Australian economy at the crossroads

The Australian economy is at the crossroads. We face the decline of our two major exports – coal and iron ore – and few people can see the burning platform. Although we might think that demand for coal will gradually fade out, we know from experience that once the price of alternatives crosses a threshold, demand can suddenly fall of a cliff.

Iron ore demand has been buttressed by the Chinese transition from a rural to an industrial economy, but as with all prudent businesspeople, the Chinese are actively developing alternative sources of supply: Africa, Russia and Brazil. And given the low recycling rate of steel in China, there is ample upside potential for it increasingly to use internally sourced scrap metal in the future.

We know from experience what business and governments economies do when facing threats to their economic wellbeing. Think here of Israel since the 1980s; post-war Japan and Germany; the US during the Cold War; and South Korea. They have all embarked upon large, evidence-based, sustained activities to develop alternative champion export industries. The activities do not just involve top-down programs from central governments. Without a managerial class with a vision and aptitude for risk, public sector programs are like pushing on a string.

As stated in the Productivity Commission's report, Australia's policy makers are aware of what is happening overseas. Australia has had a series of programs since the 1980s to encourage venture capital, increase business engagement with the research sector, and upgrade processes. Think here of Enterprise Connect; the Entrepreneurs' program; Automotive Supplier Excellence Australia (ASEA); Victoria's C21; the rural R&D corporations; and various export and R&D programs. But they have failed to shift the dial. Sometimes the problem is a lack of business interest, but in other cases the problem is that successful programs are not scaled up and constantly change when a new government or even a new minister arrives.

Part of the reason governments are timid about intervening in what is essentially a private sector affair is the view that there is no apparent market failure. This is not correct. There is ample economic evidence that agglomerations of successful firms breed further success – that positive externalities exist. If left to its own devices, the market might get there, but it may take 100 years. Do we have this long?

It is not clear why Australian financiers are more cautious about investing in high-risk businesses than elsewhere. It is not for lack of talent and substantial ideas – as we can see by the Australians going offshore to develop their ideas. It is not their lack of appetite for risky but rewarding investments – as we can see by the investment into mining. Nor is for a lack of political voice of businesses.

It is more that the long-term incentives in our economy have always rewarded mining and real estate investment and that our acquired ability to understand and evaluate mining and real estate investment proposals crowds out other proposals. It is much more rewarding for industry associations to lobby governments for tax cuts and wage limits than to encourage their members to engage with research and upgrade their businesses.

We probably lack a core of experts who are proficient in taking ideas from proof-of-concept through to commercial sale – such as Grey Innovation. And we lack the depth of gung-ho business leaders who can spread to their peers their tacit knowledge about how to upgrade, export and innovate.

Realigning the risk-reward trade-off for financiers – banks, investment funds and businesses with retained earnings – to favour the creation of new frontier industries will address this bottle neck. This will require higher taxes on monopoly rents, capital gains and super profits like the Norwegian 50 per cent super profits tax; ending the tax deduction that favours debt over equity; and reducing the reward for non-residential real estate development. We need our best and brightest to go into the efficient development of new industries, and not to work as tax accountants and lobbyists.

Although there was a decline in bank lending for plant and equipment in the early stages of the pandemic lockdowns, there has been a rise over the last year. If we are to take the road to a high-productivity, sophisticated capital base, we should capitalise on this. The Productivity Commission's report is a call-to-arms and we should not let another opportunity for a serious focus on productivity growth pass.

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