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## Open economy our best hope

Craig Emerson | May 28, 2009

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**AMID a deep global recession and the biggest nation-building program in Australia's history, it is worth reflecting on our greatest economic achievement, not for nostalgic reasons but as a guide for future policy development.**

No, our greatest economic achievement wasn't the construction of the Snowy Mountains Hydro-Electric Scheme.

Here's a clue: it enabled the strongest, longest period of uninterrupted economic growth since Federation, the 16 years from 1991 to 2007.

No need to dial a friend; it was the creation of an open, competitive economy. Reforms by the Hawke and Keating Labor governments to reshape Australia from a closed, sclerotic economy to a pulsating one competing successfully on global markets unleashed a decade-long productivity boom, beginning in 1991.

While economic growth continued into the 21st century, productivity growth began to weaken, enfeebled by a famine of further reforms. The deleterious effects of faltering productivity growth were concealed by two new booms: a housing boom in the early 2000s fed by cheap and easy global credit, followed by a mining boom fed by China's voracious appetite for raw materials.

Of the three booms between 1991 and 2007, only one, the productivity boom, was sustainable. But, sadly, it was a casualty of the policy laziness of an era described by Ross Garnaut as "the great complacency".

Financed by overseas borrowings and lauded by the previous Coalition government, the housing boom helped lift Australia's net foreign debt from less than \$200 billion in 1996 to \$550 billion in 2007.

As Australian financial institutions tapped into global credit markets to fund the boom, some of us warned that running such large current account deficits to fund house purchases and accumulating vast foreign debt would end in grief. But no, we were told, as long as debt was private, it didn't matter how big it was.

As P.J. O'Rourke recounted during his recent visit to Australia, Adam Smith 233 years ago could not see any enduring national benefit from a housing boom. Arguably the main beneficiary of the Australian housing boom was the Howard government, which was clever enough to campaign effectively against the interest rate risk Mark Latham might pose to debt-laden mortgage holders.

Encouraging home buyers into staggering debt to buy houses at inflated prices might have been a clever Coalition government political strategy, but it did nothing to lift national productivity.

As the housing bubble began to deflate, along came a replacement, the mining boom. Such was the deluge of money pouring into the Coalition government's coffers from company profits and capital gains that Treasury began publishing theories to explain why it was repeatedly underestimating company tax receipts. Some of this revenue windfall was saved in the Future Fund and other funds, but most was spent, almost totally on consumption.

Yet again, the then government was squandering the opportunity to invest in productivity growth (as I argued back in 2006 at the Making the Boom Pay conference organised by The Australian newspaper and the Melbourne Institute).

Now that Australia's housing and mining booms have deflated, what does the nation have to show for them? It's a pitiable balance sheet. National infrastructure is run down and inadequate for a modern, advanced country. Australia has fallen further behind the pacesetters in educating our young people, especially the disadvantaged young. The spending side of the later Coalition budgets was unsustainably large; booming spending funded by booming revenue from the mining boom.

During the great complacency, productivity growth did what you'd expect it to do; it ground to a complete halt.

When the mining boom burst in 2008, the rest of the world stripped \$210 billion off commonwealth taxation revenue. As a nation we have no choice but to adjust. The only issue is whether the burden of adjustment is fairly shared or whether it is borne mainly by people who lose their jobs.

The budget seeks to share the burden fairly, both among present-day Australians and through time. Maintaining boom expenditure during bust times would invite the rest of the world to exact a high price from Australia through sharply rising unemployment. Yet to make no effort to cushion Australians from the worst effects of the global recession, letting the market take its course, would similarly impose the entire burden of adjustment on the unemployed.

This is the Opposition's approach: make the present-day unemployed pay for its extravagant spending when last in government and for the loss of national income inflicted on Australia by a recession-ridden world.

During these challenging economic times it would be easy to replace the great complacency with the great preoccupation: a total focus on the short term at the expense of long-term policy work.

Australia has reached a new decision point: do we stick with the open, competitive model or do we ditch it in favour of re-regulation and protectionism? In Europe and the US, those who have never supported competitive markets are at it again, insisting on protection from competition. Green tariffs are being contemplated in Europe, ostensibly to protect its citizens from imported carbon dioxide. Huge industry subsidies are being demanded in the US to protect against recession and the inevitable shifting sands of changing comparative advantage.

As Kevin Rudd warned in his controversial essay in *The Monthly*, the world would forget at its peril the lessons of the 1930 Smoot-Hawley tariff that triggered a global trade war that in turn deepened and prolonged the Depression.

Yet open, competitive markets should not necessarily be free of all regulation. Regulatory failure in the US and European financial systems in the 2000s allowed lenders to take unconscionable risks and disguise their exposure from market scrutiny. There is an indisputable case for new, efficient financial regulation in the US and Europe, but there is no case for using that regulatory failure as an excuse to re-regulate markets for products and for non-financial services.

Australia must not succumb to protectionist pressures. Competition drives innovation and, through it, productivity growth. Without the competition blowtorch being applied to the belly of business, the risk is that genuine, productivity-enhancing innovation would be replaced by demands for ever larger taxpayer-funded protective subsidies.

During the great complacency, policymakers forgot the lessons of the mid-'80s when commodity prices collapsed, stripping billions of dollars from our national income. An economic strategy that ignores the imperative of productivity growth, instead relying on housing and mining booms, must eventually fail, as the booms inevitably turn to busts.

Rather than hoping for economic salvation from a new mining boom, Australia should embrace the open, competitive model and support investment in productivity-raising education, innovation and infrastructure, including high-speed broadband. And far from re-regulating Australian business, we must press ahead with the most ambitious deregulation agenda in Australia's history being pursued through the Council of Australian Governments.

Housing booms come and go with not much to show. Mining booms are welcome if the proceeds are invested wisely. But as a one-dimensional economic strategy, they leave the nation exposed to the inevitable busts. Only a productivity boom in an open, competitive economy can secure the long-term prosperity and jobs of present-day and future Australians.

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