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Dog Days are here to stay without more productivity: the great Australia complacency of the early twenty first century shows no signs of abating

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Dog Days was sent to the publisher in the days after the 2013 election of the Abbott Government.

The China Resources Boom interacted with growing weaknesses in our media and political culture to create the Great Australian Complacency of the early twenty first century. From early in the century we gave ourselves massive tax cuts and boosted private and public expenditure beyond the economy's capacity after the boom. In 2013, we faced a period of stagnant living standards that would test our polity.

"We are in the Dog Days for some time yet", I said, "—for years if we have no effective leadership. Good policy has to begin with a huge readjustment of community expectations. But a changed political culture presents political leaders with an awful choice: between easy short-term gains from telling the electorate what it wants to hear, and the risk inherent in explaining and seeking to advance the public interest".

Last month the Pre-election Economic and Fiscal Outlook (PEFO) told the electorate what it wants to hear. Real output growth would rise from this year's level by a half percentage point for the two "forecast" years to 2.75 percent. It would lift again – by assumption – in the following two "projection" years. Productivity growth has been dismally low in the twenty first century. PEFO says that in the projection years it will return to an average of the thirty years that covers the stellar 1990s. Inflation has been stuck below the bottom of the Reserve Bank's range for longer than we care to remember, but it will return in the projection years to the middle of the range. Community frustrations at stagnant real wages will be salved by a return in the projection years to wages growth a full percentage point above inflation – again, all by assumption.

Strong revenue from the return to historical growth trends in output, prices and wages in PEFO support a wafer thin budget surplus through the forecasts and the projections. That is the foundation for the Government's statements that future tax cuts of unprecedented dimension are "paid for" in the Treasury forecasts. The Government makes no allowance for Treasury's assumption of a bouncing back to historical rates of growth of every key variable again being disappointed. No cushion for a hard response at home to falling house prices. No cushion for the US travails that will follow Trump's deficit-fuelled budget expansion at the top of the economic cycle.

It is possible for Australia to return to sustainably rising living standards with sound budgets through the cycle. But we won't get there by assumption. We need to do now what we didn't do in 2013.

The stagnation of real wages has turned a significant fall in the Australian dollar into a real depreciation.

The real depreciation needs to go further. We will get there if the Reserve Bank has finally accepted that the Australian monetary present, like the present in other developed countries, is different from the past. The difference is that changes in global savings and investment propensities have reduced decisively and permanently real interest rates—set by markets for the long term and by central banks at the short end. In the happy circumstance that the Reserve Bank has caught up with monetary reality, (yesterday's) (next month's likely) cut in cash rates will be the first of a series. That will bring another fall in the exchange rate and prospect for real depreciation. The bigger real depreciation can restore strong incentives to invest in our export and import competing industries, and eventually bring large expansion again in the volume of exports.

Real wages have stagnated because demand for labour (with supply augmented by this century's historic increase in short-term work visas) is genuinely weak. The old standard way of measuring unemployment focusses on a single measure of unemployment. This obscures large increases in underemployment. The weakness will only be removed by sustainably strong growth in demand for labour. The real depreciation can make a big contribution.

What happens if the real depreciation that comes with a zero cash rate is not enough? The Reserve Bank has wondered out loud about quantitative easing. That would be a wasteful way of using an increase in assets on the central bank's balance sheet. It would be much more productive to support a comparable increase in government investment in productivity-raising infrastructure.

A variation on that theme with no immediate impact on the public sector balance sheet would be vigorous implementation of the ACCC's recommendation of underwriting new investment in firm power. Contemporary economic reality would make that mainly an investment in renewable energy, long distance transmission and storage. That would unleash large investment in energy infrastructure along the path to lowering electricity prices and reducing carbon emissions. As I have explained in the second and third of six public lectures at the University of Melbourne over the past month on Australia's climate and energy transition (links), it would set Australia up for strong investment and export expansion in energy-intensive industry, built on our unequalled strengths in renewable energy resources—Superpower of the low carbon world economy.

Ending energy policy error and incoherence of recent years would stop and reverse the huge reduction in productivity in that sector in recent years. That would be a good start on restoring productivity growth more generally. The Productivity Commission and the ACCC in a series of reports have identified an agenda of oligopoly-breaking reforms that is necessary for restoring old rates of productivity growth. There is growing awareness through the community that business as usual will not deliver acceptable outcomes. This is a necessary condition for far-reaching reform—as it was at the election of the Hawke Government in 1983.

I wrote in the week after the 2013 election that if the Abbott government sought to govern in the interests of its most powerful supporters it would preside over dissatisfaction over living standards and its life was likely to be short. Putting down the Dog Days would require a reassertion of an independent centre of our polity.
I would say the same to a new government elected in 2019.

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