

Dead economists' society may be way to save our own

[Peter Hartcher](#)

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Illustration: Rocco Fazzari

When they had finished putting together the \$10.4 billion "cash splash" handouts last October, Kevin Rudd thanked the secretary of the Treasury, Ken Henry, for his efforts with a gift.

The Prime Minister handed his senior official an inscribed copy of one of the most famous and influential books of the last century: *The General Theory Of Employment, Interest And Money*.

The British economist John Maynard Keynes published it during the Great Depression in the 1930s. And as Rudd gave it to Henry in front of a small gathering of officials he remarked: "We're all Keynesians now."

What does this mean? Lord Keynes, a terrible toff who disdained ordinary people as "the boorish proletariat", was the man who gave governments the intellectual authority to stimulate the economy.

Until Keynes, centuries of classical economic doctrine paralysed governments. The Depression went on and on, unemployment hit unprecedented levels, yet governments sat back and watched.

Economies were supposed to be self-correcting. The suffering was supposed to be morally sound. Pain was a purgative.

Keynes smashed through the doctrine with his opus. Economies were not self-correcting, he argued. And it was the legitimate role of governments to raise aggregate demand in the economy to restore equilibrium.

Under the force of Keynes's work, governments started to spend money on a grand scale specifically to create jobs. The most immediate beneficiaries? The dirty proletariat. But entire economies benefit. It's now unthinkable that governments could sit idle and watch unemployment soar to 30 per cent.

The comprehensiveness of Keynes's triumph seemed complete when Richard Nixon, a Republican, uttered the famous words that Rudd was quoting - "we are all Keynesians now." But we are now at the point where we have to ask the hard question - where does it stop?

Consider what the Rudd Government has done to date:

- In September, to head off a potential run on banks, it announced a guarantee of deposits. And to keep Australian banks supplied with credit, it guaranteed their wholesale borrowings from other banks.
- Then it committed \$8 billion to buy mortgage-backed securities from small banks and credit unions and other institutions that might have had trouble selling them into the market.
- In October it unveiled its first stimulus package, the \$10.4 billion, in one-off handouts. This was the so-called Economic Security Strategy.
- Next came \$6.2 billion for the car industry.
- Local governments were promised \$300 million for their building plans.
- Then the Rudd Government pledged \$15.1 billion in net new money for the states over four years, mainly for hospitals and schools.
- The car dealers were next. The Government pressed the banks to commit \$2 billion to a fund for emergency credit to car dealerships, with taxpayers guaranteeing the loans.
- The security from the October cash splash was fleeting, because by December the Government announced a further \$4.7 billion in spending, mainly for building rail and road and university facilities.
- In January the property developers got their deal. The Government put \$2 billion into a new fund, matched by another \$2 billion from the banks, as a contingency to allow emergency credit for commercial property developers. It could potentially expand to provide \$30 billion in credit, if needed.

It was at this point that the Opposition really started to worry. If Rudd would prop up property developers like Harry Triguboff, Centro and Frank Lowy, who would it not prop up?

- And on February 3 Rudd announced his \$42 billion stimulus package, including another "cash splash" of direct handouts of \$12.7 billion. The Opposition said this was too much; it would support a package maybe half this size.

So in five months, the Rudd Government has created economic and industry support with a measurable value of \$90.7 billion. That's the equivalent of the total annual economic output of Luxembourg or Libya.

Most of these measures go directly onto the taxpayers' tab. The effect, combined with the natural slump in tax revenues that accompanies a downturn, has been a dramatic reversal in the national budget.

Last May the Government forecast that the budget would be in surplus by \$21 billion for the year to June 30, 2009. Now, according to the latest estimate from the Treasury, it will be in deficit by \$22.5 billion. And the deficit next fiscal year is forecast to be \$35.5 billion.

There is good news and bad.

The good news is that the spending will stimulate the economy. The Treasury estimates that government spending will add 2 per cent to GDP in the year to December 31.

And, if you combine this with the big Reserve Bank cuts in interest rates, the total adrenaline for Australia this year will be as much as 5 to 6 per cent, according to Stephen Anthony of consultancy macroeconomics.com.au. For scale, the economy typically grows by about 2 to 3 per cent a year. The jolt will be increasingly pronounced as the year progresses, he projects.

"That's a massive stimulus," says Anthony, formerly a budget analyst at the Treasury and the Finance Department. The bad news? The cost.

"Already the Government is talking about a deficit next year of \$35.5 billion, but they're planning to add extra infrastructure spending in the May budget so we think it'll end up with a deficit next year of \$50 billion.

"In our modelling we just can't see a way back from that."

So what about all the other things the Rudd Government wanted to do? Stephen Anthony again: "How will they deliver the 3 per cent real annual increases they have already promised in the defence budget? How will they deliver tax reform? What about the education revolution and health reform?"

"And the really big one - they've promised to increase the pension, which will change the structural parameters of the budget."

And then there was one of the big stories of this week - the Pacific Brands decision to shut its Australian manufacturing plants and sack 1850 workers raises the question of the future of the textiles, clothing and footwear industry.

The company, owner of brands including Bonds, Berlei, King Gee, Holeproof and Sheridan, said that it would move its manufacturing offshore to China. This played to a double anxiety in Australia - the fear of coming job losses, and the worry that manufacturing cannot survive in Australia. The clamour for the Government to "do something" is intense.

The Industry Minister, Kim Carr, is due to announce a plan for the textiles, clothing and footwear sector around the time of the budget in May. A Government review of the sector recommends extending the current level of subsidy to the industry from \$170 million to \$250 million over four years.

Rudd will need to balance the ideas of Keynes with the work of another dead economist, the Austrian Joseph Schumpeter. He argued that the dynamism of a capitalist society was to be found in its ability to adapt, to redeploy capital and labour from dying firms to new ones. He invented the term "creative destruction".

It's an obvious point, but you rarely hear it made - if you try to preserve everything as it is, you allow no scope for rejuvenation. Australia had a century of experience with industry protection and learned this lesson. Bob Hawke's industry minister, John Button, said that, by the 1980s, Australian manufacturing had become an "industrial museum". By maintaining the museum, our industry went nowhere. And the protected sectors just became a drain on the competitive ones.

With tremendous trepidation, Australia opened itself to the world. To general surprise, Australia's economy not only survived, it prospered. The manufacturing that survived did so because it was profitable, not propped up. We had a 17-year boom with unemployment of 4 per cent.

Australia became a Schumpeterian case study, creative destruction at work. The test of Rudd's wisdom will be to draw the line between what to prop up, and what to allow to fail. He must discern between the firms that are crisis-stricken yet viable and the ones that are not. He has to choose what promises he can deliver and which he must postpone or cancel.

Rudd's Christmas holiday reading included Lord Skidelsky's well-regarded biography of Keynes. Perhaps his pre-budget reading should include Schumpeter's *Capitalism, Socialism and Democracy*, in which he sets out the case for creative destruction.

Because if he tries to turn the country into Museum Australia, that's exactly what he will get - an ossified economy that will not recover robustly even when the downturn ends.

Peter Hartcher is the *Herald's* political editor