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WE HAVE MADE OUR OWN LUCK FROM CHINA'S BOOM

Tony Abbott is wrong when he says our 'made in China' surplus is not fair dinkum

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WASN'T it Gary Player who once said: "It's a funny thing; the more I practise the luckier I get?" Actually it was Arnold Palmer, but it came to mind during the debate about the federal budget. Isn't the Gillard government just lucky that the budget will return to surplus in 2012-13, lucky that the Chinese economy is booming? Without the China boom the budget wouldn't return to surplus, so it's not a fair dinkum surplus, so the argument goes. In his budget reply, Tony Abbott went so far as to claim this will be a surplus made in China.

Yes, well there is an element of luck that when Gondwana split off from a northern supercontinent in the Mesozoic era, Australia ended up south of but not too far away from China. It's also lucky that our continent is endowed with abundant reserves of minerals that China needs for its industrialisation and urbanisation. Perhaps it's lucky, too, that so many people — more than 1.3 billion — live in China.

But beyond that, Australia has made its own luck. Australian leaders from both sides of politics foresaw the enormous opportunities on offer from Australia-China engagement. Gough Whitlam travelled to China before becoming prime minister and one of his first acts as prime minister was to recognise formally the People's Republic of China. Bob Hawke began the process of enmeshment with Asia, working with Paul Keating to transform the Australian economy from an inward-looking one producing goods for a small market protected from imports by high tariff barriers to an outward-looking, open, competitive economy.

That historic transformation didn't happen overnight; it took lots of hard work, lots of practice. Liberalising financial markets, gradually lowering trade barriers and moving from a centralised wage fixing system to one based on bargaining at the enterprise level was a long, arduous process.

Its payoff has included 20 years of recession-free economic growth, the creation of 740,000 jobs in the past three years, an unemployment rate headed down towards 4½ per cent and the elevation of Australia from 12th to the sixth most affluent country in the world.

It is true that if the hard reform slog had not been undertaken Australia's fortunes would not have been so tightly linked to China's historic expansion. Instead, we could have been trundling along behind high tariff barriers, producing socks and undies for low wages, winning a race to the bottom with the poorer countries of Asia. We could have fulfilled Lee Kwan Yew's prophecy of Australia becoming the "poor white trash of Asia".

Australia's reliance for its prosperity on open trade, including trade with China, should not be a matter of regret but a source of pride. It wasn't good luck, it was good management.

But like any long-term economic strategy, the China project presents regular challenges. The present challenge can be summarised in two words: capacity constraints.

So big has the China boom been for Australia, before and after the global recession, that the expanding sector of the economy is pushing up hard against the economy's capacity to accommodate it. Shortages of skills, general labour and infrastructure were exacerbated by poor government responses when they began to emerge during the Howard years.

Authorities such as the Treasury, the Reserve Bank of Australia, the Organisation for Economic Co-operation and Development and the International Monetary Fund repeatedly warned between 2004 and 2007 that these capacity constraints on the mining boom were creating inflationary pressure. But the Coalition government largely ignored the warnings, spending most of the proceeds of the mining boom on electorally appealing handouts such as middle-class welfare, instead of on infrastructure and skills formation.

In the face of government inaction the Reserve Bank board was left with no choice but to use interest rate rises to dampen inflationary pressure. And use it it did. The Reserve Bank was obliged to increase interest rates 10 times between 2002 and 2007.

Inflation eased during the global recession but the Labor government knew it would re-emerge once the recession was over and China resumed its spectacular growth. That's why the government invested so quickly and heavily in skills and infrastructure, despite the budget being forced into deficit by large revenue writedowns and stimulus spending needed to avert an Australian recession.

The 2011-12 budget continues that investment in skills and infrastructure, boosts skilled regional migration by 16,000 and makes the necessary savings to return the budget to surplus in 2012-13.

By easing capacity constraints and reducing the public sector's call on the economy through a return to surplus, the government is making its own luck, positioning Australia to gain maximum advantage from the China boom without breathing extra life into the inflation dragon.

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