

## LEAVING DOG DAYS BEHIND IN THE 45<sup>TH</sup> PARLIAMENT

Australia's 45<sup>th</sup> Parliament faces the most challenging economic environment for a quarter of a century. Real incomes per person have been stagnant or falling since the China resources boom began its retreat in the September quarter of 2011. Multi-factor productivity is negligibly higher than a decade ago. While real output has been growing only moderately below what were once considered to be trend rates, recent growth depends overwhelmingly on increases in resource export volumes that are outweighed by falls in prices, or on unsustainable expansion of government and housing expenditure. The official budget forecasts are built on unlikely export prices, growth and inflation rates and count as savings measures that have been rejected repeatedly by the Parliament, yet still point to continuing deficits. Budget weakness continues at a time when the vulnerability of Australian commercial banks to a closure of global debt markets is greater than during the GFC—when only the strength of the Commonwealth balance sheet allowed the banks to continue normal operations. After two decades in which rising incomes and wealth for most Australians eased discomfort with moderately increasing inequality, the end of the resources boom has brought sharper differentiation in economic conditions across regions and amongst citizens as well as declines in real living standards for many people.

Outside Australia there is low productivity growth and business investment in all the high income economies. Private investment tending to fall well short of savings in the developed countries and China has led to the lowest real interest rates ever, and taken the world financial system into unknown territory. There is retreat from the open movement of goods, services, capital and people that have made the past three quarters of a century the most economically dynamic time in human history. China, the world's biggest trading economy, struggles to balance short term growth against the necessity of structural change for long term development. A difficult external strategic environment raises the spectre of unexpected burdens, including in Papua New Guinea where the significance of the collapse of the rule of law has escaped the notice of most Australians.

Australia faces the challenges confronting all developed countries in the twenty first century. It faces the challenges while still coming to grips with the Dog Days that follow the resources boom. Real costs and real expenditure rose unsustainably between 2003 and 2011 as a temporary boost to prosperity was treated as permanent. The budget bleeds more with each passing year from the weakening of the tax base during the Salad Days before 2008.

Seventeen quarters of unprecedentedly stringent income including wage restraint has allowed a beginning of improvement in international competitiveness. Much of the fall in the nominal exchange rate over the past four years has become real. A much larger real depreciation is required before Australia sees the big lift in investment and exports in traded goods and services outside resources that is necessary to sustain growth with reasonable balance in external payments.

The damage continues to spread from some economic bombs exploded in the resources boom—none more damaging than the deductions against corporate income tax from many tens of billions of dollars of resource investment that will

never return the cost of capital. Time bombs set in the boom are exploding now or will be detonated over the next year—including the closure of the car assembly industry forced by the high real exchange rate of 2013-14, and the collapse of gas-based manufacturing and the huge increase in peak electricity prices from wasteful overinvestment in LNG processing for export from Queensland. A political culture that has become more vulnerable to pressure from private interests has widened the influence of private monopoly and rendered reform in the public interest more difficult.

There is some blue between the clouds. The restraint in real wages as the exchange rate has fallen raises the prospects of further depreciation in the real exchange rate if Australian monetary policy moves closer to developed country norms. The moderate real exchange rate depreciation so far has spurred growth from a low base in a range of services, niche manufactures and high value manufactures. The early stages of transition to a new model of growth in China underline the potential for expansion of new Australian exports as the Chinese new economy takes root. The trade agreements with the Northeast Asian countries strengthen Australia's position. The lift in non-resource exports so far holds out prospects that the combination of opportunities from Asian structural change and further real depreciation from normalisation of monetary policy can balance the contractionary effects of the necessary Australian budgetary contraction.

The election result brings a timely reminder that open and productivity-raising policies are viable only in the context of programmes that are widely recognised as equitably sharing the costs of adjustment and the benefits of success. This was always the reality; and big business ambitions for policy adjustments that place costs of adjustment on ordinary households while allocating benefits to itself were always built on illusion. Better late than never, that reality be recognised and embodied in the formulation and explanation of policy.

The membership of the new Parliament embodies the Australian reaction to the Dog Days of recent times. The objectives and values of members of the House and the Senate provides natural majorities for policies in the public interest. Such policies will correct budget weakness before an external shock hits us in conditions of great vulnerability. They will do as much as contemporary global conditions allow to gradually correct the stagnation in Australian productivity. The policies will assign high value to reconciliation of equitable distribution with correction of budget weakness and removal of unnecessary constraints on productivity.

Turning natural majorities into majority support for legislation in the national interest is the test of political leadership in the 45<sup>th</sup> Parliament.

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