THE AUSTRALIAN ECONOMY: THE CONTINUING "WONDER DOWN UNDER"

Australia is the only western country not in a technical recession. (A "recession" is defined as two consecutive quarters of negative economic growth). The economy is the "wonder Down Under". It has provided Prime Minister Kevin Rudd with a platform from which to lecture other economies – such as those in the Group of 20 most industrialized countries (G20) at their April 2009 London Conference - on what ought to be done about the global economy. Meanwhile visitors to Australia comment favourably on how refreshing it is to be in country where the national psychology is not weighed down by talk of economic doom and gloom. There is even speculation that Australia could be the first country out of the worst economic crisis since the Great Depression of the 1930s.

This article examines how the Australian economy has acquired this enviable status and whether it can be sustained. Ironically, while Australians are proud of their international achievement, they are not quite sure how they have achieved it! In other words, there is no single explanation. Indeed, it is possible that the Australian success has come from a number of factors that have reinforced each other.

The article begins with a listing of factors that have been in Australia's favour (in no particular order of priority). It concludes with a warning about some of the factors that at the very least need to be monitored and which may in fact contribute to a worsening of Australia's fortunate position.

China's Continued Economic Boom

Following the Chinese Communist Revolution 60 exactly years ago, it became fashionable for conservative Australian Governments 1949-72 to warn against the "red peril". The Whitlam Labor Government (1972-5) opened up relations with China (and annoyed its traditional US ally in the process). But it still took a few years before the two countries to become friendly. China for its part was well aware of Australia's record of anti-Asian racism in the 19th century and the formal "White Australia" policy that was one of the first pieces of legislation of the new system of national government that began in 1901.

Following the 1976 death of Chairman Mao and the gradual introduction of “market” reforms, China embarked upon the greatest economic revolution in world history. Over 300 million people have been lifted out of poverty in the last three decades.

Australian firms have had a mixed recent history in China. I have been part of team of writers looking at the experiences of Australian businesses in China. Some have failed, while many others have (by trial and error) managed to flourish. For example, De Bertoli wines (established in 1928) now successfully sell special wines to a particular Chinese location: the cosmopolitan eastern cities like Shanghai.

China is now Australia’s major trading partner, thereby overtaking Japan and the US. If China is the “factory” of the world, then Australia remains the “quarry” of the world. It has been a very profitable relationship. For example over 80 per cent of Australia’s iron ore exports now go to China.

For decades politicians warned Australians about the strength of China and the risk of invasion. Now politicians warn Australians to watch for any economic weakness within China – Australia’s continued wealth partly depends on China’s continued growth.

✔ Housing Market Finance

Australian housing prices have not been hit as hard as in the US. I was told recently that a house in Detroit (which used to the centre of the US motor industry: “Motown”) sold for US$2.20. There has been some decline in Australian housing prices but nowhere near as bad as the dramatic falls seen in the US.

The trigger for the US housing price crash was the “sub-prime” crisis. As a response to the “dot.com” crash in 2000, the US Federal Reserve reduced the federal funds rate from 6.5 per cent to 3.5 per cent within the space of just a few months. Then came the terrorist attack on September 11 2001 (“9/11”) and the lowering process continued. By July 2003 it was at 1 per cent, the lowest rate in half a century, where it stayed for a year. This meant that there was a lot of “cheap” money sloshing around in the financial system.

Creative financial intermediaries found exotic ways of using the cheap money to encourage people to buy homes or to buy businesses via leveraged buyouts (that is, borrowing money to buy a business with the collateral being the presumed earning capacity of the business to be bought). People with a poor credit history had to borrow below the standard – “prime” rate - and so were deemed “sub-prime” borrowers. They were privately called “NINJAS”: “no income, no jobs, no assets”. There were given “teaser” loans, with a honeymoon adjustable rate mortgages with low interest rates for (say) the first two years – with the suggestion that they could refinance the mortgage at the end of that period with another low rate loan. This would continue against a backdrop of increasing house prices – after all, it was conventional wisdom that house prices always increase – and so eventually they could sell the home at a highly increased price, pay off the mortgage and have enough money left over to buy again into the real estate market. Unfortunately the housing boom did not continue and the prices started to fall in 2005 – thereby magnifying the losses to borrowers. It created a financial crisis among the people and financial institutions who had invested in the financial instruments based on the money being lent out.

The US housing turmoil did not cross the Pacific to Australia. In the US a property is seen as an investment, with a tax write-off on the loan, while in Australia a property is seen as a family home with no tax write-off on the loan (and no capital gains tax to be paid when eventually sold). Therefore there is a very basic difference in how homes are viewed in financial terms. Additionally Australians seeking to borrow were subject to much greater scrutiny than American homebuyers and so there were far fewer suspect loans issued. There were few (if any) "NINJA" loans.

Also, many mortgage originators in the US had a short-term relationship with their clients: they located potential borrowers and potential lenders, brought them together and then walked off with their fee. Their interest in the transaction ended once they collected their fee. In Australia, by contrast, the originator is still usually a financial institution expecting to have a long-term relationship with the borrower and so much more concerned about the borrower's capacity to repay the loan over the coming decades. Australian institutions were still focussed on the basic "3Cs": Collateral, Credit and Capacity to pay back the loan".

Healthy Banking System

The Australian economy is less than 2 per cent of the global economy – but it now has some of the world's biggest banks according to market capitalization. This is not so much due to the expansion of the banks as a case of the "last person standing". Other banks have gone down – and some have even completely disappeared - and the Australian ones have been left standing.

Australian banks have had their own turbulent, nerve-wracking history, especially in the 1980s Australian boom years. But their own crises were out of the way before the current crisis swept through the western world. For example one of the world's biggest banks by market capitalization is now Westpac. This bank (formed in 1817) is the oldest company in Australia and it was originally called the Bank of New South Wales. This almost collapsed in 1992 as a victim of its greed and poor judgement. It had to be, in effect, reinvented from 1992 onwards and it is now very different from the version of the 1980s.

The banking crises of the 1980s (of which Westpac was only the most notable) forced a rethinking of matters like the tighter government regulation of banking and better corporate governance. The toxic practices followed in the US in recent years were unacceptable to Australian banking. They had learned the hard way to avoid them.

A Healthy Economy

"If you are going to be sick, you should be in good health to start with" is standard medical advice. Much the same could be said by economists: if you are going into a recession it pays to have a healthy economy to start with. One of the reasons why John Howard could keep reassuring his panicky party colleagues to ignore the opinion polls and to expect a November 2007 election victory was the fact that the Australian economy booming and that voters never voted a government out of office when the economy was doing well . Howard's stunning defeat (including the loss of his own seat) made Australian history.

Australia by November 2007 had enjoyed not just a booming economy - but the longest continuous period of economic growth in the country's history. The reformist Hawke/ Keating Labor Governments (1983-1996) created – in the mould of the UK's Margaret Thatcher (1979-1990) - an economy based on more "market" incentives, less government intervention, selling off government assets, reduced taxation, and flexible currency rates. The incoming Howard Government had a firm foundation on which to build and doubtless his period in office will be merged by historians into a generalized "economic rationalist" period 1983-2007. The 2008 collapse of western national economies has forced governments to rethink their "hands-off approach" to economies and they are rediscovering Keynesian economics of government intervention.

Australia's economic boom probably began in the early 1990s at the tail end of the Keating Labor Government (a point which Howard himself magnanimously acknowledged) with the recovery from the turmoil of the boom and bust 1980s. Commentators (myself included) were slow to catch on to the looming boom. In 2001, commodity prices were still at record lows (for example, gold was at US$250 an ounce, the lowest price for over two decades). But then the "resources super cycle" kicked in and kept going. It was to run for over seven years.

Although Australia has tried to reinvent itself, it is still a major commodity exporter (rather than, say, a major manufacturer like, say, Germany). Australia is the world's largest exporter of coal, wool, zinc, tin, iron ore, beef, barley and raw sugar. For political reasons, it has not realized its status as the "Saudi Arabia of uranium" – though it has about 40 per cent of the world's known uranium reserves. If the political issues could be overcome, it could expand that market as well away from its current limited mining operations.

In short, the Rudd Government inherited a booming economy from the Howard Government. The Government budget was in surplus and so it could afford to have expansionary measures. At the April 2009 London G20 Summit, it was noted that Australian government net debt was estimated to reach a manageable 5.2 per cent of GDP in 2010-11, compared with 45 per cent for the other OECD countries. While it is true that individual Australians have a high level of personal debt, that debt has often been accumulated in the acquisition of assets, notably houses either for use as their own homes or as investment properties.

"Kevin the Bold"

Labor Prime Minister Kevin Rudd arrived in office in November 2007 as a rather colourless former diplomat/ state government bureaucrat. He was selected to be party leader by the Labor party desperate for an election victory after the consistent successes of the John Howard's conservative coalition party (first elected in 1996). Howard had grabbed the right of centre political middle ground and held onto it every three years.

Rudd's election strategy was to promise change but in a non-threatening way. He had to reassure voters that Labor could be trusted to govern the country, while portraying Howard as old and out of touch on many issues of concern to the ordinary voters (notably industrial relations, climate change and Iraq).

The global financial crisis saw Rudd move from "Kevin the Cautious" to "Kevin the Bold". An example of his unanticipated boldness was the Government's swift guarantees to bank depositors. No Australian depositor has lost money in an Australian bank for over a century. If a bank does fail, then the customers are picked up by the other banks and business carries on. Australia was one of the few western countries before the 2008 crisis not to guarantee deposits because it was seen as unnecessary.

Indeed it could be argued that such guarantees – as in the US – contributed to the crisis via a process of "moral hazard". "Moral hazard" arises when (in this case) a bank is reassured that its risky actions will be underwritten by a government. A safety net encourages a trapeze artist to take greater risks than if there were no safety net. A banking safety net socializes the losses and privatizes the gains (that is, the banks pass their failures onto government and taxpayers, while keeping the profits in the good years).

However, the dramatic television footage of banks in trouble overseas (such as the UK's Northern Rock) meant that the Government had to be seen to be doing something. In October 2008, the Government responded by guaranteeing deposits. It argued that the panic measures in the UK, Ireland and elsewhere were seeing the movement of money out of Australian financial institutions and offshore to the government-guaranteed depository institutions.

Meanwhile, the Australian Reserve Bank, which is largely independent of the Government, moved swiftly to cut the interest rate from 7.25 per cent to a record low of 3.0 per cent. (Some economists are predicting that as the economy continues to pick up, so the rate will be increased and that it could be around 5 per cent in July 2010).

"Kevin the Bold" continues to enjoy a very high popularity rating and it seems very likely that he will be re-elected in the 2010 election, The opposition conservative parties are in disarray over many issues, such as the seriousness of climate change speculation. Howard himself keeps a very low profile and he is hardly seen. His former colleagues prefer it that way.

Few "Working Poor"

The US had a few years at the beginning of the millennium of a booming economy – but the wealth was not being enjoyed by all the workers. Journalist Barbara Ehrenreich has claimed that even before the crash of 2008 "most Americans have been living in their own personal recession for years". She claimed that the country had a "working poor". Her earlier best seller set out the grim inside story of menial, low-paid work.

Victorian novelist Charles Dickens drew attention to the UK's 19th century "working poor": people who worked hard but could not earn enough money to get out of poverty. Many "orphans" in his day were children who knew who were their parents (and saw them on Sundays) but the parents did not have enough money to care for them at home and so they had to go into institutions.

But Australia (in a less politically correct era) in the 19th century was known internationally – not least in the UK - as the "working man's paradise". There was a shortage of workers and the unions made sure that cheap Asian labour was keep out of the country so as to maintain high wages. Working conditions were better in Australia than in most other countries, not least the UK. For example, largely for climatic reasons, a shorter working week became the goal of several of the early trade unions. The "eight hour day" began in Melbourne when stone masons complained about working long hours in the hot sun. It began in 1856 among the builders and then gradually spread out to the other unions. The day for workers May 1 – "May day" - was first recognized in Melbourne.

Conservatives in the 19th and 20th centuries complained about what they saw as excessive wage demands. One of the reasons for Howard's 2007 defeat was the perception that he was trying to reduce the conditions of the ordinary worker and move over to the harsh US industrial relations approach.

A big difference, then, between the US and Australia is the comparative absence of the "working poor" in Australia. A higher basic hourly working wage, a more active union movement (the US is the only western country where only a minority of its workers has ever been unionized), an extensive national health and welfare system, and a media more sympathetic to workers have all contributed to Australia's healthy economy. Many Americans are only one pay cheque away from poverty. This keeps them on their toes but it can have (as Barbara Ehreneich has pointed out) a wearing effect on their well-being. In Australia workers know there are safety nets and so they feel more confident and less desperate. They feel more upbeat about life.

But Can it Last?

Is all this progress sustainable? Australia – with a commodity-based economy - has a dramatic history of boom and bust. For example, the Hawke/ Keating economic reforms in the 1980s gave rise to a boom that fell apart disastrously in 1987. There is no guarantee that all this progress can last. China, for example, could fall into a recession and so stop being a major customer. Many of China's exports go to the US and so a prolonged US recession would be a blow to China – and this would flow on to Australia.

Additionally, few people in the welfare sector believe the figures for the low rate of "unemployment". Staff in the sector know of many people who are under-employed (for example on part-time work but really looking for full-time work) or are hanging around with little to do on a family rural property and so have their effective unemployment disguised. Or else they have simply given up looking for work entirely (such as older workers who now call themselves "retirees").

Even the commodity boom is a mixed blessing. A high demand for Australian commodities means a high demand for Australian foreign exchange to pay them and so a higher Australian dollar. But a higher Australian dollar disadvantages what little is left of Australian export manufacturers or deters foreign tourists from visiting Australia.

In short, yes the Australian economy is the "wonder Down Under" but there is no guarantee that it can last.

Keith Suter

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NOTES

1. "Rudd Counts on Strutting the Global Stage", The Weekend Australian Financial Review (Sydney), March 21-22 2009, pp 24-5

2. Ironically, the pleasant national psychology has added to the country's Immigration problems, with young back-packers visiting Australia on "working holiday" visas being even more reluctant to return home at the end of the visa. While the conservative media fret and fume about the arrival of Asian "illegal asylum seekers", the really

illegal people are young white back-packers who over-stay their visas, with the UK as the biggest source of "illegal's".

3. Australian Business Foundation Engaging China: The Realities for Australian Businesses, Sydney, 2009

4. A good summary of this crisis is: George Soros The Crash of 2008 and What it Means, Melbourne: Scribe, 2009.

5. A warning about where all this greed was headed was given: Frank Partnoy Infectious Greed, How Deceit and Risk Corrupted the Financial Markets, London: Profile, 2003

6. Dave Agena "A meltdown in the US is a brushfire in Australia", Australian Banking and Finance (Sydney) Volume 17, Number 2, 2008, pp 3-4.

7. In 1986 The Australian Financial Review newspaper light-heatedly advised that if Australians wanted to be very rich they had to move to Western Australia. The country's only two billionaires then lived in Perth. Within five years, one (Robert Holmes a'Court) was dead from a heart attack and the other (Alan Bond) was in prison.

8. See: Edna Carew Westpac: The Bank that Broke the Bank, Sydney: Doubleday, 1997

9. Part of Howard's problem in 2007 was that his government had run out of big new ideas and so was just settling old scores. A notorious example was the abolition of compulsory student unionism at universities (and so the effective destruction of many campus student facilities). Many of his colleagues had been in the minority in the rebellious left-wing days of the 1970s and so they got even three decades later by abolishing the institutions that had caused them so much grief when they were right-wing student politicians.

10. Keith Suter "The New Australian Government", Contemporary Review, Spring 2008, pp 8-15

11. See: George Megalogenis The Longest Decade, Melbourne: Scribe, 2006

12. Barbara Ehrenreich "The Boom was a Bust for Ordinary People", The Washington Post February 5 2008 (reprinted: http://www.commondreams.org/archive/2008/02/05/6859/print/)

13. Barbara Ehrenreich Nickel and Dimed: On (Not) Getting by in America, New York: Owl, 2001

14. See: Geoffrey Blainey Black Kettle and Full Moon: Daily Life in a Vanished Australia, Melbourne: Viking, 2003