The Australian Economy and Society: Strategic Risks and Opportunities: A Comparison with Canada.

Frank Milne
Economics Dept. Queen’s University

June 2012
Outline

• A Quick overview of the Australian Economy

• Similarities with Canada

• Differences in the Australian and Canadian Economies and Societies

• Deeper problems in Australian political and bureaucratic organization.

• Implications for Australian Defence Strategy
A Fast Review of the Australian Economy: The Official View

• The Australian economy has done very well since the crisis.
• There is little unemployment.
• The banking system is safe and there were no major failures.
• Booming Exports of Iron Ore, Coal, Natural Gas and other products to China and the rest of Asia.
• Over the last 3-4 years, the Australian Exchange rate has risen from about a 10% discount, to about a 10% premium, to the Canadian Dollar. (Currently it has fallen back to parity.)
• Australian Federal government debt has risen since the crisis, but is still less than 20% of GNP.
Conclusion:

Australia is the envy of the Western world.

Complacency?
A More Realistic View of the Australian Economy:
The Current Situation

• Although the Australian economy has not suffered a major contraction or banking crisis, there are serious risks in the short to medium term.

• Official unemployment statistics show no signs of unemployment, but labor force participation rates are falling, masking soft employment in manufacturing and the private service industries.

• Minimum wages are $16.50 per hour. There are extremely high penalty wages for weekends. Any major slow-down will hit employment hard.

• The Commodity Export boom is tied to the continued growth of China. Any slowdown in China will be reflected in falling commodity prices and export revenues. This will impact the domestic economy. The effects would be serious, with a major hit on the exchange rate acting as a partial buffer.

• Although the commodity export states, Western Australia and Queensland have prospered, the other states are beginning to struggle. Australia has a Two Speed economy.
Where is the evidence?

Observe this graph of Real GDP/Capita for Australia from 1960 – 2011, particularly the last 4 years.

First observe the long view:
Where is the evidence?

Note:

1. Solid growth in the 1960’s.
2. A slow-down in the 1970’s and early 80’s.
3. Growth from the commodity boom in the mid-late 80’s, followed by the serious early 90’s recession
4. After a catch up in the mid 90’s, a resumption of increased growth until 2007.
5. Now observe 2007 until now.
The last four years:

Taking out the booming commodity sector (about 10% -15% of GDP depending how you count it), you can see a flat performance in real standards of living.

The latest 2011 numbers look pretty flat too.
Are the GDP/Capita numbers misleading? Another indicator.
Are the GDP/Capita numbers misleading?
Another indicator.

- Note the flat per capita retail sales from 2007 onwards. This is consistent with the flat real GDP/capita. This is consistent with struggling retailers and bankruptcies.

- The non-commodity export economy is flat or declining.
Other Disturbing Indicators:

- Australia has a major housing bubble. House prices have been stimulated by taxation breaks for home loans, first home buyer subsidies, etc.
- Australian banks have major exposure to housing loans.
- Both countries have seriously elevated private debt.
Australia and Canada – Similarities:

• Both countries have large commodity sectors that have boomed largely due to increasing demand directly or indirectly from China and related economies.

• Both avoided the major impacts of the financial crisis – largely due to the commodity boom fueled largely by China.

• Both have two speed economies with slowing manufacturing.

• Both have significant divergences in regional economic performance related to commodity markets. This impacts Provincial (State) budgets.

• Both have exchange rates that have increased dramatically (with the USD) due to the commodity cycle.

• Both are at risk of a Chinese slow-down and commodity downturn, leading to a major slow-down in their economies and decline in their exchange rates.
Australia and Canada – Major Economic Differences:

The composition of their economies differ.

• Canada has a far larger and more sophisticated manufacturing sector than Australia. This is partially due to Canada’s proximity to the U.S. and due to its more sophisticated university system.

• Canada’s commodity exports are largely oil/gas, lumber, wheat, etc.

• Australia had been traditionally an agricultural exporter (wool, wheat, etc.) But beginning with the mineral boom in the 1960’s its main exports have been coal, iron ore, natural gas, bauxite, etc. And to a lesser extent agricultural products, tourism and educational services.

• Australian manufacturing had evolved post WWII under very heavy tariff/protectionist barriers. This manufacturing protection was largely dismantled over the 1970 – 1995 period.
Major Economic Differences:

• Industrial protection was mirrored in heavily regulated labor markets, high levels of unionization, and industrial courts determining minimum wages and a battery of margins for various skills. This cumbersome, inefficient and increasingly corrupt system was largely dismantled in the 1980-2007 period. Labor markets have become far more competitive and flexible.

• The current ALP government, dominated by trade unionists and Left Wing ideologues has been attempting to roll back these reforms and return the country to union dominated labor markets. Industrial/union activity is on the rise.

• There are disturbing signs of increasing protectionist manufacturing policies, and meddling in the media and other service industries.

• The commodity boom allowed the previous Howard (Liberal) government to drive Federal debt to almost zero. The ALP Federal government has been fiscally lax and has increased debt by about $200 billion in four years. There has been great waste and rent-seeking by various groups associated with the Federal and State ALP governments.
Australia and Canada – Social and Political Differences:

• Australia has a serious intellectual and scientific class, but it is small by Canadian standards and has limited political or social influence. The business and political establishments pay lip service to this class, but largely ignores them.

• High quality professionals often leave the country, working for universities in the US, UK, etc, international companies or bureaucracies. Those who stay, try to avoid the political establishment, with its cronyism, petty vindictiveness and corruption.

• There is a much larger, voluble, highly politicized, pseudo-intellectual class that dominates the weaker social sciences, humanities and soft sciences in the multitude of universities. They overwhelmingly support the ALP and Green party. Both parties have extreme left factions that are pacifist and openly hostile to the Australian/US alliance.
Over the last 20 years, the major universities have evolved into large “corporations”, mass producing tertiary education. The implications of mass classes, elimination of tutorials, grade inflation, etc are now becoming apparent in increasing numbers of poorly educated graduates.

Given long term university Federal funding constraints, universities have strong incentives to “export education” to Chinese students (Canberra boasts about their $15 Billion university education export industry). Most Chinese students take commerce based degrees. The emphasis is on the money – few academics are under any illusion what type of operation they are running.

This has had extremely serious consequences for professional training and the quality of graduates and professionals in key disciplines. International companies complain volubly of professional and technical skill shortages, and inadequate training.
Social and Political Differences:

• The same quality problems have fed into the bureaucracy, so that serious policy analysis is now concentrated in a few areas. Often these analysts are overwhelmed by the far larger network of ideologues who dominate much of the policy discourse through their infiltration of a politicized bureaucracy, educational institutions and the media.

• Worse, is the infiltration of this class into the ALP and the trade unions. The current ALP/Green government in Canberra is widely regarded by professionals as incompetent – the “most incompetent in living memory”. Thoughtful, older members of the ALP are well aware of the stultifying monoculture of party apparats and trade union officials. Confidential party reports reveal deep concerns about the health and viability of the party.

• The other party, the Liberals (Liberal-Conservative in Canadian terminology) appears to be in better shape in having a more diverse and professional membership, but it is hampered by the general social and intellectual limitations of the society.
Economic Policy Formation and Implementation:

• Serious economic policy analysts in Australia are concerned that the economic reforms of the 1980 – 2000 period have stalled. Worse, the current government appears determined to roll back some of the reforms.

• A new Liberal government will favor economic reforms. How effective they perform is an open question. Already there is an agenda of issues that require attention – here are three examples:

  – Long term economic strategies require careful analysis of the impact of commodity cycles and the implementation of policies and strategies to smooth these roller coasters via budgetary policies.

  – The country is long overdue for a banking and financial enquiry. The Wallis Enquiry reported in the late 1990’s – there are serious banking issues that need to be explored.

  – The taxation system was examined in a recent detailed review. The report recommended a series of reforms. The ALP government has ignored the report - apart from introducing a poorly conceived and executed mining tax.
Defence, Strategic Policy Formation and Implementation:

• The 2009 White paper laid out a coherent framework for Australian defence and equipment requirements. (Defending Australia in the Asia Pacific Century: Force 2030).

• Equipment requirements were based on the White Paper evaluations. Two major budgetary items were:
  – F-35 fighters.
  – 12 conventional submarines.

• These (and related acquisitions) were required for forward defence of sea lanes, a flexible US Marine Corp-style doctrine for the ADF in the South West Pacific region, interoperability with the US and other S.E. Asian allies for other theaters.
Defence, Strategic Policy Formation and Implementation:

- In the most recent Federal Budget, earlier this year, the government signaled massive defence cuts. One of the White Paper’s authors is reported to be in despair as defence planning and equipment acquisition has been deeply compromised.

- The ALP government claims that the cuts were due to the requirements of an austerity budget. Careful analysis by a defence analyst (Mark Thomson (2012) *The Cost of Defence*) shows that deferred projects or expenditure cuts of $21 Billion were made from the Defence budget, beginning in 2009, long before any government discussion of austerity. The cuts were buried in obscure reporting in the budget papers.

- The Howard government from the late 1990’s until 2007, had rebuilt the defence budget to just below 2% of GDP. The ALP has cut the projected defence budget to around 1.56% of GDP – the lowest level since 1938.
Defence, Strategic Policy Formation and Implementation:

• There are claims by defence correspondent Greg Sheridan (The Australian May 31) that the economic austerity justification given in the budget is not credible, given the hidden government expenditure cuts and deferral programs since 2009. One is led to speculate that Left/Green ideological reasons are driving the cuts. Austerity is a cover story for the defence cuts.

• Although the Liberal opposition has pledged to reinstitute the White Paper recommendations, there is widespread cynicism in the ADF concerning the development and implementation of defence policy.

• Defence equipment acquisition should not be determined by short run budgetary considerations, but be determined by budget projections that plan over the long horizon. Clearly there needs to be contingency funding built into the initial planning estimates. Short term political considerations should not be allowed to over-ride the long run contingent plans.
Summary:

- Australia and Canada have strong economic similarities.
- But they have significant economic and social differences that will become more pronounced as the economic crisis continues.
- Currently they differ in the ideology of their governments, but these are short term issues that may change significantly in the near future.
- Both countries are allies of the USA, but have very different geographic and strategic problems.
- Both have had problems in acquiring similar weapon systems.
- Their defence budgets for long run acquisitions should not be influenced by short term budget surpluses or deficits.