

Comment on What Fryenberg Did Not Learn in Davos

In an interview with Gareth Hutchens of Fairfax Media¹, while in Davos, Switzerland for the World Economic Forum, Australia's Assistant Treasurer Josh Fryenberg stated that the "prevailing view about the prospects for global growth was 'less sanguine' than he had been expecting, with the one 'shining light' being the United States economy." He stated further that "it means we need to keep making the case publicly as to why we're doing what we're doing, and that is, trying to fix Labor's budgetary mess that we inherited." The purpose of this comment is to suggest that fixing the budget is only the tip of the iceberg, with a number of serious issues remaining under the surface. The budget is a problem in the sense that just when it seemed to be under control, the mid-year budget update for FY2014-2015 presented forecasts for a deficit of A\$40.4 billion which is A\$10.6 billion greater than originally forecast (a 37.2 per cent increase).² Solving that problem will not necessarily be a solution for the larger set of issues. Consider first why the US economy is regarded as a *shining light* and why the Australian economy is not.

Charts 1 A (below) and 1B (on the next page) show the quarter-to-quarter changes in gross domestic product (GDP) for Australia and the United States. The numbers are seasonally adjusted at annual rates. They are not year-on-year changes.³ For example, the preliminary estimate of 2.6 per cent for the increase in GDP for the US in the fourth quarter of 2014 means that the seasonally adjusted data for the third and fourth quarters are differenced and then converted to an annualised rate of change, which in this case was 2.6 per cent. The trend in growth rates, calculated as a moving average of the quarterly changes⁴, suggest that the increments are decreasing for Australia, but increasing for the US. This can be misleading, however, since the quarter-to-quarter changes are frequently more volatile than year-on-year changes and therefore may be less reliable for conveying the overall trend. Australia's trend in annual GDP changes is rising but not as rapidly as it is in US.

Chart 1A
Australian GDP Growth Rate

(Percentage change from previous period, seasonally adjusted at annual rates)



Source: www.tradingeconomics.com – Australian Bureau of Statistics

¹ Gareth Hutchens, "Assistant Treasurer Josh Frydenberg Says Australia Needs to Double Its Efforts to Fix the Budget," *The Sydney Morning Herald*, 28 January 2015. Available at: <http://www.smh.com.au/business/assistant-treasurer-josh-frydenberg-says-australia-needs-to-double-its-efforts-to-fix-the-budget-20150127-12z3wi.html>.

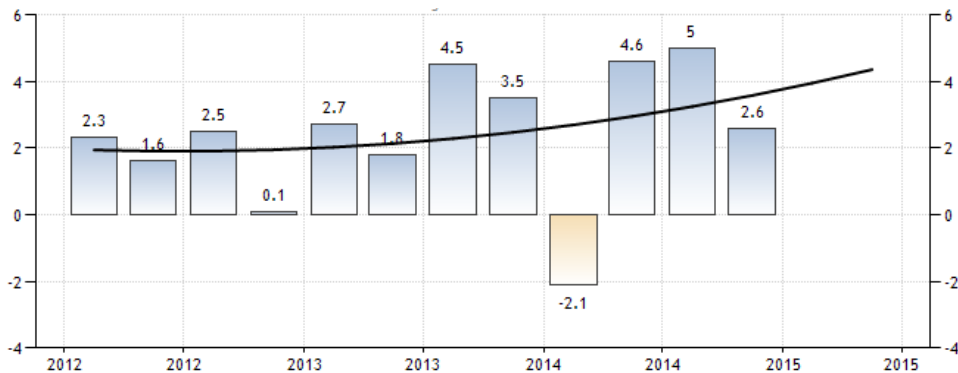
² Australian Government, "Mid-Year Economic and Fiscal Outlook, Part 1: Overview," available at: http://www.budget.gov.au/2014-15/content/myefo/html/01_part_1.htm.

³ Year-on-year changes are shown in Appendix Tables A1 and A2.

⁴ Trends for these charts were calculated with the autoregressive integrated moving average (ARIMA) model, which is available on Excel using the relevant statistical packages. They are reproduced here from tradingeconomics.com with minor modifications to the layout of the charts.

Chart 1B
US GDP Growth Rate

(Percentage change from previous period, seasonally adjusted at annual rates)



Source: www.tradingeconomics.com – US Bureau of Economic Analysis

Chart 2A
US Gross Fixed Capital Formation
(in US\$ billions)



Source: www.tradingeconomics.com – US Bureau of Economic Analysis

A number of factors contribute to faster rates of economic growth in the US since 2012, but one that seems to stand out vividly is shown in Chart 2A. The US experienced 11 quarters of increases in gross fixed capital formation (GFCF), sometimes referred to as capital investment, and only one quarter in which investment fell (first quarter of 2013). A total of US\$370 billion was added to GFCF during the period. In contrast, Chart 2B indicates that GFCF in Australia was relatively flat in all four quarters of 2012 and began to *decline* in the first quarter of 2013, with the largest drop occurring in the first quarter of 2014. This trend in declining capital investment should be worrying. It influences and is influenced by a pessimistic outlook of the Australian economy by the business sector, and the extent of this pessimism is shown in Chart 3A and 3B on the following page.

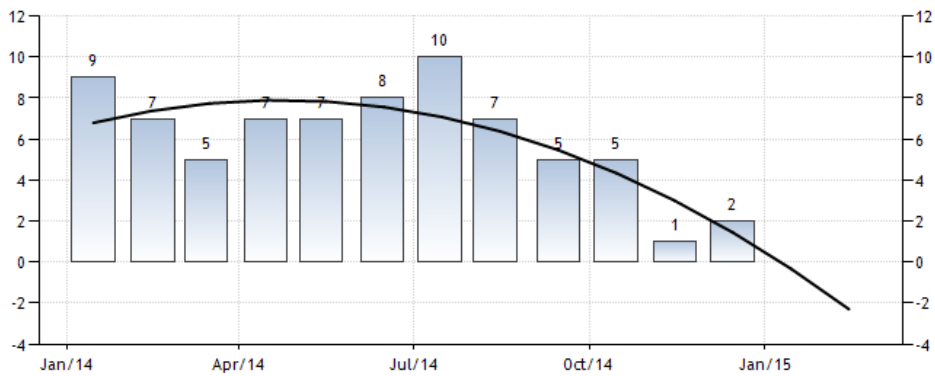
The doom and gloom that is being perceived by the business sector in Australia has been attributed at least partly to a dismal global outlook. But if global economic conditions comprise a major influence on optimism/pessimism, then the pattern of business confidence should be similar for all advanced economies. This is not the case. Business confidence in the United Kingdom has been improving since the second quarter in 2013 (Chart 3C); the confidence index began rising in the first quarter of 2014 in Canada (Chart 3D) and even Euro area businesses lost their pessimism in October 2014 (Chart 3E). Uncertainty about a nation's macroeconomic policies tends to produce a degree of pessimism that increases with the duration of the uncertainty. It can generally be corrected (or at least improved) with a clearer focus on priorities for all economic policies.

Chart 2B
Australian Gross Fixed Capital Formation
 (in A\$ millions)



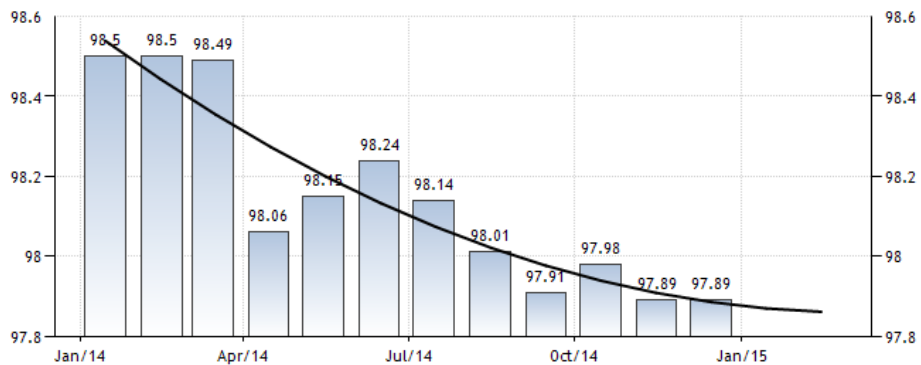
Source: www.tradingeconomics.com – Australian Bureau of Statistics

Chart 3A
Australian Business Confidence Index
 (in index units)



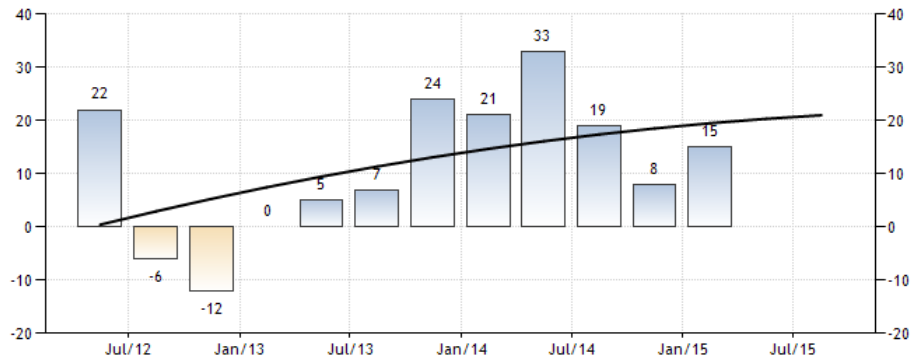
Source: www.tradingeconomics.com – National Australia Bank

Chart 3B
Australian Leading Economic Index
 (in index units)



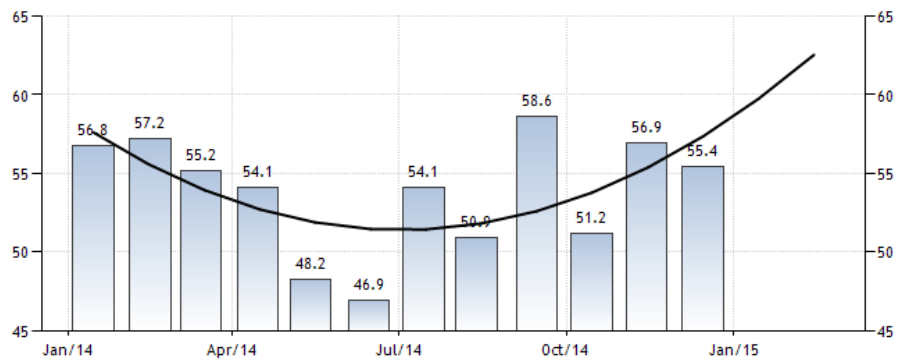
Source: www.tradingeconomics.com – Wespac - Melbourne Institute

Chart 3C
United Kingdom Business Confidence
 (in index units)



Source: www.tradingeconomics.com – Confederation of British Industry

Chart 3D
Canadian Business Confidence
 (in index units)



Source: www.tradingeconomics.com – Richard Ivy School of Business

Chart 3E
Euro Area Business Confidence
 (in index units)



Source: www.tradingeconomics.com – European Commission

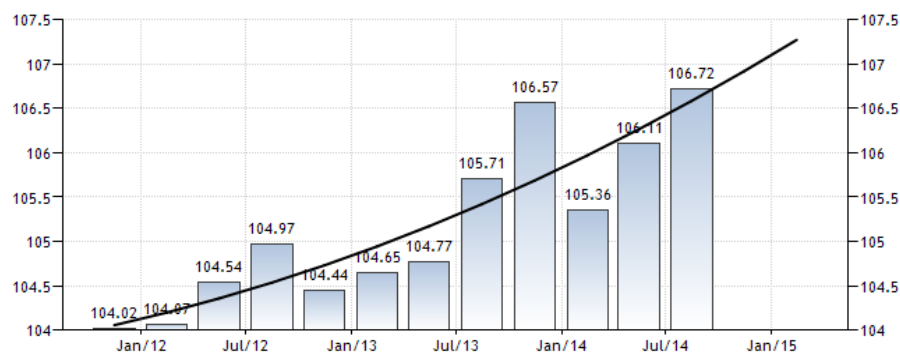
A second source of difference between the US and Australia occurs with lagging productivity growth in Australia. This is shown as a *declining growth trend* for Australia in Chart 4A and a trend for the US that has been *increasing* (Chart 4B). Productivity is easily described as output of an industry, or for the overall economy, per unit of labour input (per hour or per day) and it typically increases with better (more efficient) tools and equipment. This becomes somewhat more complicated with multifactor productivity (or total factor productivity), which measures the productivity of both *capital and labour together*. According to the Conference Board Total Economy Database, the growth rate for multifactor productivity has been less than zero for the global economy.⁵ Japan and the United States are the two exceptions to this global trend. The reasons are not yet known with certainty, but the lack of implementation of new technologies and innovation, and structural rigidities in the labour market that hinder the ability of workers to move from one employer to another, are possible causes of poor multifactor results.⁶

Chart 4A
Australian Productivity
(in index units)



Source: www.tradingeconomics.com – Australian Bureau of Statistics

Chart 4B
US Productivity
(in index units)



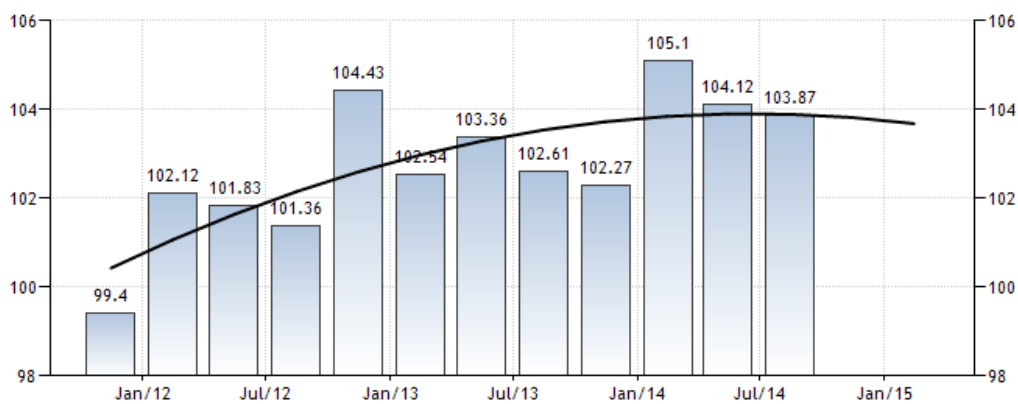
Source: www.tradingeconomics.com – US Bureau of Labour Statistics

⁵ Conference Board, Total Economy Database, January 2014 Update. Available at: <http://www.conference-board.org/data/economydatabase/>.

⁶ Australian Government, Productivity Commission, “Productivity Update,” April 2014.p. 20. Available at: <http://www.pc.gov.au/research/recurring/productivity-update/?a=135935>

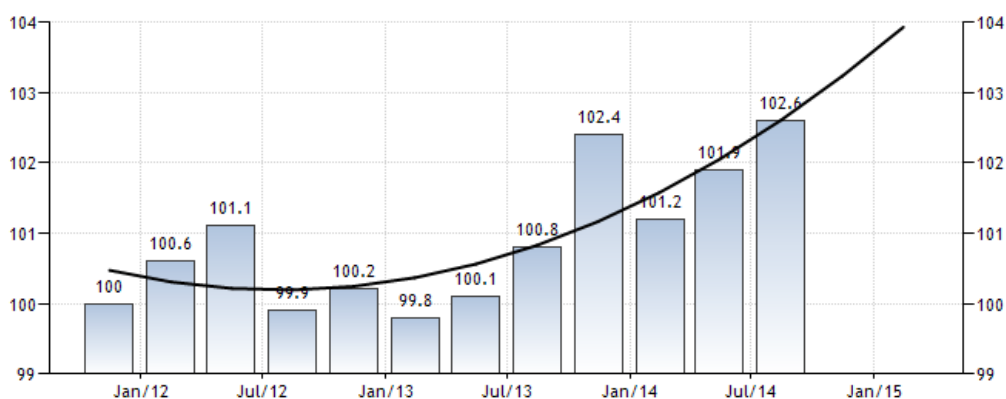
The effect of this on the respective economies is to make it easier for the US to achieve increased output with the same or lower labour costs (Chart 5A), compared to the movement in the opposite direction for labour costs in Australia (Chart 5B). The Organisation for Economic and Development has a number of publications that recommend policy frameworks (policy paradigms) that provide support for (1) innovation networks and clusters, (2) connectivity policy instruments for innovation in companies, (3) international linkages and (4) cluster policies.⁷ A similar approach is taken in the “Australian Innovation System Report” that is produced each year by the Office of the Chief Economist, Department of Industry.⁸ It is said to be a “report card on the health of Australian innovation,” and in many areas that health has not been good. But after being released, the reports seem to disappear from sight. Little or nothing in it is discussed in government or in the private sector. Little or nothing has been said about what can be done to improve the situation.

Chart 5A
US Labour Costs
(in index units)



Source: www.tradingeconomics.com – US Bureau of Labour Statistics

Chart 5B
Australian Labour Costs
(in index units)



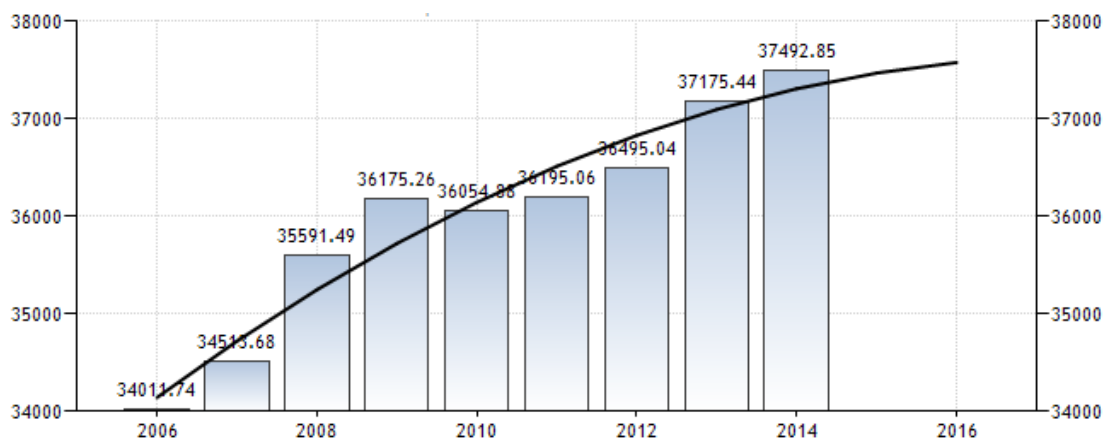
Source: www.tradingeconomics.com – Australian Bureau of Statistics

⁷ OECD, “Innovations, Networks and Clusters,” undated. Available at: <https://www.innovationpolicyplatform.org/content/innovation-networks-and-clusters?topic-filters=11389>.

⁸ Australian Innovations System – Annual Series, available at: <http://www.industry.gov.au/industry/Office-of-the-Chief-Economist/Publications/Pages/Australian-Innovation-System.aspx>.

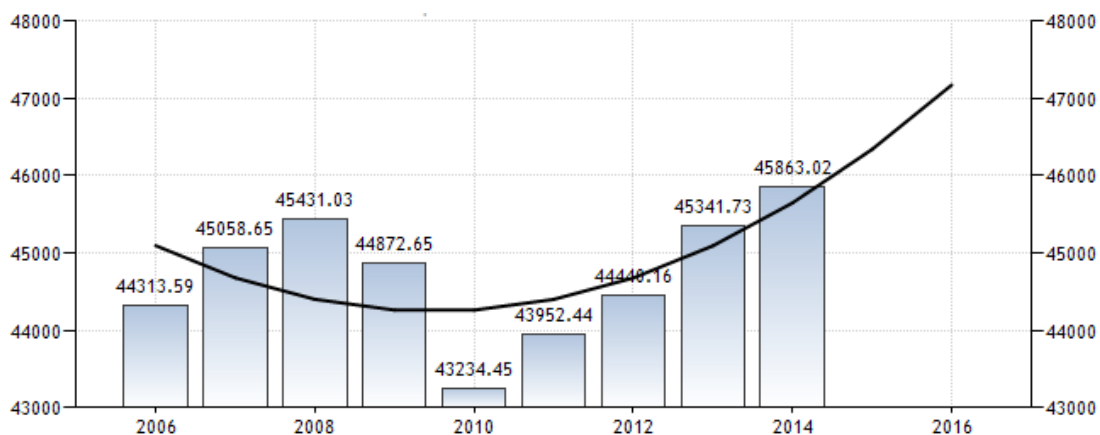
The failure to prioritise these and other submerged issues results in the loss of focus on policy paradigms that improve the rate of economic growth in Australia, either by direct means or by substantially reducing influences that tend to retard economic growth. The final set of charts, Charts 6A and 6B give a visual impression of what might have happened if we continue with “business as usual” and do nothing about the serious problems under the surface. The growth path of capita GDP in Australia (in US dollars) is likely to flatten further in the next several years (Chart 6A) and this is tantamount to robbing the current generations as well as future ones.

Chart 6A
Australia GDP Per Capita
 (in US dollars at constant prices)



Source: www.tradingeconomics.com – World Bank

Chart 6B
US GDP Per Capita
 (in US dollars at constant prices)



Source: www.tradingeconomics.com – World Bank

How do we know that these charts will be valid in subsequent years? We do not know that and there are good reasons to expect that continuing difficulties will remain for the US economy. First, wages there are lagging behind productivity increases and if this continues consumers’ income may not be enough to purchase current US output, especially when overseas demand for US products is declining (resulting in lower GDP growth in 2015). Second, corporate earnings in the US are

beginning to feel the influence of a stronger US dollar, as well as from the overall weaknesses in the global economy, so that domestic investment and employment in the US may begin to weaken. Third, the increase in consumer spending in Q3 2014, compared to that in Q3 2013 (3.2 per cent compared to 2.0 per cent) and the increase in Q4 2014 compared to Q4 2013 (4.3 per cent compared to 3.7 per cent) could have been due to lower prices, particularly lower fuel prices, and that may not continue into 2015.⁹

Finally, as is generally known the US Congress has employed a variety of tactics to reduce government expenditure with a view to restoring a fiscal balance. While government expenditure has increased in 2014, it was mainly through a surge in expenditure by state and local governments. This may not continue into 2015. Although the austerity manoeuvre undoubtedly contributed to the drop in the fiscal deficit for 2014 (see Chart A8 in the Appendix) it also constrained economic growth, possibly by several percentage points.¹⁰ At the moment we cannot be sure about any of this, but we know the statistics that are currently available reflect what is happening now and to ignore that because it is easier to look only at the tips of icebergs would be folly.

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4 February 2015
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⁹ Data are from Table 1 of Bureau of Economic Analysis, "News Release" (full release and tables), 30 January 2014. Available at: http://www.bea.gov/newsreleases/national/gdp/2015/pdf/gdp4q14_adv.pdf. An easy-to-understand summary of the US economy can be found a *New York Times* editorial, "The Economy, Past and Future," 2 February 2015. Available at: <http://www.nytimes.com/2015/02/02/opinion/the-economy-past-and-future.html?ref=opinion>

¹⁰ Studies are likely to emerge for several years in an effort to estimate the effect of austerity on the US economy and on others as well. It is mainly a matter of determining the point at which a reduction in the cost of holding specific levels of debt equates with the cost of holding back economic growth by deleveraging.

APPENDIX CHARTS

Chart A1: Australian Annual Growth in GDP (Year-on-Year)



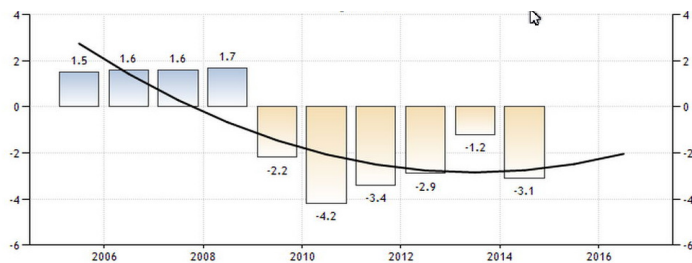
Source: www.tradingeconomics.com – Australian Bureau of Statistics

Chart A2: US Annual Growth in GDP (Year-on-Year)



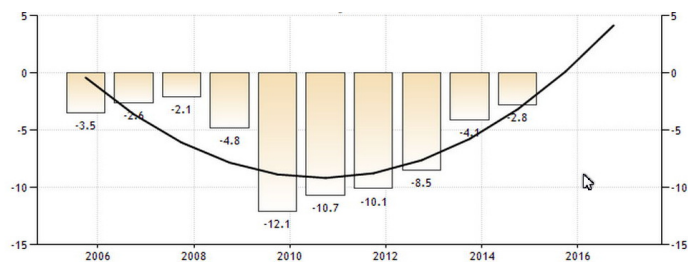
Source: www.tradingeconomics.com – US Bureau of Economic Analysis

Chart A3: Australian Government Budget (per cent of GDP)



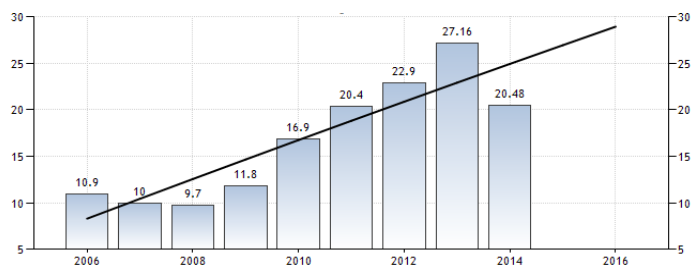
Source: www.tradingeconomics.com – Australian Government

Chart A4: US Government Budget (per cent of GDP)



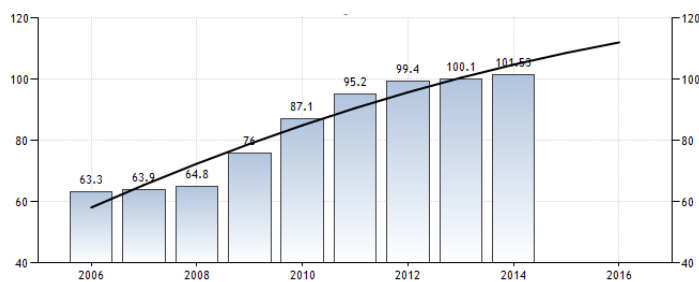
Source: www.tradingeconomics.com – US Treasury

Chart A5: Australian Government Debt (per cent of GDP)



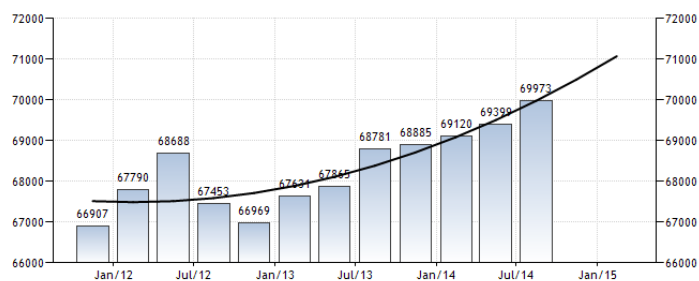
Source: www.tradingeconomics.com – Australian Office of Financial Management

Chart A6: US Government Debt (per cent of GDP)



Source: www.tradingeconomics.com – US Bureau of Public Debt

Chart A7: Australian Government Spending (in A\$millions)



Source: www.tradingeconomics.com – Australian Bureau of Statistics

Chart A8: US Government Spending (in US\$ billions)



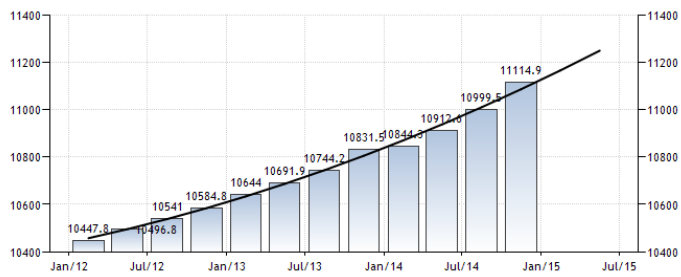
Source: www.tradingeconomics.com – US Bureau of Economic Analysis

Chart A9: Consumer Spending in Australia (in A\$ millions)



Source: www.tradingeconomics.com – US Bureau of Economic Analysis

Chart A10: Consumer Spending in the US (in US\$ billions)



Source: www.tradingeconomics.com – US Bureau of Economic Analysis