

**JOBS AND SKILL SUMMIT -
DINNER SPEECH—1 September 2022
Final**

Prime Minister, Treasurer, Summit participants.

We are meeting at a time of stress and opportunity for the Australian economy and polity. This Summit is making progress on some important jobs and skills opportunities. I am going to talk more broadly about our national prospects.

This Summit isn't the place and time in which we agree on a comprehensive approach to our problems and opportunities. But it can be the occasion when we stop kidding ourselves about the extent of the problems, and share new thoughts about the best way forward.

We are kidding ourselves about how well our economy is performing absolutely, and relative to other developed countries. True, for nearly three decades from 1991, we experienced the longest economic expansion unbroken by recession of any developed country, ever. That ended in the first half of 2020.

In late 2020 and early 2021, our economy bounced back more quickly from pandemic recession than most developed countries, because our fiscal expansion was bigger and faster. Since then, we have looked ordinary in a troubled developed world.

Our 28 years of economic expansion were not uniformly good. Through the first decade, we had the strongest productivity growth in the developed world. For the next decade, through the China resources boom, we experienced large increases in average incomes despite lower productivity growth. In the *Dog Days* from 2013 to the pandemic, productivity, wages and median incomes grew less than in

other developed democracies. Unemployment moved from being well below to well above the US.

We can't turn the economy back to before the pandemic. Even if we could, pre-pandemic conditions are not good enough. That's high unemployment and underemployment and stagnant living standards.

The problems from the *Dog Days* and the pandemic have been compounded by the Russian invasion of the Ukraine and its disruption of global energy markets. Unlike Western Europe and Northeast Asia, Australia as a geographic entity has higher terms of trade when gas and coal prices rise. But under current policies, average Australians are poorer.

We are kidding ourselves if we think no deep wounds will be left in our polity from high coal and gas and therefore electricity prices bringing record profits for companies, and substantially lower living standards to most Australians.

We have to stop kidding ourselves about the budget. We need unquestionably strong public finances to have low cost of capital, private and public, for our Superpower transformation, and to shield us from a disturbed international economy and geo-polity. Yet we have emerged from the pandemic with historically large budget deficits in the Commonwealth and most states and peacetime record highs of public debt. We have large deficits when our high terms of trade should be driving surpluses. Interest rates are rising on the eye-watering Commonwealth debt. We talk about the most difficult geo-strategic environment since the 1940s requiring much higher defence expenditure, but not about higher taxes to pay for it. We say we are underproviding for care and underpaying nurses, and underproviding for education and failing to adequately reward our teachers. The most recent Treasury intergenerational report update tells us that the ratio of over-65 to conventionally work-age

population will rise by half over the next four decades, bringing higher costs and fewer workers to carry them.

In the face of these immense budget challenges, total Federal and State taxation revenue as a share of GDP is 5.7 percentage points lower than the developed country average.

Let's stop kidding ourselves.

AN UNEXPECTED ECONOMIC OUTLOOK

The Pre-election Economic and Fiscal Outlook was released four months ago, to inform the discussion of economic policy during the election campaign. It said that average real wages would decline by 3 percent in the two years to next June. By the time of the Treasurer's statement three months later, the expected decline had increased to 7 percent.

We should see the statement not as a forecast of the future, but as a warning of dangers to be avoided.

The facts have changed, and we should be ready to change our minds.

TWO EARLIER CRISES WITH EFFECTIVE RESPONSES

When we stop kidding ourselves, we will recognise the need for policies that we now think impossible.

Australians accepted change that had been impossible on two earlier occasions when we faced deep problems, and responded with policy reforms that set us up for long periods of prosperity, national confidence and achievement.

Postwar reconstruction in the 1940s was followed by a quarter century of Full Employment and rising incomes. The reform era from 1983 until the end of the twentieth century set us up for a decade of extraordinarily strong productivity growth in the 1990s and the longest period of economic expansion unbroken by recession ever in any developed country.

The Curtin and Chifley governments were determined that Australians would not return to the high unemployment and economic insecurity of the interwar years. As a young economist, I learned about it directly from the leading economists who had been in the rooms where it happened.

The 1945 White Paper on Full Employment was premised on the radical idea that governments should accept responsibility for stimulating spending on goods and services to the extent necessary to sustain Full Employment. Jobs would not be made for jobs' sake, but would emerge from flexible use of modern methods of production. This would achieve the highest possible standards of living for ordinary Australians.

The White Paper broke comprehensively with prewar monetary orthodoxy. The necessary capacity to control credit was eventually achieved through establishing the Reserve Bank of Australia, with Full Employment the first of its statutory responsibilities.

Success was based on using economic analysis and information to develop policies in the public interest; on seeing equitable distribution of the benefits of growth as a central objective; and on sharing knowledge through the community about economic policy choices. This built support for policies that challenged old prejudices and vested interests. Personal and corporate taxation rates were much higher than before the war. Full Employment and a wider social safety net supported structural change and much larger and more diverse immigration. The real burden of what was at first an

overwhelming war debt was reduced by a burst of high inflation early in the Menzies Government, and then by steady, moderate growth in output and prices. Menzies' political success was built on Full Employment--helped by Menzies insulating policy from the influence of political donations to an extent that is shocking today.

The postwar economic success came to an abrupt end with the global energy shocks and recession during the Whitlam Government. It was followed by nearly a decade of persistently high unemployment and inflation, slower productivity and incomes growth and fierce conflict over income distribution.

The malaise ended with the election of the Hawke government in 1983 and the beginning of a reform era extending until the end of the century. Australia relative to the rest of the developed world experienced much higher growth in output, employment and for a while productivity and incomes than ever before in our national story. The reform era defeated deeply entrenched business and trade union interests that stood against the national interest. Amongst much else, it delivered wage restraint, in the context of expansion of health, education and other public services and of superannuation; reductions in preferential taxation treatment of capital income, while lowering marginal rates of taxation; and removal of most industry protection.

The essential ingredients of success had much in common with postwar reconstruction: the prime role of economic analysis and public education; resistance to pressures on the policy-making process from sectional and vested interests; focus on equitable distribution of the benefits of growth. In both successful reform eras, comprehensive change across many activities, with large effects on performance of the economy as a whole, was easier than a succession of smaller changes. A reform affecting only one part of the economy would excite opposition from affected parties, without attracting the interest and support of the wider polity.

Both reform eras made effective use of a professional public service. The 1945 White Paper and an ambitious development programme were drafted by able young officers of the Department of Postwar Reconstruction who later led other agencies. As reform momentum developed under the Hawke Government, the public service secretariats of the Economic Policy Advisory Council, and after the 1984 election the Cabinet Committee on Long Term Economic Growth, for a while became clearing houses for reform ideas and public education on them. Then and later, the public service more broadly was harnessed to the reform agenda.

Prime Minister Hawke was able to change his mind when the facts changed. When he invited me to work as his economic adviser a couple of days after his election, he asked if I was comfortable with the new Government's announced economic policies—and hastened to assure me that trade liberalisation would be possible once the community was confident that employment was growing. I expressed concern about the promised fiscal stimulus, coming on top of massive expansion in the Fraser Government's dying days. That wouldn't be a problem either, the Prime Minister said. He had been briefed by the Treasury and the outlook was much more difficult than disclosed before the election. Policy would be adjusted to the realities.

THE CENTRALITY OF FULL EMPLOYMENT

I grew up in a Menzies world of Full Employment.

Workers could leave jobs that didn't suit them and quickly find others—often moving from lower to higher productivity firms. Employers put large efforts into training and retaining workers. Labour income was secure and could support a loan to buy a house. Labour was scarce and valuable and not to be wasted on unproductive tasks. Businesses that could not afford rising wages

closed and released their workers into more productive employment. Steadily rising real wages encouraged economisation on labour, which lifted productivity.

The 1945 White Paper discussed risks of inflation from Full Employment. The average unemployment rate went lower than the authors had in mind, to below 2 percent for two decades, without high or accelerating inflation.

As Peter Martin has observed recently in *The Conversation*, low unemployment creates opportunities for people whose long unemployment make them unattractive as employees. Employment makes them employable.

Through the Whitlam and Fraser years, wage regulation and the exercise of power by strong unions generated the “real wage overhang” which the Accord set out to remove in 1983. The real wage overhang increased the minimum unemployment rate that could be achieved without inflation.

The lowest unemployment rate that can be achieved without inflation—in economists’ jargon, the NAIRU—is not an output from an econometric model. It is an observable reality.

How low can unemployment go without accelerating inflation? Through the *Dog Days*, the Australian authorities spoke and acted as if it was 5 percent or more. In 2019, Bank executives speculated that it might be as low as 4.5 percent. In the following year, during the pandemic, the Governor surmised that it might have risen back over 5 percent again.

I discussed these matters in my book *Reset: Restoring Australia After the Pandemic Recession*, published in February 2021. I said that it was possible that the Australian unemployment could fall to 3.5 percent without generating accelerating inflation—the rate in the US

on the eve of the pandemic. Its lowest rate without accelerating inflation may be lower—or higher. There was no need to guess. We will know when unemployment is so low that labour market pressures are causing inflation to accelerate.

Full Employment disappeared from the Bank's discussion of monetary policy through the decade of persistent unemployment that preceded the pandemic recession.

Full Employment has the large benefits for productivity that I have already discussed. It also has immense social benefits. It provides the best social security for people who are able to work. The current Newstart benefit may be adequate if its role is to provide sustenance briefly while recipients are looking for their first jobs, or moving quickly from one to another. It is too low to support people for longer periods.

Full Employment encourages and increases the value of high labour force participation. Employers seek out potential workers amongst people who had been unemployable. This encourages participation of women who had spent long periods out of the labour force; the infirm and old; the poorly educated; and those with little established engagement with the wage economy.

Full Employment is hard work for employers. Many prefer unemployment, with easy recruitment at lower wages. Yet Full Employment has advantages for many employers. It brings larger and more stable demand for consumer goods and services for businesses selling into the Australian market. And for employers who identify as Australians, it brings enjoyment of a more cohesive and successful society.

If we had had Full Employment through the *Dog Days*, and the higher participation that comes with it, economic activity and government revenue would have been much higher. Lower unemployment and

higher participation from the fiscal and monetary expansion since early in the pandemic recession have increased output and revenue. There is more to be won as we move to Full Employment.

I was heartened by the return of Full Employment in the Governor's statements after Reserve Bank Board meetings for a while from October 2019. The references to Full Employment were followed by a fundamental change in policy as the pandemic hit the economy in the first half of 2020. Together with the cessation of immigration and the radical fiscal expansion, this allowed unemployment to fall to 3.4 percent in July 2022—the lowest since 1974.

Why aren't real wages rising?

There is no conundrum. We do not yet have Full Employment. The Reserve Bank abandoned its pursuit of Full Employment before we knew how low the rate of unemployment could go without becoming the source of accelerating inflation.

Will we see larger nominal wage increases if global energy and other prices continue to rise strongly? Probably. Would that tell us we have achieved Full Employment? Probably not. If nominal wages rise more rapidly, but more slowly than average prices, they are not the source of accelerating inflation. The spectre of a virulent wage-price spiral comes from our memories and not current conditions.

Economics is less amenable than physics to definitive mathematical analysis because it is about people, whose responses to similar phenomena change over time. We build models in our minds or computers that fit observed reality at one point in time, and reality changes. Then we have to think harder about what is going on.

We should now think hard about the implications of two big changes.

One is the tendency now for global private intentions on savings to exceed intentions on investment even at zero or negative real interest rates. That keeps global real long-term interest rates low, and ours with them. They may be negative even at Full Employment.

Some participants in the monetary policy discussion say that we should raise cash rates to their “neutral” level. That doesn’t remove the need for hard thinking. “Neutral” is the rate which keeps the economy growing steadily at Full Employment with acceptably low inflation. What might that be? Maybe higher and maybe lower than the cash rate now. Neither is the neutral rate of interest an output from a model. It is an observable reality.

We would expect abundance of capital and declining natural increase in the labour force to raise productivity and real wages once we achieve Full Employment. But other factors can intervene.

One is immigration. Immigration affects the link between productivity and real wages. It is much more likely to raise rather than lower average real wages the more if it is focussed on permanent migration of people with genuinely scarce and valuable skills that are bottlenecks to valuable Australian production, and cannot be provided by training Australians. What is genuinely scarce and valuable? In *Reset*, I suggested a market test: admitting skilled migrants when they earn wages higher than the Australian average.

Ignoring the links between migration and wages can have unwelcome consequences. I was talking with the Western Australian Premier at morning tea, and he gave me permission to tell me a story about one unwelcome surprise. The time our Prime Minister was in Fiji talking about recruiting nurses, the Premier was trying to recruit nurses in Ireland. The Premier sought a meeting with the Irish Minister for Health—unsuccessfully, because the Minister was in Perth recruiting nurses. Low wages made Australia a promising recruiting ground. Australian nurses would be great for Ireland. But

replacing Australian by Fijian nurses may not be best for Australia or Fiji.

A second is oligopoly. We have to think about the increasing role of economic rents in our economy. Productivity is reduced and the profit share of income increased by monopoly and oligopoly. Former Chairman of the ACCC, Rod Sims, has drawn attention to the increasing role of oligopoly in the Australian economy, and the competition policy reforms that would reduce it. In some parts of the economy, competition is not possible, or would not lead to efficient use of resources. Here we have to rely on taxation of economic rent or regulation of investment and prices to secure the public interest. A significant part of the increase in the profit share in recent years is in mining, where wages are high relative to other sectors. The appropriate public policy response is mineral rent taxation and not pressures for higher wages.

FULL EMPLOYMENT WITH RISING LIVING STANDARDS AND THE RIGHT AMOUNT OF DEBT

It matters how we get the jobs that take us to Full Employment. Increased employment comes from both domestic and trade-exposed industries. Employment in domestic industries is expanded by higher government expenditure, lower taxes and lower interest rates. Employment in trade-exposed industries is driven by competitiveness—by currency exchange rates, and Australian relative to international productivity and wages.

Too much domestic demand and too little export growth can lead to Full Employment with unsustainable levels of debt. There has to be a judicious balance between domestic and trade-exposed industries.

Strong growth in the export industries depends on access to international markets for goods and services, as well as on competitiveness. Here we face barriers from the breakdown of the

multilateral trading system and our relationship with our biggest trading partner, China; and the coming climate change-induced decline of coal and gas.

Fortunately, Australia's potential as the energy Superpower of the zero carbon world economy can allow us to bypass these blockages.

AUSTRALIA'S ZERO CARBON SUPERPOWER OPPORTUNITY

Australia has a powerful national interest in the success of the international community in holding human-induced temperatures to 1.5 degrees above pre-industrial levels. That will require steady progress in reducing global emissions to net zero by 2050.

Some countries are much better endowed than others with natural and human resources to do well in the zero emissions world. Australia is better placed than any other country.

My new book, coming out at the beginning of October, *The Superpower Transformation*, is the sequel to *Superpower* three years ago. It describes how Australia can build and operate the Superpower.

We have five crucial advantages:

1. The best combinations of solar and wind resources in the developed world. Solar and wind power and storage to balance their intermittency are highly capital-intensive, so costs are much lower in developed countries than developing. With good policy and management, this gives us the lowest energy costs in the post-carbon world.
2. By far the world's main exporter of mineral ores requiring large amounts of energy for processing into metals and other industrial inputs.

3. An abundance of the critical minerals required globally to build the machines and infrastructure of the zero carbon world.
4. The largest endowments per person of land suitable and available for sustainable production of biomass as a zero carbon industrial input and for sequestering carbon in plants and soils.
5. The human skills and infrastructure from the established mining, minerals processing, forestry and agricultural industries, which have high value in zero emissions industries and processes.

Australia moving from an extreme laggard to the leading group amongst the developed democracies would significantly strengthen the global effort, through its contribution to global policy diplomacy.

We can make an even larger contribution to the global effort by using our comparative advantage in zero emissions production. We can lower the cost of other countries' timely achievement of net zero by exporting zero emissions processed metals and other materials, renewable electricity and hydrogen, critical minerals, and carbon credits. *The Superpower Transformation* discusses how Australian export of zero emissions goods and services could reduce global emissions directly by about 7 percent. This would cover much of the hardest and costliest decarbonisation in the rest of the world. This is in addition to the one and a quarter percent of global emissions removed by Australia itself going to net zero.

Australian industry gets little competitive advantage from Australia being richly endowed with gas and coal. With the exception of Western Australian gas, these are made available to domestic industry at close to international prices.

Our low-cost renewable energy is different. Australian renewable electricity and green hydrogen will be twice and more as expensive in importing countries as in Australia. It will not make economic

sense to use Australian electricity and hydrogen to process Australian materials in other countries.

Making good use of the Superpower opportunity would make immense demands on Australian capital, labour skills and administrative capacity. Capital expenditure of about 5.5 percent of GDP in zero carbon energy and industry would be required from now until the 2050s. That is big. But it is within the range of capital expenditure allocated to mining developments during the China resources boom.

Mobilisation of capital and labour to utilise the low carbon opportunity requires all levels of government to plan for provision of new and complex skills and new forms of public infrastructure. It requires processes for environmental and planning approvals on an unprecedented scale. It requires systematic effort to remove bottlenecks in hugely expanded supply chains. It requires removing oligopolistic elements of supply chains that have raised Australian costs above international levels.

Productivity growth doesn't always involve improvements in individual industries and firms. It can come from stronger specialisation in activities in which Australia has comparative advantage: putting a higher proportion of our labour and capital into activities where we have exceptional strengths relative to the rest of the world. A long period of steady expansion of the zero carbon industries will see costs falling and Australia's comparative advantage strengthening. The restructuring of the economy to focus more strongly on these can be the source of sustained productivity and incomes growth.

The cost of capital sits alongside the quality of natural and human resources as determinants of competitiveness in the zero carbon economy. Capital costs will be competitive if our public finances are unquestionably strong, and if we avoid large fluctuations the real

exchange rate. That, in turn, is supported by steady expansion of capital expenditure. Ensuring steady growth in capital expenditure is a responsibility of government as regulator of new projects. This can underpin stable growth with Full Employment.

Most of the new development would be in rural and provincial Australia. Much of the solar, wind and storage developments would require Indigenous support and in some cases leadership.

THINKING THE UNTHINKABLE

There is a tide in the affairs of men which, taken at the flood, leads on to fortune. Omitted, all the voyage of their life is bound in shallows and in miseries.

The realities facing Australia are much more dangerous than revealed to the electorate in May this year. But the zero carbon opportunities are much richer. Policy will need to change more than we thought necessary, and more than we think possible. But stop kidding ourselves, make the necessary impossible changes in policy, prepare thoroughly to build the zero emissions Superpower, and we can have Full Employment with rising incomes and the right amount of debt for a long period ahead.

In this successful Australia, rising standards of living will rely less on regulated wages and more on fiscal transfers than in the past.

We have to raise much more revenue while increasing labour force participation and investment. I suggest for consideration two reforms from my book *Reset*. On taxation of personal income, *Australian Income Security*, based on guaranteed minimum payments and lower marginal effective taxation rates, would supplement low wages while encouraging participation. On taxation of corporate income, using cash flow rather than accounting income as the tax base increases incentives for business innovation and

investment without reducing total revenue. It shifts the burden from normal income in competitive parts of the economy to economic rent. These two reforms would increase the budget deficit in the short term, which fitted perfectly the fiscal expansion required during the pandemic recession. That opportunity has passed, but the longer-term case for the changes is stronger than ever. After a while, increased labour force participation would claw back part, but not all, of the initial revenue loss from *Australian Income Security*. Sooner rather than later, the efficiency gains from the new corporate tax base would return all of and then more than the lost revenue. Our debt requires us to make good any loss of revenue. There are many opportunities for raising additional revenue in Australia while enhancing equity and improving or at least not damaging economic efficiency. The mineral rent taxation to which I have referred is just one of them.

Following introduction of *Australian Income Security*, wages would carry less of the load of maintaining and enhancing workers' living standards. This would reduce the risk of unintentionally increasing the lowest sustainable unemployment rate.

The shift to cash flow taxation would encourage investment and innovation. If comprehensive corporate taxation reform were judged for the moment to be too hard, there would be large gains from applying the cash flow tax as a trial in zero emissions activities on an "opt-in" basis.

Prime Minister, I was delighted to hear you say at the National Press Club on Monday that you are ready to have a crack.

Prime Minister and Treasurer, the challenges are bigger than the public official forecasts told you to expect. And the opportunities are greater.

Some of your predecessors faced challenges of similar dimension, and left our country vulnerable by avoiding them. Others stood up to the challenges and set the country up for long periods of success. Prime Minister Curtin and his Treasurer Chifley, followed by Menzies, faced and overcame the challenges. So did Prime Minister Hawke and his Treasurer Keating, followed for the first few years by Howard.

You have become Prime Minister and Treasurer at a critical time in our history. You have been elected with a Parliament that is strongly aligned with the economic, climate and integrity reforms that can secure the next era of national prosperity and achievement.

On that full sea we are now afloat. Australians now will join you in taking the current when it serves, or lose our ventures.

Ross Garnaut
Parliament House, Canberra.
1 September 2022