The Australian

Wacky wiki world can't mine its boom

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A LEAKED missive suggests the nation of Ergastia has some parallels with Australia.

SIMPLE folks at best, Ergastia's government is struggling to manage a mining boom.

The Ergastian Loiterers' Party (ELP) views the boom as an opportunity to do more of what Ergastian politicians do best; that is, spend other people's money. So do its allies, the country subsidy dependents, who have never seen a pork barrel on which they did not want to stand.

The position of the Greens, however, is more complicated. Faced for the first time with a Dutch disease they are not seeking to legalise, subsidise or promote, they will need to be bribed into allowing the boom to continue.

Ergastia's legendary rent seekers, including its unions, are seeking assistance to cope with claimed high adjustment costs. And proposals to lock away part of the gains from Ergastia's good luck could have the unintended consequence of underwriting wasteful spending.

As a result, we expect an outcome that locks in self-indulgent economic policies.

Yet Ergastia is well placed to absorb its increased wealth and should devote part of it to reducing public debt and to tax reform.

Analysis of its adjustment is simplified by the fact that its economy consists of only four goods.

These are lumps, which are dug out of the ground and exported; alcopops, which are produced and consumed in Ergastia but also exported; flat screen televisions, which are imported; and electricians providing services that must be consumed on the spot.

Explosive growth in Ergastia's neighbours, Marxistan and BollyVroomVroom, has dramatically increased demand for lumps, with two consequences.

First, as the income from the higher demand for lumps has percolated through the economy, Ergastians have splurged on TVs, alcopops and electricians (these being the only goods they consume). And second, the lump industry has sought to expand.

All this strains Ergastia's economy, which is already at full employment.

Luckily, Ergastia, under a long-gone reforming government, shifted to flexible exchange rates. The lump boom has therefore driven a substantial appreciation of the $E.

That has helped the economy adjust to the Ergastians' spending spree. Ergastian alcopops (which are traded on the world market in US dollars) now earn less in $E, so exports fall, while foreign TVs have become cheaper, causing imports to rise.

Higher imports and lower exports, some now diverted to the domestic market, allow the increased demand for consumer goods to be met.

Demand for electricians has also risen but the appreciation makes electricians' services more expensive compared with the lower prices for TVs and alcopops.

As a result, Ergastians skimp on electricians' services, while some electricians, who would otherwise knock off at 4pm, put in longer hours. So this market also moves into balance.

At the same time, the appreciation of the $E, by shrinking Ergastia's other trade-exposed sector, alcopops, frees up the inputs lumps needs to expand.

That expansion changes the relative returns to Ergastian capital and labour because lumping is more capital intensive than the rest of the economy. Expansion by lumping therefore increases the demand for capital compared with that for labour, bidding up profits relative to wages.

Overall, Ergastians are plainly better off, with higher incomes in real terms, which should make it possible to compensate any losers. Moreover, while world prices for lumps will decline as capacity increases, export volumes will remain high, providing an income boost for years to come.

The Ergastian Council of Trade Unions (ECTU) is nonetheless up in arms about high adjustment costs. Those concerns are greatly exaggerated. Since turning its back on a century of protectionism, Ergastia's economy has been highly dynamic, with thousands of people changing jobs every year, so changes can be readily absorbed.

Moreover, although it has had phases of capital xenophobia and for many years had a "Purple Ergastia" policy, Ergastia now welcomes foreign capital and skilled labour.

This reduces the gain from the boom to the Ergastians, as they are now sharing the returns with foreign investors and workers, but also reduces the extent to which growth in lumping requires contraction in other activities.

Indeed, thanks to strong foreign inflows, greater flexibility in Ergastia's economy and lower internal barriers to trade, the boom has been associated with unusually small differences in growth rates between sectors and between Ergastia's states.

Last, while adjustment involves costs, preventing change would be even costlier, not least for workers in declining activities.

Treasury and the Reserve Bank of Ergastia (RBE), while welcoming the boom, have urged that part of the proceeds be placed in a Sovereign Wombat Fund (SWF) invested overseas, and hence quarantined from the domestic economy, but available in the event of a downturn.

This proposal overlooks the fact that merely placing assets in a fund does not prevent creative politicians from disbursing them: indeed, the ELP did just that with wealth funds it inherited from its predecessors, even as the economy was booming.

Moreover, having funds stashed away increases the credibility of the commitments politicians can make to rent seekers, while reducing the pressures for reform should a downturn occur.

It would be far better to return any fiscal dividend from Ergastia's boom to taxpayers, by reducing public debt and through tax reform, if necessary with requirements to save the benefits in particular forms.

However, a SWF may prove attractive to the governing coalition, especially if it makes it easier to sell increases in the inefficient taxes it has recently imposed on lumping.

As such a fund is unlikely to impede wasteful spending, Ergastia's economy would experience both the costs of increased taxation and of misjudged public expenditure: squandering, as is Ergastia's wont, much of its recurring good fortune.

As this reality sinks in, we expect rocketing Ergastian consumption of alcopops. In a confidential interview, Prime Minister Gillet welcomed the prospect, since alcopops are locally produced, largely unionised and heavily taxed.

Attached as requested are biometric samples drawn from the alcopops served at that interview and from the coaster bearing Ergastia's proud motto: "Above All: Dignity in Debt".