THE CURSE OF CASH

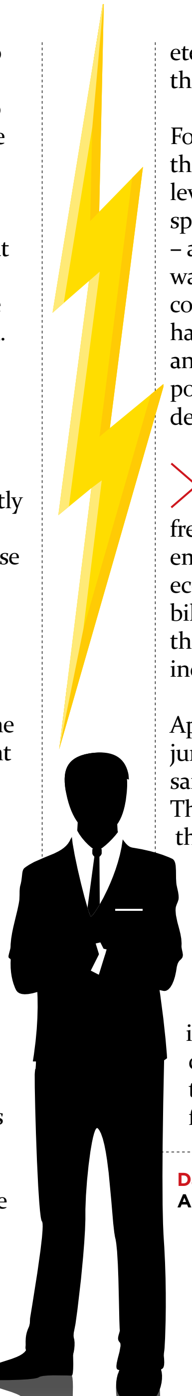
Will governments try to change the way that corporates behave when it comes to excess cash? David Bowers investigates

The very idea that cash can become a curse is anathema to most corporate treasurers. After all, most of the problems that they face every day tend to be as a result of having too little cash rather than having too much. That said, you can have too much of a good thing. And nothing excites highly indebted governments more than the sight of excess cash sitting on corporate balance sheets.

We all know that it is not as simple as that. But the fact is that policymakers are turning their attention to the unusually high corporate saving rates, and looking at what they can do to force (sorry, I mean 'encourage') companies to put their cash to work. As the strategy of austerity meets growing political resistance, so other ways need to be found to reduce governments' indebtedness. Lowering the private sector's incentive to save is now rapidly moving up the agenda.

The problem is straightforward. Central government debt (as a percentage of GDP) in the developed economies is currently at levels last seen at the end of World War II. The fact that governments are highly indebted is especially important because they get to set the policy responses. So what were the policy responses that caused government indebtedness to fall by two-thirds in the 30 years following the end of World War II? Indebtedness certainly did not drop as a result of multi-year public spending cuts; rather, it fell because of a sustained pick-up in nominal growth, aided by post-war reconstruction and the rise of the baby-boomer generation. Those peaks in government indebtedness were also preceded by periods of negative real interest rates.

In other words, policy penalised excessive cash holdings by allowing inflation to pick up. At present, the legacy mindset of 'inflation targeting' means that real interest rates are limited to -2% to -3%. That may be insufficient to expedite the adjustment process. It could be that policymakers need to be more flexible around their inflation targets. And that may mean letting inflation rise temporarily to 4-5%. As we wrote in an earlier column (see page 15 of *The Treasurer*, March 2013), monetary policy is under growing pressure to be more debtor-friendly than creditor-friendly. This could be a real challenge for many corporates because they are the most 'creditor-like' that they have been in almost half a century. It also means that they now have to confront one of the eternal truths in finance, which is that – one way or another – the creditor always pays.



We all recognise that governments are big net borrowers. For every big borrower there has to be a big saver. At present, the main counterpart to governments' borrowing is a high level of corporate saving caused by low levels of capital spending. Companies are running themselves for cash. And – as UK chancellor George Osborne is discovering the hard way – government borrowing is not going to come down until companies stop saving and start spending again. That may not happen until cash 'becomes a curse'. If your cost of capital is 7-8% and you are sitting on cash earning negative real returns, at some point your shareholders will probably start to kick up a fuss and demand a change of strategy.

In our view, governments are going all out to change the way that corporates behave. Their goal is to reduce corporate free cash flow generation. They want companies to invest and employ because that is how they will get sufficient nominal economic growth to boost tax revenues and reduce the welfare bill. What is also becoming clear is that cash-rich multinationals that do not 'get with the programme' will find their tax affairs increasingly scrutinised.

Let us not forget that the very first G20 communiqué in April 2009 sought "to take action against non-cooperative jurisdictions, including tax havens… to stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over". As we go to press we await the outcome of this year's G8 summit, where the focus will once again be on strengthening international tax standards, working on greater international tax information exchange to tackle tax havens and enabling developing countries to collect tax that is due to them.

Now governments cannot have it all their own way. They need to create an environment where productivity-enhancing investment opportunities are visible and encouraged. But companies need to be ready to engage. The 'curse of cash' is that if inflation does not get you, then the taxman will. The risk for corporates could be that if you don't use it, you'll lose it.

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