

Catching Europe's ills

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The political focus last week has put economic management centre stage. This is a welcome development given the parlous state of the world economy and the need for a coherent understanding of the transformative global forces that will shape the Australian economy and society generally over the coming decades. The danger in the current debate is that spin and politics will lead to policy choices that might make the marginal voter (or minor party politician) happy but at the expense of the interests of most Australians.

As we now know from decades of government failure in Europe, much is at stake if Australian politicians get the economics wrong. The crisis in Europe (the region of choice for what not to do economically) was caused by a number of bad policy choices made over many decades. It has come to a head because of large-scale, macro-economic mismanagement, but this was a result of a wide series of policy errors over time which have merely been exposed by a sudden unexpected shock.

Some of these mistakes include: too much government focus on redistributing wealth rather than generating wealth; a focus on large-scale intervention to meet environmental goals set by the emergence of the green parties rather than serious assessment of the costs and benefits of policies; wasteful industry support through massive subsidies that badly distorted markets over many years; the idea that governments drive the economy and create jobs rather than the idea that governments provide the conditions through markets and transparent regulations that enable the private sector to create jobs; a reliance on Keynesian economics that led governments to create an enormous overhang of government debt generated by spending on activities that did not generate sufficient return to service that debt; and labour market rigidities preventing real wage flexibility when an economic shock occurs.

The idea that the government needs to plan the future shape of the economy and that businesses will follow, leads to political rather than economically sensible decisions being made that distort incentives and impede economic advancement. Governments and the private sector need to work together, rather than sequentially.

Alarming, the flawed ideas behind Europe's policy failures are the same ideas that have shaped the policy debate in Australia in recent years. True, Australia is not at the same stage as Europe today but many of the policies and principles behind Europe's problems – such as unyielding support for "national industries"; a clear agenda for redistributing wealth rather than a balance between its creation and redistribution; an excessive emphasis on environmental policies for electoral purposes rather than sound evaluations of the trade-offs between growth and the environment; a decision to build the national broadband network without a serious evaluation of the costs and benefits – look eerily familiar. Indeed, in the climate policy debate, the admiration for the European approach and desire to be part of the European carbon trading market is a clear endorsement by the Australian government that Europe is somehow on the right track. Australia seems to be following the European model with a lag.

It is clear that there is a role for government in redistribution and regulating markets and providing funds for research and development. The extreme Right is wrong to focus on unfettered markets and the extreme Left is wrong to dismiss markets and leave everything to government. The best policy will balance the potential benefits of markets with good government regulation. There are many places where the government should be working with industry, but this needs to be based on a clear empirical case for intervention and an evaluation and understanding of the costs and benefits to ensure that the intervention is really in the national interest.

The Productivity Commission is a unique institution whose role it is to do exactly this task. But by continually sidestepping the commission in making enormous commitments to funding grand "national building" projects that are easy to spin but are claimed to be unnecessary to evaluate, the Australian government is making the same mistakes as many governments in Europe have in recent decades.

Eventually, the costs are borne by taxpayers.

The debate about the car industry is vacuous. Where is a detailed evaluation of the industry's future given the state of the world economy, and the global car industry, or the productivity potential of the industry that can be independently evaluated by experts? Politicians on both sides come out in support of the industry based on anecdotes or on electoral exposure, not on a clear framework or plan, because the issue has not been given to the experts in the commission to evaluate.

I am confident individual politicians haven't done the research to make a clear policy recommendation for the car industry that would be in the long-term interest of most Australians. If the analysis is available, why isn't it transparently circulated for the public and experts to evaluate?

Australia is a lucky country, but we need to ensure we continue to make our own luck by not focusing on politics when making large-scale investments in the Australian economy. Decisions will be made by politicians, but they need to be based on clear evidence using the input of experts to debate the issues, and using hard data to focus on reality rather than dreams.

There are many dreams in Europe today among the many millions of unemployed that have been shattered by the false illusions of politicians. This is the real lesson from Europe for Australia.

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