Entitlement and Inequality: Why dumb economics is killing our communities

Communities in Control Conference: "Think Differently"
Melbourne, 25 May, 2015

Presentation by

Stephen Koukoulas

Economic visionary and advisor; Managing Director of Market Economics

Thank you for that very kind introduction, and look, the economy matters.

Before I get started I'm just going to give a little bit of a background.

Look, I am an economist, I live in Canberra, I used to be a banker, I do use PowerPoint, and I'm a Collingwood supporter, so I don't know which of those is the worst but apart from that, some people say that I'm not a bad guy, so that's just a bit of background to sort of get the show started.

And in a funny way, when you look at the economy, it does matter; the economy is really important for issues of fairness, equity, decency and these sorts of things, because without economic growth, it's very, very hard to provide decent education, healthcare, disability care, to build decent roads and these sorts of things that are obviously so important to the wellbeing of the economy.

Now, before I get into it, just a few really important, what I think are important, basic facts about the Australian economy.

This year our economy's going to be producing gross domestic product, that's all the output of the economy, of about $1.65trillion. We're the 12th biggest country in the world, in US dollar terms. Not bad, given that we're 52nd in terms of our population, so we're a big economy; we're doing really well.

And of that $1.65trillion, if you're good at maths and divide by 365 days, we produce over $4.5billion a day in GDP.

So, our decisions to spend, to build stuff, to go out and all the rest of it feeds into what is a really big economy.

Interestingly, if we look at our wealth per capita, now this is not a distribution thing, but it's just the total GDP divided by our population, we are the fifth richest country in the world, in US dollar terms again.

The only countries that have a higher per capita than Australia at the moment are Luxembourg, Qatar, Norway, I can't remember the fourth one at the moment, but it is clear we're doing really well; we are a rich economy.

So when you think about issues of fairness and distribution and wellbeing, you think, "Well, why aren't we doing a little bit better, given how prosperous we are?" And that's where the inequality issue comes a little bit later.

And the other thing to remember is that we've had 24 years without a recession. We're into our 25th starting soon. Isn't that remarkable?

That is actually good news, because we just have to look at places like the Eurozone, for example. Look at Greece, look at Spain, look at Ireland, and these sorts of really troublesome economies.

When you do have a recession, when something goes wrong in the economy, be it poor policy or poor regulation of the corporate sector and the banks blow up and all these other things happen, unemployment gets to 20% or in the case of Greece, 25%. Youth unemployment gets to 50%; half of the youth are unemployed. Services are cut, again, look at the decisions in Ireland and Greece and all those countries that I mentioned in the Eurozone, and in America of course when they had their recession a couple of years ago, services are cut, healthcare's cut.

It's very, very hard for governments who are highly indebted in a recession to maintain their funding. So in a sense, that's what gets to my first slide, hopefully, and economics matters and growing an economy matters.

Now, hopefully this is relatively non-controversial. There are issues about measuring GDP, so if you chop down a forest and sell it, that is GDP for sure, so I'll just put aside some of those issues, they are important, but what matters in terms of the themes I'm going to go through today is growing the economy.

If you grow the economy, you create jobs, that's critical. So, there's nothing worse in my view than running an economy that doesn't have something close to full employment.

Giving everybody a job gives them a purpose, an income that they can do the basic things in life, and if they happen to achieve well, they can do some nice things in life.

If you happen to be one of those people that gets lucky, earns a few extra dollars and you can do a few nice things in life. It raises living standards. The critical issue I think in all of this is that it's got to be done fairly and with a degree of equity in it.

Now, I don't mind Bill Gates inventing Windows and getting $50billion or $80billion, I don't know how much money he's got. Good on him, he's done something very, very clever.

But what does matter, and we've seen this in the debate currently about corporates, big companies in Australia, not paying their fair share of tax. Having their headquarters in Singapore or the Bahamas or somewhere and not paying tax.

You and I spend our money at these shops and buying these things on the assumption that if the company makes money, good on them, but they've got to pay their fair share of tax, and I think that's one of the issues that's got to be continually looked at over the course of the next few years, a really big important public policy issue.

So, fairness and equity.

And I think most people don't mind paying tax as long as everyone else pays their fair share. Where people get really annoyed is if I'm paying my share of tax as a wage and salary earner but someone else isn't because they've got some complex dodgy, albeit legal, system set up so they don't pay any tax. That's unfair, that's why people feel resentful about those sorts of things, so again, people are happy to pay tax, they see the money going into decent things in life, but none the less, it's got to be fair and equity.

And then there's the economic management issue. My goodness, I've been so frustrated; you follow me on Twitter you can probably see how cross I get sometimes and I think *Q&A* tonight, where Joe Hockey's on *Q&A*, I'll be really cross again, I can just tell.

I know I'm going to be tweeting like a crazy cat tonight, but anyway.

But it's the issue of debt and deficit, and managing an economy. I worked for the previous government, it was a lot of fun, really interesting and all the rest of it, but what's the point of having no debt and running a deficit if your unemployment rate's 10%?

Stupid economics, dumb policy, really dumb.

I'll turn this around to sort of just give you the balance, there would be no point running a big budget deficit if your economy was booming. You use economic policy, or you should use economic policy, to manage the business cycle.

Now, things happen to Australia and to every other country. Iron ore prices go up, they go down. House prices go up, they go down. Interest rates go up and down. The Aussie dollar goes up and down. That influences how the economy performs, of course it does, it matters a lot to how our economy grows.

If you're a policy maker sitting in Canberra and you see the economy being weak, for whatever reason, it doesn't matter what the reason is really, but if you see the economy being weak, the unemployment rate ratcheting higher, what should you do?

You should spend a bit more money. You should run a deficit for a few years until the economy gets really strong again, and then you wind it back. It sounds really simple doesn't it?

But no one does it.

Well, the previous government tried to but it just sort of shows the frustration of having the objective being a budget surplus or a little bit of government debt or no debt when the economy's in trouble.

So the argument about government debt and deficits, I often get asked the question, "Well is a budget deficit good or bad?" But it's a bit like asking the question, "Is sunshine, a sunny day, a beautiful sunny day good or bad?"

Well, if you're a holiday maker and you're at the beach, a sunny day is fantastic. If you're a farmer out bush, it hasn't rained for two years, you try to grow a crop and it's a sunny day, it's a disaster. So it's a bit like saying, "Is a budget deficit bad or good?"

It depends.

If your economy's weak, a deficit's good. If your economy is strong, then a deficit's bad, you should be running a budget deficit when your economy's strong. And what's happened with the Australian economy over the last five or six years? Even though we avoided a recession during the GFC, we've still had a, what we call a "weak economy."

It's generally been weak and this next slide will show how the unemployment rate—hopefully you can all see that there, or look at the back screens.

You can see that over the last couple of years the unemployment rate's been creeping up and up and up. We had that terrific period from the mid-'90s through to about 2007 before the GFC really hit us, the unemployment rate got to 4%, fantastic, really good news. It could have been three but let's take four as being not a bad outcome.

GFC came along, the unemployment rate did go up. As you can see there, it went to about 5.75% at the peak, but the stimulus measures, the running of budget deficits, interest rate cuts, and the little bit of good luck from China remaining strong, helping our exports sector, stopped our economy going into recession. We spent the money in the stimulus measures, the unemployment rate went back down to about 4.75%.

Now, the last couple of years you can see the unemployment rate creeping up very, very slowly but very, very steadily.

It's above 6% and it's been above 6% for basically the past year now. So it is a problem. It's telling me that the economy's been too weak. It's telling me that policy settings, including from our friends at the Reserve Bank who set interest rates, of course, have been too tight.

You can choose your level of unemployment.

The former RBA governor Ian Macfarlane, who was a really interesting, vibrant sort of policy maker; one of the really good and interesting people when it came to how he managed interest rates.

He doesn't run the budget of course, or he didn't run the budget.

Unemployment is a matter of choice; you can choose an unemployment rate if you're a policy maker. Now, in the short-term, I hate to be short-term long-term, but in the short-term, something comes along, the unemployment rate spikes up.

You can either choose to leave it there or you can choose to do something about it, and again, it comes to fiscal policy stimulus. And this is the quite funny thing about the budget that came out a few weeks ago, whenever that was, is that the budget was framed with forecast of the unemployment rate staying above 6%, in fact, increasingly a little bit more in the next nine to 12 months, going back up to 6.5% and staying there for the next two-and-a-half years.

So the government's chosen specially to have a higher unemployment rate. You've got to remember that a 6% unemployment rate's about 750,000, 760,000 people. That's a lot of people who are unemployed when you think about it, rather than 6%, what's that mean? It's almost three-quarter-of-a-million people. So if it gets to 6.5%, it will be over 800,000 people. That's a choice.

Now, this is where the other interesting policy issues come in, because a high unemployment rate means that wages growth is very weak.

Now, I won't do a survey here but I dare say most people are not getting big pay rises. In fact, we're seeing it from a number of the unions at the moment, the public sector wage claims are all 1.5%, 2%, really low wages claims, and when you've got high unemployment, when you've got three-quarter-of-a-million people unemployed, it's very hard to put your hand up and say: "Oh gee, that 1.5% pay rise you've given me is pretty rotten," because your chances of achieving a bigger pay rise are quite low.

Now, you can see there both public sector and private sector wages, they're at record lows, and it's because the unemployment rate's going up, and what that means is it's a rather simple sort of equation, because when you think about inflation in Australia, it's on average 2.5% – that's the RBA target.

So if wages growth was in the previous couple of decades about 3.5%, 3.75%, you're getting a real wage increase every year. So if your wage is going up 3.5%, prices are going up at 2.5%, you're 1% better off over the course of the year.

Doesn't sound much, but you accumulate that over 10, 15, 20 years, and your living standards go up because of that.

But when wages growth's at 2.5%, prices are going up at 2.5%, you've got no real wage increase. In that earlier example, you can afford to spend more money, your real wages are going up so at the end of the day you've got a bit of money left over so you'll spend some more money, you'll do something and the economy has a self-fulfilling growth momentum.

Right now when wages are barely or not even keeping up with inflation, consumer spending not surprisingly is quite weak, because people don't have spare cash.

The only way people can increase their spending when wages growth is running at the same rate as inflation is either to run down their savings, that's probably not a great economic solution to the problem, or they can borrow more.

That's certainly happening in the property market, but again, there's concerns about people having too much debt and beating up house prices to these sort of crazy levels that we're seeing, particularly in Sydney, and that's an issue of economic management too.

And that's why the Reserve Bank was reluctant to cut interest rates, so you get this problem occurring when wages growth is too low.

So I'm not advocating we all put our hand up for 10% wage increases, no, but what I'm saying is we've got to have a policy setting in place that grows the economy faster, generates a bit of employment, and that leads to some increase in real wages.

It can be a modest increase, but something that just improves living standards; it's all about the economy growing stronger.

Now, again, I hope you can see this chart (referring to PowerPoint presentation).

It's trying to show that what's happening also in terms of fairness and equity if you like, is that long-term unemployment's on the rise.

That green coloured line as you can see there, that's short-term unemployment, that's people who are unemployed for less than four weeks.

I don't have any problem with that, it's like someone resigning from their job today, they have a couple of weeks off and they start their new job in a few weeks.

Fine, that's normal churn in the labour market, we've all done that at some stages in our lives; you change jobs, you have a couple of weeks off in between. That's short-term unemployment and remarkably that line's steady. That hasn't changed, it rarely does, it's a bit over 1% of the workplace. There's always change in jobs; that's fine. You look at medium term unemployment; that's people who have been employed for between one month and a year.

Now, before the GFC hit, as you can see there, it got down to just about 2% or a little above 2% of the workforce. It shot up during the GFC, came back a little bit, but now the trend increase, apart from that last data point, but the increase is quite clearly there.

There are more and more people who've been employed for between one month and 12 months. That's a bit of a worry, but then you look at the final line, the blue line, which is long-term employment, people who have been unemployed for a year or more. That was nice and low before the GFC, although having said that, 0.75% of the workforce is still too high, but it was actually relatively low.

Look what's been happening, it's been grinding higher all for the last five years.

So basically what you can assume from this chart here is that all of the increase in the unemployment rate in that chart that I showed you a couple of charts ago is long-term unemployed.

And when you've been unemployed for a year or more, well, there's motivational issues; you lose your skills, you're not working, you lose an ability to engage with the labour market, so when a job comes up you probably lose your enthusiasm for looking for a job.

It's soul-destroying, and most economic theories, most economic research on long-term unemployment, does actually lead to the conclusion that it's very, very hard for someone who's been unemployed for a long time to reattach to the labour market and get themselves a job.

So again, that's pretty unfair isn't it? Particularly when we're the fifth richest country in the world, you think: "Well, surely, surely, there's a policy in place that can make sure that all people unemployed, whether it's for one month or two years, can be retrained, re-skilled, maintain their attachment to the labour market?" So when the economy's stronger, which I think's the most important thing, when the economies stronger, there's a job for them to do.

And I also think back to the period just prior to the global financial crisis, don't know if you remember it, but when the economy was very strong in 2006, 2007, when the economy was booming, we had a skill shortage. Remember that?

Some of these big mining companies were looking to hire people and it was spilling over into the hospitality section throughout Perth and other parts of the economy.

Well, a skill shortage means that when a firm wants to hire someone, all the people who apply for them don't have the skills, by definition. But that occurred with the unemployment rate at 4% still, so okay, 4% is a low unemployment rate, but why don't we have a target to make that 3% at the low point, or 2.5%, I don't know, something lower. Because every percentage point on unemployment is 150,000, 200,000 people.

How could it be possible that we had back in 2007, still 550,000, 600,000 people unemployed and a skill shortage? I'd be spending money retraining, reskilling people, because it's fair and it's equitable giving people a chance to have a job.

Now, how do we grow the economy faster? We can't control the iron ore price that China pays us, despite Twiggy's efforts to perceive we can, but we can't control the iron ore price, we can't control the world economy, we've only got limited control over some other parts of the economy, but there are a couple of things that we can do, and this is infrastructure spending.

Sounds simple, let's build a second airport in Sydney, hooray, they're doing that after all these years.

Let's make sure our rail, public transport facilities, even roads to some extent are an important part of infrastructure, that they're all as good and as efficient as they can be, and it's really, really simple.

The benefits to the economy of building infrastructure are huge. Not only when you're building it, so when you're building that airport in Sydney, for example, you're putting concrete and wires and the buildings and the terminal and all that sort of stuff, it creates jobs when you're doing it, obviously.

When it's finished, you're actually increasing the capacity of the economy to grow faster, so more planes can come in with tourists who want to spend their money here, great for our economy.

Business people can come here very easily, and for the fast growing region in Asia, for example, who want our fresh fruit and seafood and all these other things, you've got the freight facilities to send the stuff back out. So, not only do you have the benefit of when the thing's being built, you're creating jobs, you're creating opportunities and the economy's stronger, much, much stronger, but when the thing's finished, your ability to grow your economy faster to generate jobs and to maintain that wonderful virtuous cycle of economic activity is also greatly enhanced.

It says to me that it's such a simple thing, and if you look at this chart (referring to PowerPoint presentation), what's happening to it? My goodness, it's falling off a cliff.

Because this is basically public construction work done, that's for all intents and purposes infrastructure spending. You can see the building the education revolution during the GFC, that's just the bottom green line, the bar went straight up. School halls and things like that were built and then it fell back down, but what's happening now is it's falling further.

That, I think, is a really bad thing. It's a really bad thing that just hasn't been addressed by the government.

They talk about it, they have arguments with state governments about assets recycling and all this other stuff. Just get on with it. Economics shouldn't be that difficult – just implement the policy.

Is it obvious? I think it is. Let's just build this infrastructure.

And the other thing that makes it even more perplexing, here's chart of interest rates, this is the 10-year government bond yield.

That's the price that the government, through the financial markets, can borrow money for a 10 year term, a 10 year government bond, and they're currently paying under 3%.

Wouldn't you love to borrow money for 10 years for 3%? How much would you borrow? It would be amazing.

But the government because of their debt and deficit fetish and whatever, don't want to borrow. They want to try to pay for it from recurrent revenue.

"Oh, we can't borrow money, we can't ever have a concern about our debt and deficit levels," whereas some people, some of us, are suggesting that these incredibly low interest rates, and I don't know how long they're going to last, I've been around long enough to know that interest rates change.

In fact, just look back ten years ago; a ten year government bond was between 5% and 6%, it was above 6% at some stage. Okay, it's still relatively low interest rates but now they're less than three. It's half the borrowing cost, and for Australia with its AAA credit rating, with really low levels of government debt, being a rich economy, and decent economy, foreign investors would fund it like there's no tomorrow.

The thing to remember about this is if you had the government and they decided, "Lets borrow $10billion, $20billion," I don't know, whatever number you want, pick a number.

"And we're going to allocate that specifically for these infrastructure projects," so it's sort of off-budget, so it's separate from the budget because if it gets caught up in the budget then it's all tangled up with revenue from GST and company tax and all that other stuff.

If you have it off budget, like the NBN was funded, for example, you can see we've borrowed exactly this much, this is what we're doing with the money, these are our annual interest costs for this project, and who knows, maybe at the end of the day you can see them to the private sector when they're built.

Or, you just collect tolls if they're a road or you collect revenue if it's an airport. You can fund it down the track, but in the meantime you grow your economy more quickly, more rapidly, and you're generating jobs not only today, as I said before, you're improving the productive capacity of the economy.

And you just have to, if you've travelled around the world sometimes, you have to see the poor quality infrastructure in some countries, it holds back their ability to grow.

And infrastructure does actually relate to things like power generation too; without electricity, goodness knows where we'd be. So you need the government sector to be providing this infrastructure to allow your economy to be a little bit stronger, creating a few more jobs, and growing more rapidly.

Make sense? Makes sense to me.

Now, here's my favourite chart (referring to PowerPoint presentation) and it looks like a dog's breakfast, I'm sorry, and it's from Justin Wolfers who's one of the professors at Harvard I think, so I'll explain it for a second.

On the bottom is per capita GDP, so as you move from left to right it's higher per capita GDP. There is some weird company that measures happiness in each country, a degree of happiness.

What this chart shows is that if you have more money, you're happy. Now, would you be happy if I gave each of you $1000? Yeah. I'm not going to do it, I'm sorry.

I'd be happy if you each gave me $1000 too, but no, no. It's not meant to be showing that people are greedy and nasty and they want more money and all these other sort of things.

What it shows is that if you've got money, if you've got a strong economy and you can sort of—and these are all different countries, so there's Hong Kong, all the rich countries in the top right-hand part and all the poor countries, Benin, Togo, with per capita GDP of $1000 or $500, they're not very happy. Their kids are dying, they can't feed themselves, it's horrid.

So money does give an opportunity, this is sort of the economist in me coming out here, I like growing an economy because it gives opportunity, wealth, and expansion.

You can fund your healthcare, you can educate your kids, you can do a whole lot of things and your whole economic wellbeing improves if an economy has more wealth in it.

So that's why I like growing the economy, that's why I like infrastructure spending, that's why managing the business cycle is really, really important. And it's a really, really simple chart, I think, that just illustrates quite nicely why growing an economy's good. Why increasing living standards.

And the question that doesn't come into this, if we had a three-dimension one, this is my wish one day to have a three-dimensional chart, is to sort of say, well, there's an income distribution component to that. I don't know which one is the U.S.A., I think I do know the U.S.A., it's just sort of in that right-hand side.

One of the things about the U.S. even though most people are happy there, the degree of income inequality has worsened, that it's become less equal, since the GFC.

There's still a rich economy but there are chronic problems there, that healthcare's starting to decline, that the rise in life expectations is slowing down; it hasn't quite fallen yet, but it's changing. Their economy's a bit weaker, people can't afford to go to the doctor despite ObamaCare. There are issues that are associated with increasing inequality or a weakening economy, so both go hand-in-hand.

Thomas Piketty has written ... about how greater equality, income equality, is good for the economy.

It's about this growth thing that I was talking about, and this is a stylised example or a bastardised example if you like.

So just say there are ten billionaires and you give them a billion bucks each, and I don't mean to pick on Gina Rinehart but I will. So, she's got $20billion at the moment, right.

She spends her money and does all these things with her money, good on her, whatever. Whatever, I'm not getting into that sort of thing necessarily.

But if you gave her an extra $1billion, do you think she'd spend any more on things? I don't know. The price of iron ore changing by 0.50c probably adjusts her wealth by $1billion, I don't know. It doesn't matter. So in a sense if she gets really, really rich by an extra $1billion, the effect on the economy, on spending, on GDP, on jobs, probably wouldn't be that much.

She'd still be doing whatever she's doing, that's fine, whatever, good on her. But, if you had $1billion and you gave $1000 each to one million of the low-income workers, the poorest, if you like.

You gave them each $20 a week for a year, that's $1000 roughly. $20 a week extra either in their pension, in their pay, in some form of distribution, greater equality, less inequality.

Now, we know every economic theory book says that the low-income earners have a high, they call it "marginal propensity to consume." They spend the money they get. They have to, just for subsistence, just to have a roof over their head and a decent feed every day. You give them an extra $20, they'll spend it. They might bring forward the purchase of an essential item that they couldn't otherwise afford. Once every few weeks they might do something nice; they might go out for dinner and go to the movies or something, but as they spend that money, the economy gets a boost.

They go to the local corner shop, they buy something, the economy is stronger.

So those million people with $1000 a year extra spend the economy, what happens to the economy? It's much stronger. It grows faster.

And this is the Piketty thesis distilled into, like, 90 seconds if you like, but it works, the economy's stronger, job creation is there, you're giving money to people who are inclined to spend it rather than a high-incomer, a high-wealth person, who's spending all they can anyway.

There's only so much more that they can spend. So again, this is sort of the end point of the process about income distribution. Now, I'm not saying we tax the rich massively and give it all to the poor, but I am saying that policy, we've got a progressive income tax structure.

$18,200 of your income is tax-free and then it goes up to 0.47c in the $1.00 and 0.49c with this extra levy.

Great, good, progressive income tax structure.

Some of the personal benefit payments are skewed to low-income earners, as they should be. If we take a little step over time towards more of those policies so that someone who's got $5billion, $10billion, doesn't notice that they're paying an extra $10million a year in tax, they won't even know.

It's the fluctuation in the share price of whatever they own by a cent or something like that, and you redistribute that to low-income earners, your economy’s faster, it grows more, there are more jobs, people are better off, and when there’s more jobs and a stronger economy, governments can afford to provide healthcare, education, all these things that we find so dear, that are so important in my view to running an economy in a decent, fair way.

Thank you.