THE AUSTRALIAN

Poorly positioned for the future

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Illustration: Eric Lobbecke Source: The Australian

THE opposition was right to ridicule the Asian Century white paper. But that hardly means the changes under way in the world economy can be dismissed; on the contrary, positioning Australia to grasp the opportunities they create, while managing their risks, should be at the heart of the opposition's economic strategy.

Last week's energy white paper confirms just how substantial the gains could be. It estimates Asian demand could increase our net energy exports from 13,000 petajoules in 2012-13 to 23,000 petajoules in 2034-35. And that comes on top of projections that the volume of our minerals exports could rise by 40 to 60 per cent in the period to 2025.

Asia's continued growth therefore has the potential to significantly strengthen our comparative advantage as a primary producer, increasing the returns we secure from our abundant natural resources. But those returns come with substantial challenges attached.

It is, to begin with, foolish to think the prize will simply fall into our laps. For despite the Asian Century report's claims, proximity is not destiny: rather, the very same reductions in global transport and communications costs that have helped Asia become the world's factory mean we are far from being the only game in town.

With about $75 billion worth of Australian resources projects being cancelled or deferred in the past 12 months and a further $100bn at serious risk, that raises questions the government's white papers completely ignore.

If responding to the Asian Century really is the defining challenge we face, what can possibly justify industrial relations laws that allow unions to hold up new mining projects, not only so as to secure higher wages but also to control rostering and other management prerogatives, reducing productivity?

And how can it be sensible for us not merely to be the only resource-based economy to impose a carbon tax but also to commit, sight unseen, to a new Kyoto protocol?

What, too, can possibly justify a mining tax that discourages investment by imposing very high effective tax rates on risky projects, while collecting little or no revenue?

As for environmental approvals, why is the commonwealth adding delays, complexities and uncertainties to processes that instead require drastic streamlining?

It is not solely the fact that our resource rivals are gearing up to seize an ever greater share of world production that makes those questions so vital. For reducing our competitiveness does more than compromise our ability to compete in the upswing: it also magnifies our vulnerability to the downswings.

The higher the cost base of our projects, the further back they will be in resource companies' development pipelines, the lower will be the returns they secure when in production and the more quickly they will be scrapped when markets sour.

Locking in high costs today therefore ensures tears tomorrow. Those tears will come, for no resource boom lasts forever. And when they come, the pain could be especially great.

That is not to suggest there is anything new in our exposure to the commodities cycle. Rather, it is an enduring feature of Australia's economy. Most advanced countries trade in broadly similar goods, exporting Volvos and importing BMWs, or exporting microprocessors and importing computers. That intra-industry trade, as it is known, accounts for about 75 per cent of the European countries' exports and imports, and nearly 70 per cent of those of the US.

But our goods trade mainly involves exporting primary products and importing manufactures, with intra-industry trade accounting for barely 20 per cent of the total, which is uniquely low by the standards of the Organisation for Economic Co-operation and Development.

That unusually high degree of specialisation helps make us prosperous, as it reflects our large stock of natural resources per capita; but its flip side is far greater exposure than most advanced economies have to price volatility, with consequences magnified by the fact that for commodities, low prices and low volumes go together. Little wonder then that in every decade since the 1960s, the variability of Australia's terms of trade has been more than twice the average of the advanced economies.

But severe as the resulting shocks have been, in the past their effects were mitigated by our exporters' low costs and by the relatively high growth rate of their productivity.

The remarkable adaptability of Australia's farmers, for example, repeatedly helped cushion adverse price movements in the 20th century, as even when prices fell, producers could hold up net returns by reducing the volume and value of inputs needed to get each dollar of revenue.

This time, however, is different. Our dependence on resource exports is greater than ever. Yet with productivity stagnant or declining, our affluence does not come from securing more bang for the buck in our export industries; we are richer only because we have gotten more bucks for the bang.

And that is true not just for exporters but, thanks to the high dollar, also for ordinary Australians, whose real income growth has come almost entirely from sharp falls in the price of imported consumer goods.

There is, however, a fundamental difference between those roads to prosperity: with sensible policies in place, higher productivity, like a trapdoor, is a one-way street; but higher commodity prices are not.

The government should therefore be doing what it can to lower costs and promote the flexibility our economy will need when shocks hit; in fact, it is doing the opposite, compromising our gains during the good times while increasing the risks of a hard landing when they come to an end.

True, faced with such a hard landing, a drop in the exchange rate would help the economy adjust; but its flip side would be to reverse the import price reductions that have largely underpinned consumers' sense of rising economic wellbeing. With that reversal amounting to a cut in real wages and incomes, the mood of the nation could swing sharply.

And the government's revenue flows, which are now more dependent than ever on the terms of trade, would swing with it, making spending promises that are already unaffordable entirely delusional.

As community expectations gallop ahead of available funding, there is more than a hint of relevance to the finding of a recent World Bank study that excessive public spending appears to be at the heart of economic mismanagement in the wake of natural resource booms.

To all these risks and challenges, the government has no solution; indeed, they do not even rate a serious discussion in its white papers.

That is a vacuum the opposition must fill: for unless it does, Asia's century will not also be Australia's, as it can and should be.