection to the common worker. As the Prime Minister has already indicated that Australia's inflation cannot be correct until a world wide solution is found, the government, itself, could probably implement such a measure - say through an indexed special bond - without too much loss of face. A programme such as proposed with the U.K.'s National Savings plan would likely be quite popular with the average voter. Furthermore, the policy could be so designed, perhaps through limiting the amount of indexed bonds one could purchase, to yet provide another means of redistributing wealth on a more "socially just" basis. A policy dear to the hearts of most Social Democrats!

Quarterly wage indexation, though not yet a reality, seems as likely to promote inflation as to reduce it. The results will have to be seen. The extension of the programme into Australia's financial markets would occasion substantial instability and structural change in the capital market, and potentially even more instability in the economy. Thus an understanding of what this type of indexation might entail is desirable, if not a necessity, for anyone involved in the financial sector.

Fortunately the OECD Committee on Financial Markets in its recent publication, Indexation of Fixed Interest Securities, has provided an excellent summary of the pros and cons of financial indexation as well as a recount of the overseas experiences. Though devoted basically to, as the title implies, fixed interest securities, one can easily extrapolate its concise seven page summary to cover all financial assets. It warns that the implementation of even a modest indexation programme may subsequently spread indexation into other areas and that "widespread use of indexation could fuel inflation". It further discusses the consequences that indexation would have on the effectiveness of monetary policy, the balance of payments, and the structure of financial markets. The report concludes somewhat diplomatically that the adoption of financial indexation "would need to be evaluated with care".

The report itself is followed by an even more interesting appendix which provides a much more detailed evaluation of the problem, and five annexes. For those not satisfied with the booklet's 57 page coverage of financial indexation, the last annex provides a detailed bibliography for further readings.

Selling at \$1.55, Indexation of Fixed Interest Securities, certainly must provide the best "book for the money" buy on the market. (OECD Australian Agent: BCN Agencies, 658 Pittwater Road, Brookvale, Sydney, N.S.W., 2100).

