Economics and the election

Over the last decade Australia has developed a reputation as a 'miracle economy'. While Asia experienced a financial crisis, Japan remained mired in recession and then SARS hit Asia again, and while America slowed in the wake of the tech wreck and September 11, we powered steadily on – growing at a little under 4% per annum despite a savage drought.

We had a bit of luck. But mostly our performance was the reward for Australians' hard work and their preparedness to vote for good economic policy. Over twenty years we slashed tariffs, introduced competition policy and freed up financial markets. We rebuilt our tax system, restored fiscal responsibility to government, strengthened the independence of monetary policy and made our labour market less bureaucratic. Utilities and regulation were rationalised. All this required political courage and, contrary to the conventional wisdom that politicians are congenitally 'poll driven', governments of both political persuasions took huge political risks to achieve what they did.

The result was a surge in productivity and a new competitiveness. After a long slow decline, our export market share grew strongly. Our economy's new strength and resilience, and generally deft judgements by our central bank meant that when the international environment turned sour we kept growing strongly. In these circumstances import volumes continued to soar and exports faltered. But this was a temporary luxury our new found competitiveness meant we could afford.

But it's six years since the Asian downturn and three years since September 11. In some ways our luck has turned. There's been a record grain harvest and a Japanese recovery. And China's growth has transformed our terms of trade to their highest in 30 years as it buys our mineral exports and depresses the price of the manufactures we import.

Yet our gains are beginning to be challenged. Imports are surging, but export volumes have stagnated through this period rising a little only very recently. In fact a major driver of our poor export performance is no longer the drought, or weak external demand, but the loss of market share. Before the Asian crisis our share of world exports was just short of 1.2% and rising. It fell sharply with the Asian Crisis and the drought, as one would expect. But, following a brief recovery it is now below 1% for the first time in the series' history.

We are now running current account deficits a fraction under 6% of GDP – running up our foreign indebtedness by almost $50 billion each year. Had our terms of trade not risen the figure would have been around 8% of GDP. It is hard to believe that investors funding our deficits would have been unconcerned by such figures. And future rises in export volumes should be discounted to some (relatively unpredictable) extent by the likelihood that export prices will fall back and that we will have to pay more on our borrowing as global interest rates rise.

None of this is to counsel despair. But it does suggest due prudence. It shows the need to renew our commitment to economic reform and so the need for a broader economic debate in this election. We need to focus on building the next economic miracle not spending the proceeds of the last one.

Economic debate in this election should focus on the parties' plans to improve:

- **Prudence**: We should run substantial surpluses on recurrent budget during good times. This 'loads the fiscal cannon' giving us room for equally big deficits to fight future downturns. Budget surpluses also help redirect resources towards investment and exports to remake the next economic miracle and pay our way in the world. But large surpluses are politically hard to sell – few governments want their hard work handed over to their political opponents as a financial windfall. So we should continue to develop our fiscal institutions. Both parties have now adopted policies for 'funds' for the future which will help. Policies to set up such funds should be made more concrete in due course. And, as the BCA proposed some time ago, there is a case for developing more independence in our fiscal institutions. We should also turn around our very poor private savings performance by expanding and simplifying our superannuation system and continuing the gradual extension of compulsory super.

- **Productivity**: Governments play an important role in funding critical infrastructure in our economy whether it is physical as in the case of roads, or in 'human capital' and innovation that makes us more productive. In each of these areas we could do better. Especially with surpluses on recurrent budget we should be far less afraid of borrowing to fund economically justified investment. If we are to have an election auction, as much of the bidding as possible should focus on investment in future human capital, including improved incentives for business research, development and commercialisation.

- **Participation**: When in government, both major parties have taken hard decisions on tax reform. Yet there is plenty still to be done. Most particularly we need to lower high effective marginal rates of taxation further up the income scale and most urgently for families on much lower incomes whose family payments are withdrawn as their household income rises. Ultimately we need to rebalance our country's tax mix, fix the work/family balance and get work/retirement choices right. Policies ranging from taxpayer-funded maternity leave to life-long learning provision for older workers then come to the fore.

There would be something sad and ironic about a country that had, not without pain, woken up from the complacency bred during its time as the 'lucky country', again beginning to backslide. The alternative is so much more appealing: Australia – the country that learned to make its own luck – and kept on making it.

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