Australian economy faces “painful” adjustment

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Two leading economists have warned that the Australian economy faces a major “adjustment” with higher unemployment and lower incomes in the coming period, as Chinese demand for coal and other minerals declines as a result of “structural” changes in its economy.

Delivering the keynote address to the Australian Agricultural and Resources Economics Society conference in Sydney this week, Australian National University Professor Ross Garnaut made clear he expects significant falls in the record terms of trade that have provided a major boost to the Australian economy over the past decade.

He indicated that the decline was “likely to be considerably larger” than that anticipated by the government in a White Paper published last year, as well as estimates by other authorities, and “may encompass periods when they fall to levels that are low by historical standards.”

China’s State Council has announced that it will undertake a policy of greater energy efficiency in the coming period, lowering consumption by state-owned enterprises and provincial governments. With a reduction in the proportion of investment in Chinese gross domestic product, the demand for coking coal and iron ore will also fall.

“A big adjustment is coming,” Garnaut told the conference.

“There will be no growth in thermal power generation, slower growth than we are accustomed to for gas and an absolute reduction in China’s coking coal and iron ore use this year, at the same time as supply is expanding for them all.

“So we are facing substantial downward pressure on Australian export prices over the next couple of years, a falling exchange rate and a big downward adjustment in incomes.”

The impact of these changes on gross domestic product would determine “how painful that adjustment will be.”

Garnaut’s comments were supported by resource economist Professor Bob Gregory, who said the biggest shock facing Australia over the next two years was the end of the multi-billion-dollar mining investment boom and falling terms of trade.

“If every year you lose 2 percent of GDP out of this sector, this is a very, very depressing scenario. This is the shock we’re going to face and it’s hard to think about what’s going to fill the gap,” he said.

Gregory said mining investment would rise again this year before “falling off a cliff.”

Garnaut told the conference that the China resources boom had underpinned the most recent third of the longest period of unbroken economic growth in the economic history of Australia, or any country in recent decades. But the optimists of a 21st century resources boom were likely to be disappointed by both the volume of exports and the level of prices.

In an interview with ABC radio, he said the housing and consumption boom of the 1990s would have “come to a hard landing if it hadn’t been followed immediately by the resources boom.” But it had left a “difficult legacy.”

“We are now likely to face major adjustments in incomes and living standards. If we do not manage the adjustments well, we will face a long period of economic stagnation and uncomfortably high unemployment,” he told the conference.

He warned that the government’s White Paper, following official fiscal and monetary authorities, had been “complacent” in managing fluctuations in the terms of trade.

"In the China boom, far from doing what we can to minimise the lift in the exchange rate [the Australian dollar has risen by about 60 percent over the past three years] we have embraced it. I am afraid that having sown the wind, we will reap the whirlwind. We have to come down from a hump in domestic expenditure, incomes and costs that is extreme in every direction.

"We will have to adjust to much lower incomes … Downward adjustments on the scale that we will face sooner rather than later are immensely difficult. This is the unhappy other face of the resources boom."

Garnaut noted that incomes in Australia had risen while they had stagnated in the rest of the world following the financial crash of 2008. But this situation was coming to an end. It was necessary to initiate "productivity-raising reform," and this was what the Gillard government's White Paper had advised.

But these proposals, framed in the language of "national" economic development, are aimed at covering over fundamental class divisions.

Like all other Labor-oriented economists, Garnaut, who was a key advisor to the Hawke Labor government and produced the current Labor government's report on climate change, looks back fondly to the days of "productivity reform" initiated by the Hawke and Keating Labor governments.

Those changes were achieved through a vast restructuring of workplace conditions, destroying many long-standing conditions, increasing unemployment, casualisation and part-time working. Combined with the greatest redistribution of wealth up the income scale in recent economic history, they led to a widening of social inequality.

Now a new onslaught must be initiated. This is the agenda being demanded by major sections of business of whatever government comes to power after the scheduled September 14 federal election.

Immediately the election date was announced, the Australian Chamber of Commerce and Industry chief Peter Anderson called for a "bidding war" by the Liberal and Labor parties for the introduction of measures to increase "productivity."

Those demands will be intensified in the months ahead, as the vast economic changes resulting from the end of the China boom begin to take effect, leading to a rapid intensification of social and economic struggles.