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Another state where PS unions could do harm

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THERE is a direct link between the NSW election and Australia's deteriorating international competitiveness.

In both, the central issue is whether the public sector unions, operating in parts of the economy sheltered from international competition, will be allowed to impose costs that ultimately fall on our trade-exposed industries, compounding their problems as the resource boom becomes a distant memory.

Those costs go well beyond the featherbedding and gold-plating that have contributed to soaring electricity bills. Rather, should Labor win, they will likely include pay increases that bear no relationship to productivity growth, such as those the Andrews government recently awarded Victoria's ambulance drivers, prompting the state's firefighters to put in a record claim of their own.

And they will also likely include cost slugs to privately provided social services, ranging from childcare to aged care, adding to the already heavy imposts Julia Gillard inflicted as she sought to shore up her union support.

That those increases will harm consumers and taxpayers is obvious. But the economy-wide impacts make the pain all the greater. In particular, removing the lid on public sector costs will further boost the price of the goods the Reserve Bank defines as "non-traded" — that is, the goods whose prices are set domestically, rather than being constrained by the threat of imports or by competition on world markets from rival exporters. And as those prices rise, our international competitiveness will suffer.

The mechanism is simple: the higher the price of non-traded goods, the more the traded goods sector must pay to bid away from the non-traded goods sector the labour and capital it needs. An increase in the relative price of non-traded goods therefore makes exports more expensive by raising the price of the inputs producing them requires. At the same time, it makes imports, which don't have to pay Australian prices for their inputs, cheaper.

That is why economists refer to the ratio of the price of non-traded goods to that of traded goods as "the real exchange rate", with an increase in that ratio being a "real appreciation", that is, an increase in the exchange rate.

That real appreciation has occurred in spades. Since 2003, prices for non-traded goods have increased by 50 per cent, while prices for the goods which face international competition have only risen by 16 per cent. Non-traded goods are therefore 30 per cent dearer now, relative to traded goods, than a decade ago.

That the resource boom would lead to a real appreciation was understandable. With the near doubling in our terms of trade lifting domestic incomes by more than 10 per cent above their trend level, demand was sure to grow for services such as meals out and home renovations, inducing an increase in their cost as suppliers scrambled to expand.

But the terms of trade peaked nearly four years ago; and since then, as export prices for our minerals have more than halved, per capita incomes have fallen. However, the price of non-traded goods has continued to climb, aggravating the real appreciation we inherited from the boom years. And granting public sector unions their never-ending wish list would only push that appreciation further.

Unfortunately, a further appreciation is the last thing our economy needs. On the contrary, with export prices falling, the relative price of non-traded goods should be falling too, reducing costs in the export sector and easing the pressure on it to contract. If that doesn't happen, either the nominal exchange rate must drop by more than it otherwise would, restoring the export sector's competitiveness (but increasing import prices and so making con-sumers poorer), or unemployment will be higher than it needs to be.

Those outcomes are hardly to be welcomed; but don't expect the public sector unions to lose any sleep. Unlike the competitive parts of the economy, their members' jobs are not at risk: even when there are downturns, employment reductions almost always involve early retirements on generous terms. And it isn't merely the job security they enjoy that sets the public sector unions apart; what makes them unique is the scope they have to select their employer, punishing governments that resist their demands while going all out for those who act as lackeys.

That gives the public sector unions two bites at the pay rise cherry: once over the bargaining table, and then again at the ballot box. But it's even better than that, because the employer they help elect faces few incentives for ruthless cost-cutting. Sure, consumers and taxpayers would prefer better, cheaper services; but with public sector productivity so difficult to measure, who can prove that costs are higher and quality lower than they ought to be? And as the Victorian and Queensland elections so clearly showed, the public sector unions have the ability to inflict significant damage on governments that take them on.

Little wonder Working Life, the website run by the ACTU, has boasted that the Victorian election was won in "key seats where Victorian unions had concentrated campaigning and resources". And little wonder too that Annastacia Palaszczuk's first words of thanks were to the unions. Nor will it end there: as Working Life ominously put it, the recent campaigns have "profound implications for the future of grassroots political campaigning in Australia".

But that doesn't diminish the economic costs of those union victories by one iota. If inefficiency devours public budgets and drains consumers' wallets, then regardless of who wins, there will always be a gap between what government promises and what it delivers. And if our adjustment to the end of the resource boom is compromised, it is not the well-off who will suffer but those who can least afford to see their livelihoods threatened. That is what is at stake on March 28; everything else is verbiage.