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# Bad ideas are slow killers

**HENRY ERGAS** THE AUSTRALIAN JUNE 25, 2012 12:00AM

**BEAMING from ear to ear, Wayne Swan declared the latest figures on Australia's economic growth "stunning". As for Julia Gillard, she hailed the "remarkable" data as "proving the doomsayers and sceptics wrong". "They are proof," Swan added, "that something special is happening in our country."**

On that score at least, he may be right. Far from rising spectacularly, per capita incomes actually fell last quarter, as they had in the quarter before that. Moreover, as wages grew more rapidly than productivity, unit labour costs rose, undermining our competitiveness. And hours worked fell for the second quarter in a row. Obviously, too much weight should not be placed on quarterly results. Typically, they go through two cycles of annual revision before settled estimates emerge. And our economy does have enormous strengths, thanks largely to the resource boom. But the most recent data highlights important risks.

To begin with, we are more vulnerable than ever to changes in the terms of trade (the price at which we sell our exports, relative to the price at which we buy our imports). From 2003-04 on, rising terms of trade increased the returns to exporters, strengthened the dollar and provided consumers with windfalls in the form of lower prices for imported goods and for cheap holidays overseas. However, since the beginning of the year, the terms of trade, though still high, have fallen by more than 10 per cent, and seem set to decline further.

At the same time, we are in the middle of an investment surge, with annual investment nearly twice as high as a decade ago. That accentuates a long-term rise in the economy's capital intensity, with the capital stock per person employed more than doubling since the early 1970s.

Rising capital intensity means an ever-larger share of income must go to depreciation, that is, to merely replacing capital as it wears out. And it also means that the efficiency with which capital is used is a crucial determinant of our economic performance.

Over the period from the mid-1980s to the early 2000s, capital productivity (measured as the output we get in the market sector for each unit of capital) stayed fairly constant, despite ever greater use of capital. That was partly thanks to microeconomic reform, which squeezed inefficiencies out of the capital-intensive transport, communications and electricity sectors. Since then, however, capital productivity has plunged, and is now 20 per cent below its 1999 level.

So while we need to devote a rising share of gross income just to keeping the capital stock intact, our output from each unit of that capital stock has fallen.

The combined effect of these trends is apparent in the ABS's estimates of what it calls "real net national disposable income". Unlike the conventional national product and income measures, which Swan trumpeted, this series adjusts for changes in the terms of trade. And it provides for the costs of replacing the capital stock, netting depreciation off from the income available to Australians. The picture it paints is therefore more realistic than the traditional indicators. And much less rosy, with consecutive quarterly declines in per capita disposable income in 2012.

But the story doesn't end there. For there are also disturbing signs on the competitiveness front. True, the most widely cited measure of labour productivity increased. But wages growth outpaced it. Real unit labour costs therefore increased sharply, accelerating a loss of competitiveness that has been under way since the Fair Work Act came into effect in 2009. As that happened, hours worked in the market sector fell, as they had in previous quarter too.

None of that suggests the economy is in collapse -- far from it. But those trends make it all the more worrying that public policy, rather than enhancing productivity and competitiveness, seems intent on crippling them.

Laws on coastal shipping passed through parliament last week are merely the latest example. Nothing more sharply highlights their protectionist intent than the way the legislation's objectives are defined.

Since the Hilmer reforms, objects clauses in industry-specific legislation have invariably stressed the interests of the industry's users. They have, in other words, clearly put consumers first. Not in this case, however. Rather, this legislation's objective is unabashedly to promote the Australian shipping industry.

Nor is there any mystery about how.

By greatly increasing the obstacles foreign-flagged ships face in servicing Australian ports, the legislation reverses the liberalisation begun by the Hawke government and pursued by Paul Keating and John Howard.

Having thus curtailed foreign-flagged competition, it then provides ways to impose on shippers the Maritime Union of Australia's wish list of terms and conditions, potentially doubling labour costs.

No wonder the MUA gave the legislation its enthusiastic endorsement. But it may have overplayed its hand. For there are entire sectors for which the cost increases could be the last straw. Cement, already hard hit by the carbon tax, is one, as these laws ensure shipping directly from Southeast Asia to our cities will be far cheaper than transporting Australian clinker through the coastal trade. The legislation is called the Revitalising Australian Shipping Act; it could instead be the death knell for the industry's users.

To this risk, the government's response is to cast bread upon the waters, throwing taxpayers' money at Australian shippers. But contrary to the biblical parable, in which "after many days you will find it again", long experience shows those subsidies vanish down the bottomless pit of the MUA's demands.

The costs therefore grow as the benefits dwindle. Not that the wider public realises that. For rather than facing a public, transparent Productivity Commission review of its policies, the government preferred an in-house assessment by Transport Minister Anthony Albanese's own department. Yet even that assessment finds significant harm from forcing shippers to "substitute more expensive Australian ships for cheaper foreign ships".

But the government doesn't seem to care. What counts is that the policy delivers on a promise to the MUA, keeping the faceless men at bay.

And like Gough Whitlam's mining minister Rex Connor, who worked from the premise that the Australian economy was "indestructible", Gillard and Swan are convinced they can get away with it. Perhaps they can. After all, like smoking, poor policies are slow killers. But if history has one lesson, it is that no economy is too strong to be destroyed.

The national accounts data should have driven that home to Gillard and Swan. That it prompted puerile triumphalism, not sober reflection, says it all.

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