Labor

SPEECH | WE'LL PUT PEOPLE FIRST

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IS THE AUSTRALIAN ECONOMY TOO SIMPLE?

INSURANCE COUNCIL OF AUSTRALIA ANNUAL FORUM

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It is a pleasure to be speaking at the Insurance Council's annual forum today.

As part of Labor's economic team, I have appreciated my engagement with the ICA over recent years. You have a strong working relationship with Bill Shorten, Chris Bowen, Katy Gallagher, Matt Thistlethwaite, Jim Chalmers and others on the Labor front bench. Smart oppositions use the time to engage with the community, craft policies, and prepare for the possibility of taking government. Regardless of your politics, I doubt anyone would disagree that this Labor opposition has produced more carefully crafted policy proposals than any opposition in a quarter of a century. We don't just want to win the next election: we want to have a clear plan for growth in the decades ahead.

It is particularly appropriate to be speaking about the role of government in the economy to the Insurance Council. In a sense, we are engaged in the same enterprise: managing risk. This is an idea that goes back to David Moss, who called government the 'ultimate risk manager'. We have a social safety net to guard against the risk of poverty, a public health care system to deal with the risk of illness, and a public education system to remove the risk that a poor family might not be able to afford to educate their child.

You can think of your taxes partly as an insurance premium, with progressive taxation reflecting the fact that those of us who earn above-average incomes tend to have been fortunate in our family background, educational opportunities and career breaks. The notion of government as risk manager doesn't cover the full gamut of what governments do, but it does encapsulate many of their important roles. I'll come back to this later in the talk.

So, how is the economy currently travelling?

Looking at the Australian economy today, we can readily identify challenges and opportunities. If I put on my Edward De Bono yellow hat, I notice:

- A broad-based pickup in global growth in 2017. As the Reserve Bank has noted, Chinese growth is increasingly consumption-driven, East Asian semiconductor trade has been healthy, and European machinery investment has been strong. In the United States, Japan, Germany and Britain, unemployment is at a multi-decade low. Most forecasters have revised up their estimates for global growth in 2018 and 2019.

- Commodity prices remain solid, though analysts are worried about the medium-term outlook given the changes that China is making on how it manages local production to improve urban air quality.

- If you're a business, global interest rates are almost as low as they have been since 3000BC.

- The Western Australian economy is finally starting to turn around, after suffering a severe drop in recent years.

On the other hand, if I put on my black hat, I can't help noticing:

- Inflation continues to be low - below the Reserve Bank's target. That's a sure sign
  the economy has something of an output gap that has built up over several years of sub-par economic growth.

- Household income growth is weak, which is dragging down consumption growth. Our spending on essentials hasn't changed, but we're spending less on discretionary purchases, such as restaurants and recreation. The household debt to income ratio remains frighteningly high. Remember those 5000-year low interest rates? Let's hope they don't rise too quickly.

- The labour market is soft. At 5.5 percent, our unemployment rate is 1-2 percentage points higher than in many other advanced countries. If we had America's unemployment rate, 180,000 more Australians would have jobs. If we had Germany's unemployment rate, 250,000 more Australians would have jobs.

And that's before we get to underemployment and the increase in 'permanent casual' employment – problems that my colleague Brendan O'Connor has articulately discussed.

- The Australian economy suffers from a concentration problem – yes, a concentration problem. More than half of our industries are dominated by a handful of players. In department stores, newspapers, banking, health insurance, supermarkets, domestic airlines, internet service providers, baby food and beer, the biggest four firms control more than 80 percent of the market. As a nation, we have a plethora of mergers and a paucity of start-ups.

Looking ahead, the one thing we know about the challenges of the future is that they will not be those of today. That's why we advise young people to acquire broad-based skills – writing beautifully, crunching numbers, motivating teams – because those attributes will continue to be value even in the face of changes to the labour market.

In this sense, we encourage young people to diversify across possible jobs. If you want to be a mechanic, don't become so specialised in fixing petrol-powered driven cars that you can't adapt as the world changes to electric driverless cars. If you're a speech therapist, make sure you're adept at working with new technologies that are providing real-time feedback to patients. And so on.

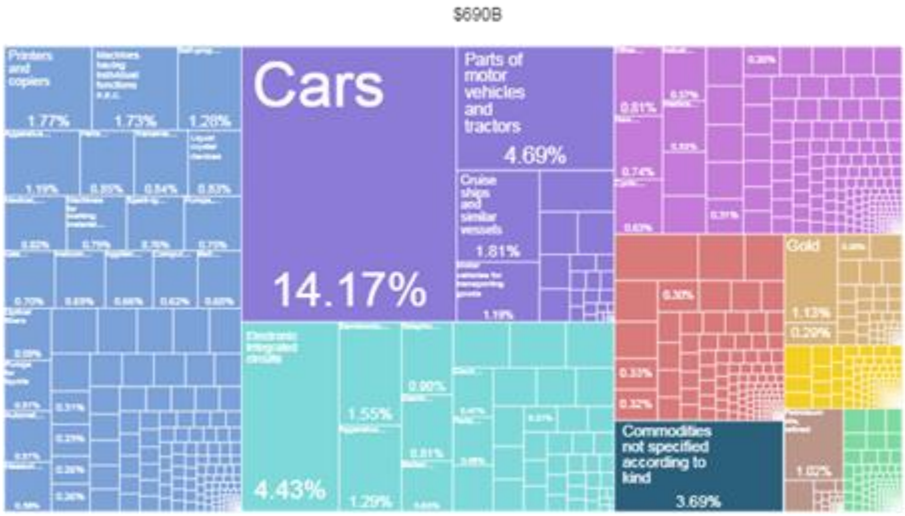
Nations also need to be adaptable. The economic principle of comparative advantage tells us that the world can become richer when countries specialise at what they do best, and engage in global trade. But while some specialisation is good, too much can create excess risk. If your national prosperity strategy relies on exporting sugar, you're going to be at risk when diet soft drinks take over. Just like a worker who only has a single skillset, a country that makes just a few products takes on a lot of risk in the world economy. And while we have a welfare system to protect the worker, there's no global social safety net for a country that puts all its eggs in the wrong basket.

Perhaps the most useful way of thinking about a country's degree of specialisation is the Harvard *Atlas of Complexity*. Developed a decade ago by a team led by Ricardo Hausmann, the atlas begins with the idea that some products are more complex than others. To make medical imaging devices or jet engines takes plenty of knowledge and extensive networks of people. To make wood logs or coffee beans requires less knowledge and smaller networks.

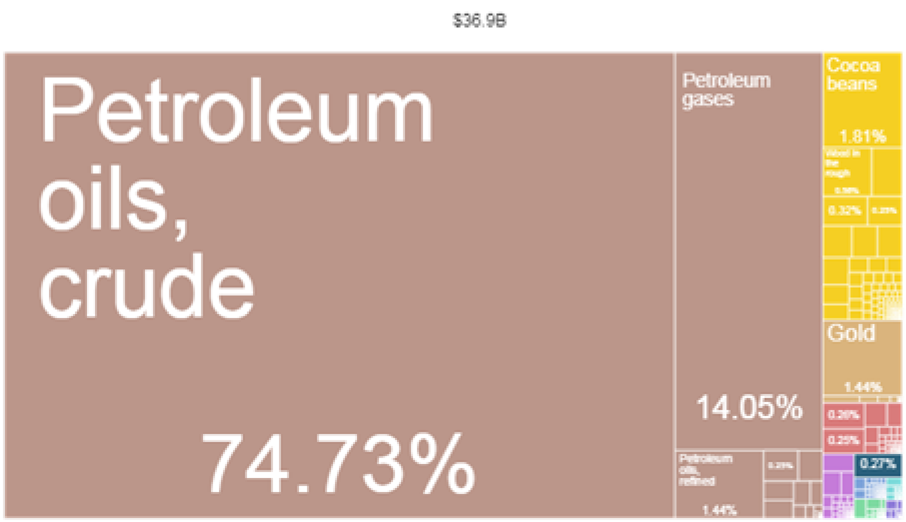
Hausmann and his team liken the problem to scrabble. A player with just a few letters can only make a few words. Having a broader mix of letters opens the possibility of making more words. Countries that are more complex are like scrabble players who can make more words.

As a proxy for the complexity of an economy, the Harvard team use the products that it exports. A product like medical imaging devices is considered complex, since few other countries export it, and those who do tend to export a wide range of other products. By contrast, a product like diamonds is not considered especially complex, since diamond exporting countries tend to just export diamonds.

From the diversity of a country's products, it is then possible to work back and calculate a proxy for the diversity of its economy. The world's most complex economies are Japan, Switzerland and Germany. Here's a visualisation of Japan's exports.



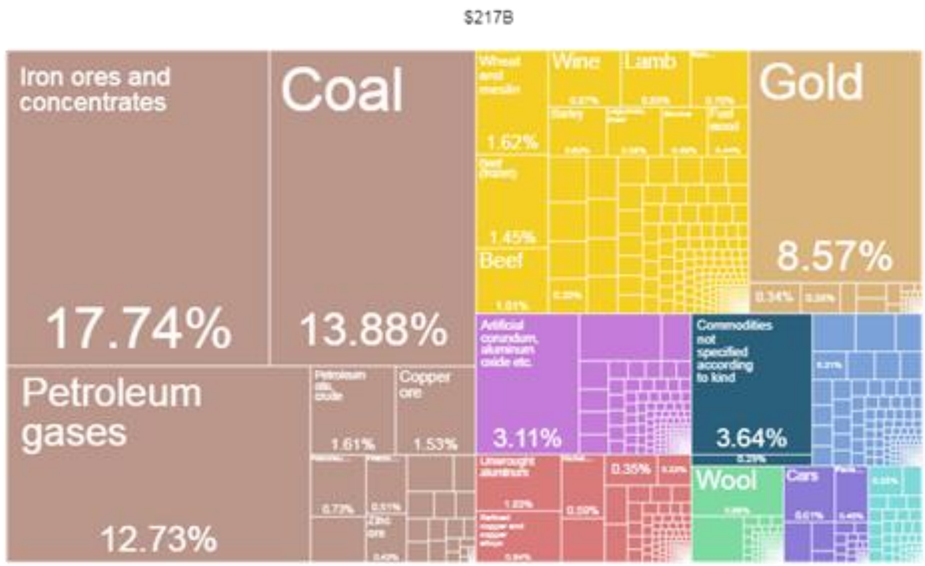
The three least complex economies are Cameroon, Guinea and Nigeria. Here's what Nigeria's exports look like.



As you might expect, economic complexity correlates pretty highly with a country's income level, explaining about four-fifths of the variation across nations. But it also turns out to be a good predictor of future economic growth, even given its level of development. Take two countries with similar levels of income, and the growth prospects of the more complex country are better than those for the less complex nation. Complexity does a better job at forecasting a nation's economic future than many other measures, such as a country's average education levels, governance levels or the World Economic Forum's competitiveness index.

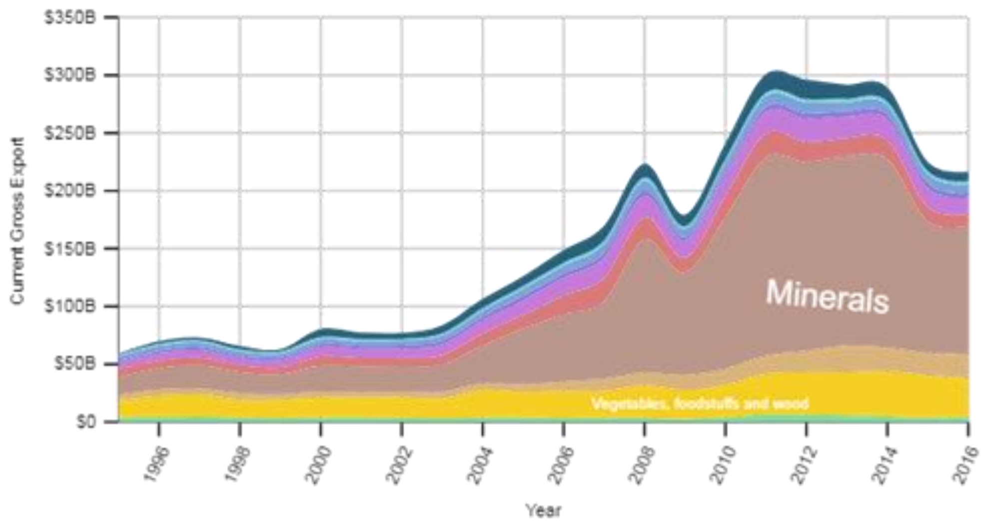
How does Australia fare on the Economic Complexity Index? In a word, badly. Out of 122 economies that the experts have assessed, we come 65th, just below halfway. For a nation that consistently ranks among the top 20 for our income per person, this is an astonishingly poor performance.

Here's how the Atlas of Economic Complexity sees Australia's exports.

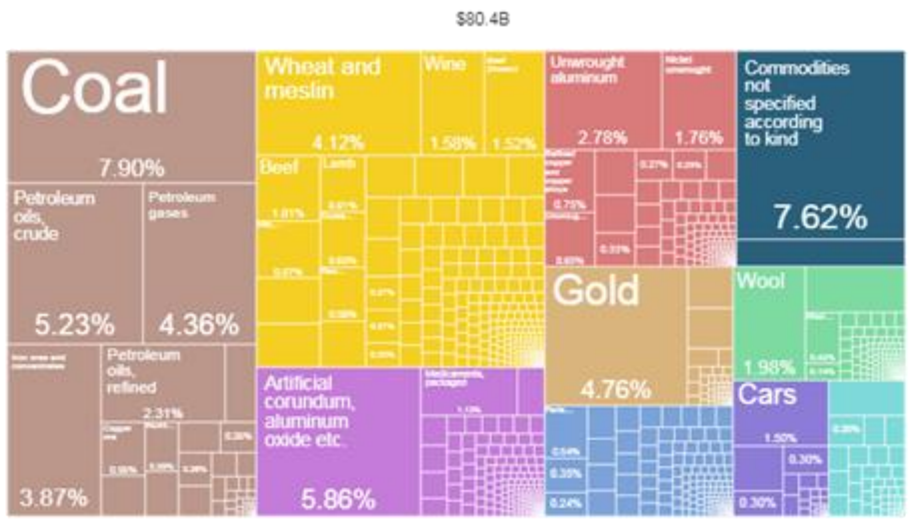


It isn't just that we export relatively few products; it's that those we export tend to be exported by pretty undiversified countries.

Now, an easy response would be to say that Australia's lack of complexity is a response to the mining boom. And it's certainly true that the boom focused our mind on the fact that the commodities used to build Chinese skyscrapers were fetching stratospheric prices. Here's the trend in our export mix over the past few decades.



But it turns out that even before the boom, our exports weren't particularly complex. Here's our exports in 2000.



Over the longer run, Hausmann and his colleagues estimate that Australia's economic complexity ranking stayed pretty constant from the mid-1960s to the late-1970s, then fell markedly over the past generation. On their measures, we have never been an especially complex economy. But we've gotten a lot 'simpler' in recent years.

Now, there are certainly limitations to the methodology that the *Atlas of Complexity* uses. Services exports are excluded, which means that higher education, tourism, financial services and legal services exports don't get counted. Further, the Hausmann approach only looks at trade, so a nation could in theory have a complex and diversified domestic market, but only sell simple products to the rest of the world. But just as the proof of the pudding is in the eating, the proof of any growth theory is how it predicts growth. And anyone who wants to airily dismiss the *Atlas of Complexity* needs to explain the fact that it has a pretty good track record of forecasting past economic growth across nations.

More broadly, the suggestion that Australia's economy might be a bit too simple for its own good accords with a concern that I've expressed about the past two-and-a-third centuries of economic growth, in the period following European settlement. When I look at the Australian economy over that period, I see a country that picked six pieces of 'low-hanging fruit'.

In the early-1800s, it was the vast tracts of land taken from Indigenous inhabitants. In the mid-1800s, the Gold Rush. In the first half of the twentieth century came abundant inventions (cars, airplanes, telephones, radios, fridges, washing machines, typewriters). After the war, the low-hanging fruit came in the form of a migration boom. In the 1970s and 1980s, the expansion of mass education spurred growth. And in the 2000s, we benefited from the mining boom. Economically, we've been the lucky country.
So when we look at future sources of growth, we have two options: we can either hope for another piece of low-hanging fruit, or we can seek to make our own luck. Labor believes we should do the latter. That's why Bill Shorten, Chris Bowen and our whole economic team are committed to developing a more complex Australian economy.

To foster greater complexity, we need to boost education standards in Australia. This is why we are committed to investing in schools, to creating more apprenticeship places, and to putting the demand-driven system back in place in our university sector. As Tanya Plibersek has noted, it's hard to imagine that we can be the clever country by cutting billions out of our education sector.

Across our corporate sector, we have too many mergers, and too few start-ups. As I've noted before, market concentration is a feature of much of our economy. It's good for the individual monopolists, but bad for the economy as a whole. Labor wants to encourage more new business formation, and an environment in which entrepreneurs start enterprises not with the aspiration of being bought out by the oligopolists, but of taking a share of the market. Competition law in the app age isn't easy, but it's fundamental for our economic future that we get this right.

Our research and development sector needs more government focus, and more sustained investment. Basic science helped underpin innovations from wi-fi to the Gardisil vaccine that prevents cervical cancer. Yet as Kim Carr has pointed out, cuts to the CSIRO, to innovation programs, and to university budgets reduce the chances that Australia can develop whole new industries that will create jobs, spur growth, and help develop a more complex economy.

On the trade front, we need to encourage a wider variety of export industries. As Shadow Minister for Trade in Services, I've appreciated the keen focus that Jason Clare has upon ensuring that trade agreements are in our national interest. Labor believes new trade agreements should be scrutinised by the Productivity Commission, to ensure that the benefits outweigh the costs. It's an idea that should be supported by anyone who agrees that trade deals should be about economic results, not ministerial photo opportunities. And by the way, if the Turnbull Government doesn’t secure an exemption for Australia from the US’s proposed new steel and aluminium tariffs, that will make us a less complex economy too.

Finally, a more complex economy needs great infrastructure. As Anthony Albanese has pointed out, that means more investment in roads, rail, and the infrastructure to support transport of the future, including driverless cars. It also means better broadband. As Michelle Rowland has noted, the rollout of a second-rate National Broadband Network has come at a cost to Australia’s economic potential. It’s hard to develop the industries of the future when you’re constantly buffering.

So like the insurance industry, we in Labor are constantly thinking about risks and opportunities. Our economic team spends a lot of time speaking with business leaders, and we’re inspired by the energy, focus and ideas that characterise our best companies. But for the economy as a whole, we also believe that it’s vital not just to think about how to lift up the best performers, but also how to improve the quality of the economic ecosystem. The complexity approach isn’t perfect, but it is a reminder that we have a lot of our national eggs in just a few baskets. Or, if you prefer the more literary Harvard metaphor – that we have too few scrabble letters.

There’s much to be proud of in Australia’s economic story, but we shouldn’t limit our ambitions to what has been done in the past. As my colleague Ed Husic often notes, the waves of technological change to come could conceivably dwarf those we’ve seen in the past. Geopolitical rebalancing will doubtless affect our economy in ways we can’t imagine today.

Nations don’t buy insurance policies, but they can achieve the same outcomes in creative ways – by investing in a stronger education system, by ensuring we have a competitive economy and by improving our infrastructure.

We look forward to working with you on these reforms in the years ahead.

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