

Big project spending will stir up stagnant economy

Talking point



Richard Holden

Glenn Stevens made headlines last week by suggesting economic growth below 3 per cent is the new normal. As he put it: "Perhaps the growth we have seen is in fact closer to trend growth than we thought".

Over the last five years Australian GDP growth has averaged just 2.5 per cent. Although he didn't use the words, it seems that Mr Stevens has bought into the economic theory "secular stagnation", whose most forceful recent proponent has been former US Treasury Secretary Larry Summers. And if he's right then we are set for a long, ongoing debate about the role of fiscal policy in economic management.

Secular stagnation posits that there has been a permanent lowering of the equilibrium real rate of interest – and hence potential stable growth rate of advanced economies – because of a shift in the supply of, and demand for, savings.

In short, there is too much money

chasing too few investment opportunities. This shift probably occurred after the massive productivity gains from the 1990s information technology revolution tapered off. But the shift was masked by the huge real estate bubble in the US and elsewhere in the 2000s. Indeed, in Summers' view, the only reason that the US economy did not overheat during the housing bubble was because of the underlying decline in potential growth.

Why is the RBA just coming to this realisation now, when it seems to have been apparent elsewhere for some time? Well, unlike the US, Australia experienced a massive mining boom that provided huge productive investment opportunities. Until recently.

Arguably, the mining boom was the thing that masked secular stagnation in Australia the way the housing bubble did in the US.

Australia, too, has seen a massive run up in housing prices, but relative to the US this was driven more by people trading existing housing stock at higher and higher prices, rather than overpaying for newly built houses in Las Vegas and Arizona. Or Dublin,

Ireland for that matter. Now that the mining boom is over, Mr Stevens' "new normal" is there for all to see.

This depressing scenario (pun sort of intended) raises the obvious question of what might be done about it. That's a vital question because of what a growth rate with a 2 in front of it means for unemployment and the federal budget. Don't forget that the 2015 budget assumed economic growth in 2016-17 would be 3.25 per cent and that unemployment would peak at 6.5 per cent. Not only is it an important question, it's bound to be a controversial one in that it puts at centre stage the role of fiscal policy in managing economic growth.

There are broadly two options to address this decline. The first is to reduce the actual rate of interest. Unlike the US, Australia has room to move on short term interest rates. Exactly 200 basis points of room. But it is unclear that further reductions in rates will have much more effect given the large cuts that have already occurred.

Reducing long term interest rates through bond-buying programs ("quantitative easing") is also possible,

but may fuel asset price bubbles. Still, given the economic slowdown, interest rate cuts seem prudent. But they can only go so far, and achieve so much, before we hit the so-called "zero lower bound". Indeed, if one thinks that the real rate of interest is now negative then it's impossible to match the actual interest rate to it.

That logic leads to the second possible response: provide the missing investment opportunities being chased by over-abundant saving. The best prospect here is large-scale infrastructure investments—something Australia sorely needs. These, of course, cost money. But precisely because of low interest rates, governments can borrow very cheaply.

However, this sounds all a bit "Keynesian" and certainly doesn't fit well with the Coalition's focus on debt and deficits. And this sort of spending may not be short-term, unlike in response a recession.

In fact, if the secular stagnation hypothesis is right, then low growth is not the only "new normal" we will need to get used to.

We will have to reboot the old debates about government spending. If

monetary policy is less effective than it used to be then the spotlight will shift to fiscal policy. Yet the need for large-scale government spending opens the door to every wasteful pet project imaginable. We could quickly be facing "pink bats on steroids".

To combat this, we will have to start thinking about government spending in two distinct categories: investment and recurrent spending. Investment in infrastructure should be treated like a business treats capital expenditure and charged to the bottom line over its useful life, not in one hit when the investment is made. And it should be subject to the same kind of cost-benefit calculations that private enterprise performs.

If Mr Stevens is right, and secular stagnation has hit Australia, then we will not only need to get used to low growth, but a more nuanced public debate around spending programs. And Mr Abbott may get his wish: to go down in history as "the infrastructure Prime Minister".

Richard Holden is professor of economics at UNSW Australia Business School. Twitter: @propholden.

Letters

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Ignoring the gifted comes at a cost



Those of us who work with gifted children and their (often distressed) parents are too familiar with the problems identified by Emily Parkinson ("Stretching the gifted", AFR, August 17). Primary teachers generally don't have the training to identify less obviously gifted children. In my working practice, I've even seen highly-gifted children being dumped into remedial programs.

The average classroom has an ability range of at least 50 IQ points. This means that a class of 10-year-olds can have the intellectual range of eight-to-13-year-olds. The average teacher (and

school) is not equipped to deal with this diversity: simply handing gifted students the text book from the next year up is not an adequate response.

Even when schools do accelerate gifted kids, there are often substantial timetabling and other difficulties for students and teachers. This can be compounded by the specific requirements of the subjects being taught.

Too often, the way maths is taught in primary and junior secondary schools gives gifted students little scope, and many switch off. The problems with maths programming are highlighted

by the poor PISA (Program for International Student Assessment) band scores.

Much of the problem can be sheeted home to two factors: a lack of recognition of the value of teaching as a profession and a systemic refusal to cater for the needs of gifted students.

Until these are addressed, we'll continue to experience the national economic penalties of both a brain drain and an enormous amount of lost potential.

Kerrie Magee
Epping, NSW

Hard to break habit of hiding gay life

In your article "Votes v vows" (AFR, August 15) you quote Janine Middleton talking about her time as MD of JP Morgan London. Her description of her gay staff "editing" their lives in a business context perfectly described how I reflect on my almost 40 years in financial services.

Yes, I chose to withhold part of myself, to constantly use genderless language to describe my partner, to exclude myself from social events – but these were all survival mechanisms. This approach has been hard to break, even after my staff, and managers, demonstrated their inclusiveness.

While the approach of businesses has changed significantly, don't discount the residual impact of years of conditioning on gay employees. Efforts to remove all barriers, all conscious and unconscious bias, against gay men and women deserve to rank equally with the efforts to remove discrimination based on gender and race.

Thank you Janine Middleton for giving me the words to describe how my life has been "managed" across so many years.

David Madden
Bowral, NSW

Why the gay obsession?

Bill Shorten is adamant that as soon as he becomes prime minister he will legislate for gay marriage. With the economy and unemployment, I would think the matter of gay marriage would be the least of his concerns.

It boggles the mind why the issue of gay marriage has taken on such prominence in recent times. How many votes is there in the gay-marriage issue? What about the ramifications of the Trans-Pacific Partnership that we hear so little about. Why doesn't Mr Shorten concentrate on these and other more pressing matters? We are tired of politicians concentrating on the minors while the majors are being neglected.

Jay Natus
Glen Aplin, Qld

Union probe essential

The federal opposition may perhaps have a legitimate concern in relation to the now declined speaking engagement by Justice Dyson Heydon ("Labor steps up push to oust Heydon", AFR, August 19). But including in this concern opposition to the Royal Commission into Trade Union Governance and Corruption exposes Labor to criticism.

These are separate issues. Given the revelations of wrongdoing before the commission so far, there is no doubt that it is in the interest of workers, business, and the union movement itself, to continue with an inquiry.

Michael Schilling
Millswood, SA

The Modest Member showed the way

Paul Keating has always tried to use history, or rather his sour and distorted version of it, as a political weapon (see his grotesque comments on Menzies in World War II). His claim that he did not seek Howard's support for financial reforms begs the question of how far those reforms would have got had the Coalition actively opposed them.

Others can comment on the details of Howard's policies in opposition and government, but the project of "dismantling the whole Deaconite legacy and model of national protection" would not have been politically possible but for the long, lonely years of work by Bert Kelly, the "Modest Member", ceaselessly arguing and writing to exactly that end, and gradually achieving a turnaround in public opinion and policymaking. Mr Kelly was a Liberal and received no help from Labor – rather the reverse.

It is a pity Keating did not acknowledge this brave and lonely figure or the Coalition "dries" who followed him, but generosity of spirit has never appeared to be one of his long suits.

Hal Colebatch
Nellands, WA

Renminbi move is a storm in a teacup

The hysteria over the increased flexibility of the renminbi continues. It is suggested that the People's Bank of China (PBOC) made three devaluations of the renminbi as a deliberate attack in a currency war. The facts are somewhat different.

The PBOC rebased the renminbi in a single move. The next day's reference point was calculated based on the market move of the previous day. This was not some PBOC secret formula as had applied in the past. It was referenced directly to the market behaviour of the previous day just like

every trader does with every other currency pair in the world.

The same happened on the third and all subsequent days following the original rebasing. The market trading is used to set the reference point for the trading band on the next day. It's not currency manipulation by the PBOC. The market – but apparently not the Americans – believe the renminbi is overvalued, and the market has moderated and continued the depreciation pressures.

Irrespective of how the depreciation is being achieved we have to ask just

how serious it is. The answer that this is very much a large hysterical storm in a very small teacup. A depreciation of the renminbi in the order of 3 per cent is a very small calibre round in any so-called currency war.

This liberalisation of the exchange rate should also be placed in the context of the redeployment of China's foreign currency reserves through the Asian Infrastructure Investment Bank.

Daryl Guppy
Guppyrader,
Darwin, NT

