

TITLE: PM stokes the wrong fire

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The idea that we can undo a harm by doing a good deed has a long, if not proud, history in human morality. Some religions have spruiked the idea of selling alms and prescribing penance for our sins for millennia, but more recently governments have discovered the power of the “offset”. Offsets for carbon dioxide emissions make polluting OK and offsets for land clearing make habitat destruction OK. Offsets prevent politicians from ever having to say no.

The weekend’s announcement that the federal government will spend \$1 billion trying to boost Australia’s manufacturing industry is the latest incarnation of the offset mentality.

The government’s obsession with speeding up the mining boom has delivered an exchange rate and a shortage of skilled labour that is devastating the manufacturing industry. But rather than take its foot off the mining boom accelerator or admit that the miners’ boom means a bust for manufacturers, the government is trying to buy itself some taxpayer-funded alms.

Spending \$250 million per year will do virtually nothing to help the \$100 billion manufacturing industry cope with an exchange rate that is 40 per cent above its historic average. It’s like fighting a bushfire with a water pistol. But if it salves the guilt or persuades the electorate, then maybe it’s worth it.

It is, of course, a long time since the federal government could simply raise or lower the exchange rate, but that doesn’t mean there is nothing it can do about it. The main driver of the high exchange rate is the mining boom and while world commodity prices are beyond the influence of Australian governments, the consequences of the boom are not.

The first thing a government that actually cared about manufacturing would do is to create a sovereign wealth fund in which it would deposit the proceeds of a mining tax as lucrative as the original one developed by Treasury.

Salves

By temporarily parking the proceeds of such a fund offshore during a boom, the outflow of funds would help lower the exchange rate. Such an approach also softens the pain of a mining bust as the money can be brought back onshore when it's needed.

The second thing a government concerned with the manufacturing base, as opposed to the guilt that comes with its demise, would do is to strip away the enormous subsidies that are adding fuel to the mining boom fire.

Subsidies are used to encourage an activity that the market is underinvesting in. Just why state and federal governments are so keen to encourage an activity that is already booming is one of the great unasked questions in Australian politics.

The third thing that a commonwealth government that was serious about maintaining the diversity of the Australian economy would do is abandon the undue haste with which it seeks to approve major mining developments.

If it really believes there is a skills shortage and it really believes these projects will deliver benefits for decades, then why try to build them all at once?

Much has been said about the "paradox" of the dollar staying high while commodity prices have fallen, but the explanation is quite simple: there is about \$250 billion worth of new mining projects being funded by foreign investment. As the capital inflow floods in, the dollar is pushed higher; and when the profits start to flow out, the dollar will collapse.

Simultaneously trying to double the size of our coal exports and become the world's largest exporter of LNG while massively expanding our exports of iron ore requires a lot of skilled labour, a lot of foreign investment and high domestic interest rates to prevent the non-mining majority of the economy from overheating.

The economic theory that underpins the conclusion that the massive expansion of the mining industry will crush other trade-exposed sectors of the economy is not radical; it's the neoclassical orthodoxy.

The Right's obsession with reducing public investment in health, education and transport is based explicitly on the assumption that any expansion of such activity will "crowd out" private sector activity.

The government is to be commended for trying to develop a coherent plan for manufacturing but unless the Prime Minister confronts the obvious fact that the more rapidly the mining industry grows the more rapidly the manufacturing industry will decline then net plans, and the future of manufacturing, will come to nothing.

Julia Gillard says she can make hard choices, but in the choice between what's good for mining and what's good for manufacturing, she has squibbed it.

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