DISCUSSION PAPER SERIES

IZA

IZA DP No. 7505

Australia: The Miracle Economy

P.N. (Raja) Junankar

July 2013

Forschungsinstitut
zur Zukunft der Arbeit
Institute for the Study
of Labor

Australia: The Miracle Economy

P.N. (Raja) Junankar
University of New South Wales,
University of Western Sydney and IZA

Discussion Paper No. 7505
July 2013

IZA

P.O. Box 7240
53072 Bonn
Germany

Phone: +49-228-3894-0
Fax: +49-228-3894-180
E-mail: iza@iza.org

IZA Discussion Paper No. 7505
July 2013

ABSTRACT

Australia: The Miracle Economy

Most of the countries of the OECD are still suffering from the Global Financial Crisis (GFC) (or as the Americans call it the Great Recession), but the Australian economy appears to be powering ahead. It is a miracle economy! Unlike most of the OECD countries, Australia did not even have a recession. In this paper we study the behaviour of the Australian economy compared to some of the OECD countries and see that, in fact, Australia has a "miracle economy". The comparisons are made in terms of several macroeconomic indicators, GDP, Unemployment, Inflation, Current Account Balances, and debt.

JEL Classification: E24, E30, E60

Keywords: OECD, Great Recession, macroeconomic indicators, unemployment

Corresponding author:

P.N. (Raja) Junankar
The Australian School of Business
The University of New South Wales
UNSW Sydney NSW 2052
Australia
E-mail: raja.junankar@uws.edu.au

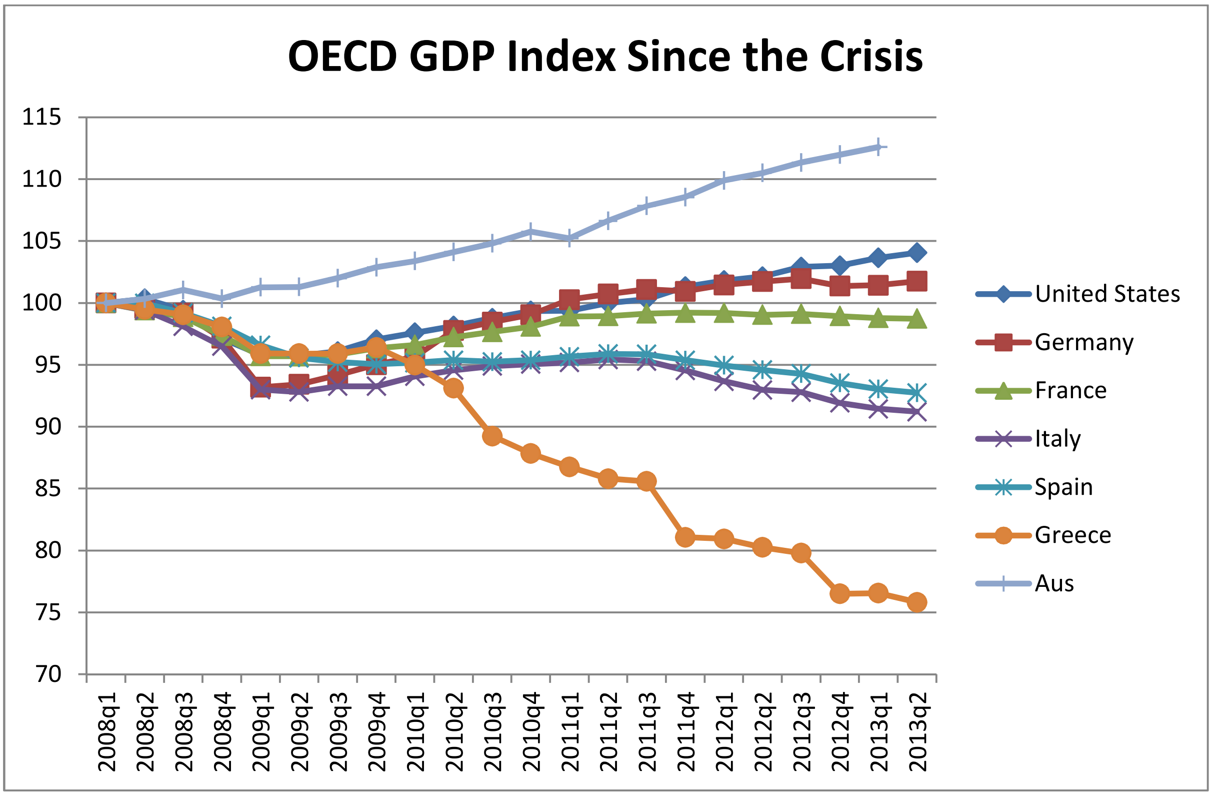
Australia: The Miracle Economy

1. Introduction

Most of the countries of the OECD are still suffering from the Global Financial Crisis (GFC) (or as the Americans call it the Great Recession), but the Australian economy appears to be powering ahead. It is a miracle economy[1]! In the past few months, it appears that the Australian economy is finally slowing down as the resources boom comes to an end. Unlike most of the OECD countries, Australia did not even have a recession (at least in terms of a commonly used definition in terms of two negative quarters of GDP growth). However, if we listen to the politicians it appears that the Australian economy is suffering from a major crisis of ballooning government debt and an impending crash. In this paper we study the behaviour of the Australian economy compared to some of the OECD countries and see that, in fact, Australia has a "miracle economy". The comparisons are made in terms of several macroeconomic indicators, GDP, Unemployment, Inflation, Current Account Balances, and debt.

2. How has Australia fared in the GDP stakes?

Figure 1: Australia leads in the GDP Race



Source: OECD

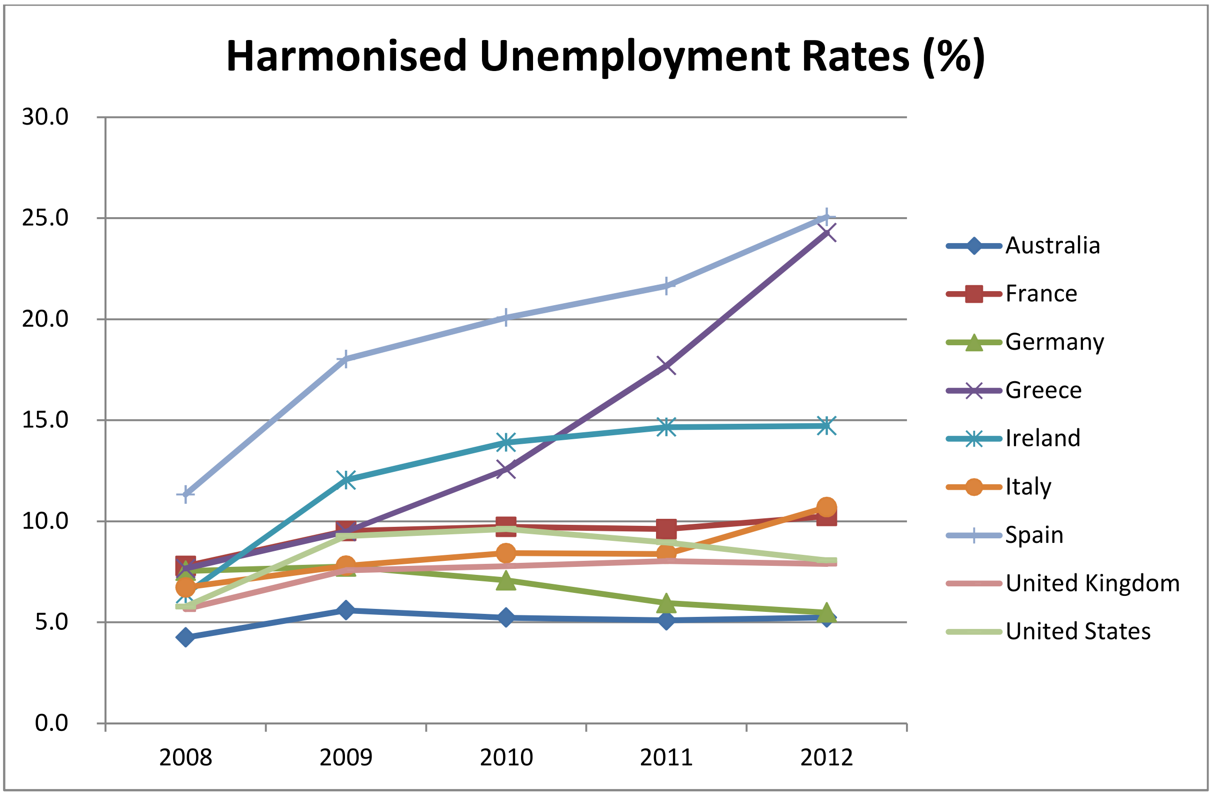
[1] See Ulf Rinne and Klaus F. Zimmermann (2012) "Another economic miracle? The German labor market and the Great Recession", *IZA Journal of Labor Policy*, 1 (3).

Figure 1 shows that Australia has outperformed several OECD countries. If we look at an index of real GDP (that is corrected for inflation) we see that the only countries where the GDP has gone above the level it was in 2008 (the start of the GFC) are USA, Germany and Australia. Even the "wunderkind" Germany took three years before its GDP returned to the pre-2008 levels. Australia never had a fall in its GDP, and continued to increase consistently. Its real GDP is 12.5 per cent higher than it was in 2008, while a country like Greece has had a fall of almost 25 per cent in its GDP. However, unlike many of the OECD countries Australia not only had a massive and timely stimulus package but did not introduce "austerity" measures. It did slowly withdraw the stimulus measures and in part this is responsible for the recent slowing down of the economy.

3. How does Australia Fare in the Labour Market

In Figure 2, we present the data where we see that although the unemployment rate increased slightly, it has come down again (although not back to the pre-GFC level). All the other countries had higher unemployment rates than Australia in the post-2008 period. Only at the end of 2012 did Germany catch up with the Australian economy. Countries like Greece and Spain that are going through a significant financial crisis and the imposition of austerity measures to satisfy the lenders, the European Central Bank and the International Monetary Fund (IMF), have had a dramatic increase in unemployment rates. The austerity measures were supposed to help these economies to recover, but it appears that the situation has only got worse. Youth unemployment rates in many of the Eurozone countries have escalated to almost fifty per cent, leaving a younger generation scarred for life.

Figure 2: Unemployment Rates in the OECD

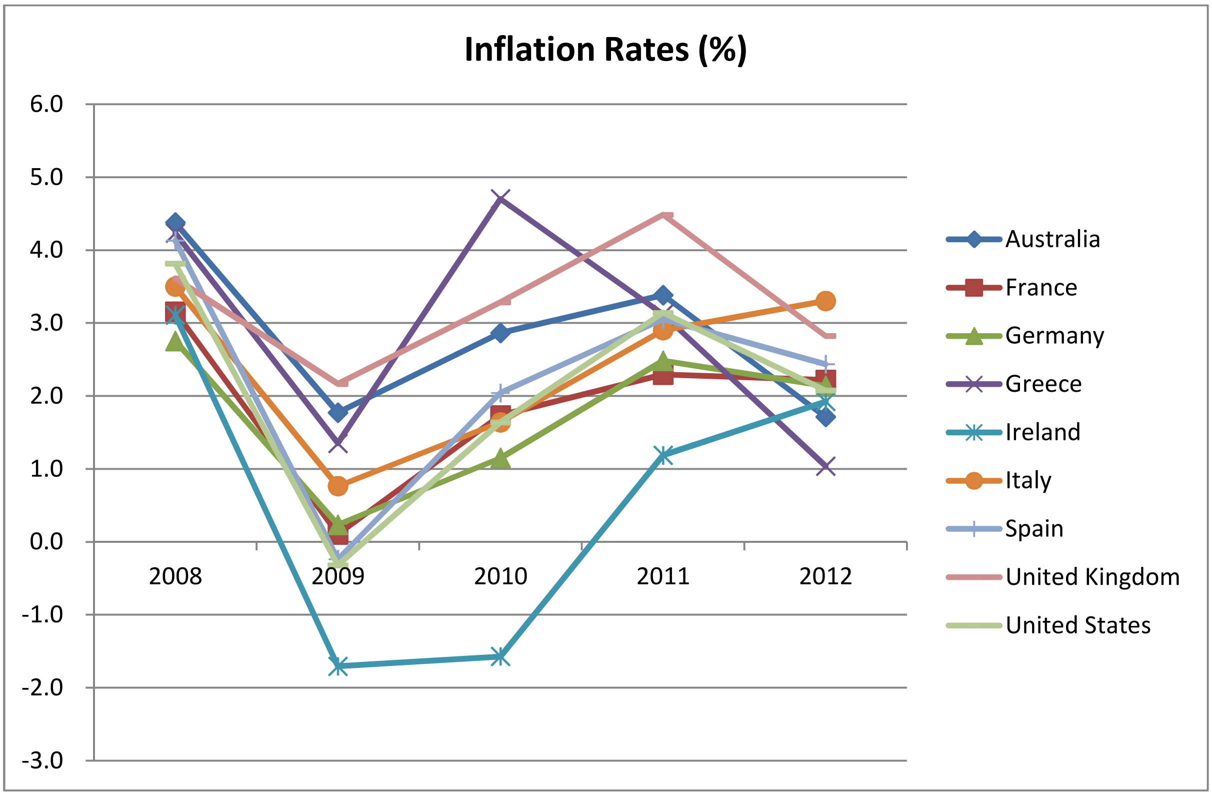


Source: OECD

4. Inflation Rates

In the aftermath of the crisis, there was a significant worry in most of the Central Banks that the countries would face deflation. Some countries did face a short period of deflation, namely Ireland, Spain and the United States. Central Banks introduced massive increases in money supply and began a process of "Quantitative Easing" (the buying of financial assets by Central Banks). After years of attempting to control inflation by controlling the money supply (or targeting interest rates), suddenly they faced a problem which they did not know how to handle. In the process, inflation did pick up for a short time but it appears to be coming down again. Again Australia seems to have managed the economy better than many other countries: there is no fear of a deflation and inflation is well within the Reserve Bank's target range.

Figure 3: Inflation Rates

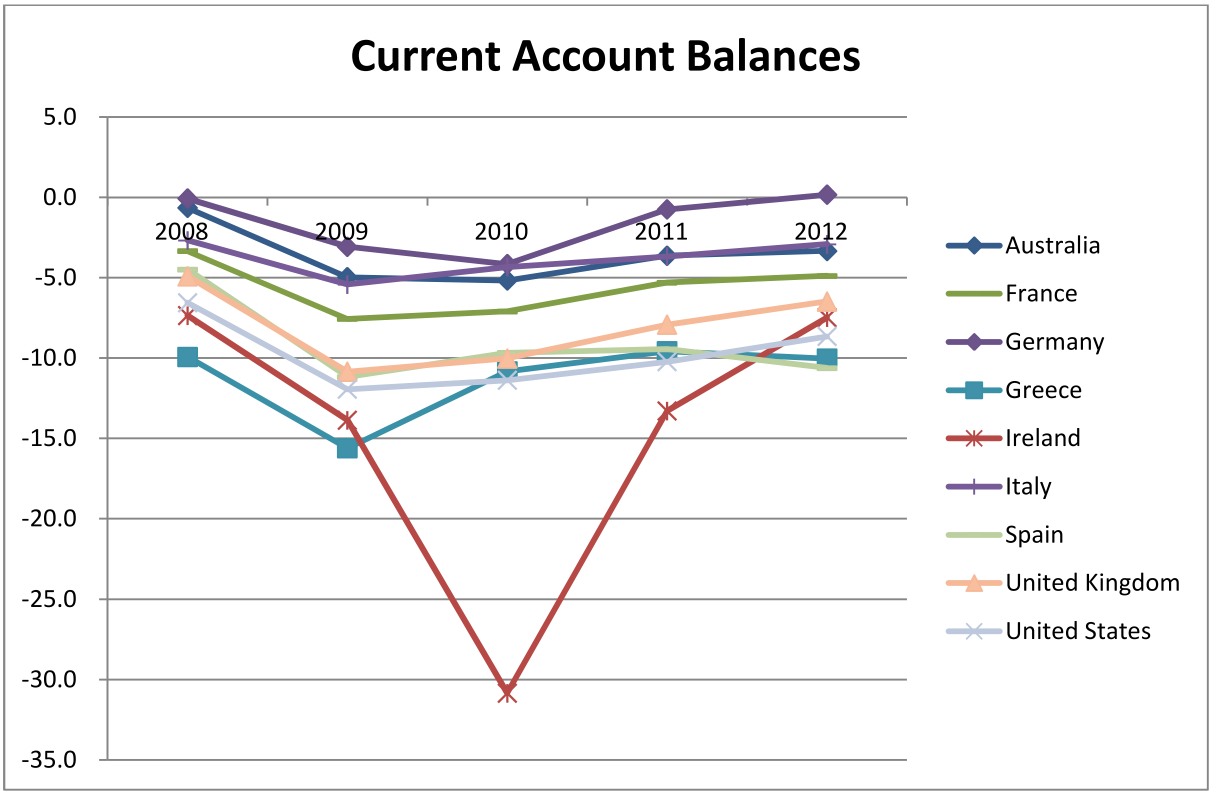


Source: OECD

5. Current Account Deficits

Almost all the OECD countries had current account deficits, even Germany that usually had a current account surplus was hit by the crisis but it had recovered by 2012. Ireland had a spectacular increase in the Current Account Deficit (as a proportion of GDP). The GFC led to a big fall in international trade and for most countries the CADs increased. Again Australia has done relatively well with only Germany and Italy with lower CAD ratios. Although most economists and Central Bankers no longer seem to target CADs by using monetary policy, some politicians seem to be concerned about its level. Australia has almost always (for the past hundred years or so) had a CAD and a capital account surplus.

Figure 4: Current Account Deficits to GDP (%)



Source: OECD

6. Budget Deficits and the Government Debt[2]

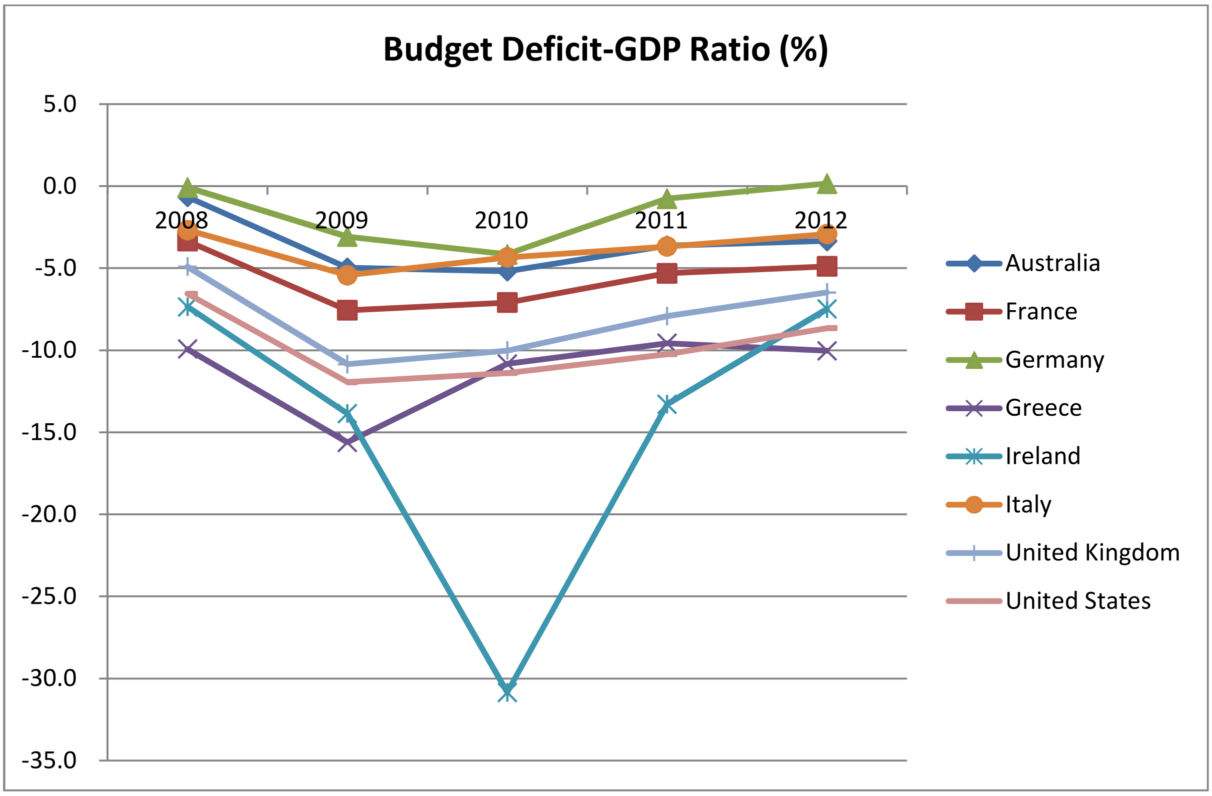
There has been much discussion in the political arena about the substantial problems Australia is facing because it has a budget deficit and that the government debt is ballooning. However, again, when we compare the performance of the Australian economy with OECD countries we find that we are doing surprisingly well. In many of the OECD countries, immediately after the crisis struck many countries engaged in fiscal expansion and monetary easing. However, in some countries within the Eurozone (initially Greece) faced the possibility of a financial collapse and they had to approach the European Central Bank and the IMF to get credit. This credit was eventually provided with strings attached. In particular they were required to curtail their budget deficits and their government borrowing. The imposition of austerity measures were meant to increase the confidence of the private financial sector and to help expand the economy and hence lower government debt. In fact

[2] Under the Maastricht Treaty Article 126 of the Treaty on the Functioning of the European Union (EU) obliges member states to avoid excessive budgetary deficits. The Protocol on the Excessive Deficit Procedure, annexed to the Maastricht Treaty, defines two criteria and reference values for compliance. These are a deficit to Gross Domestic Product (GDP) ratio of 3%, and a debt to GDP ratio of 60%. During this crisis many of these countries broke this rule.

what happened, as many Keynesian economists predicted was that austerity measures (increased taxation and reduced government expenditure) would lead to a fall in GDP and hence the deficits would widen, and the debts would increase.

The Australian government had the good fortune to have begun the recessionary period with budget surpluses (thanks to the resources boom which was fuelled by the growth of the Chinese economy) and weathered the crisis without a significant problem. Its expansionary fiscal policies (the stimulus package) helped to prevent a recession but of course did lead to budget deficits and an increase in Government debt.

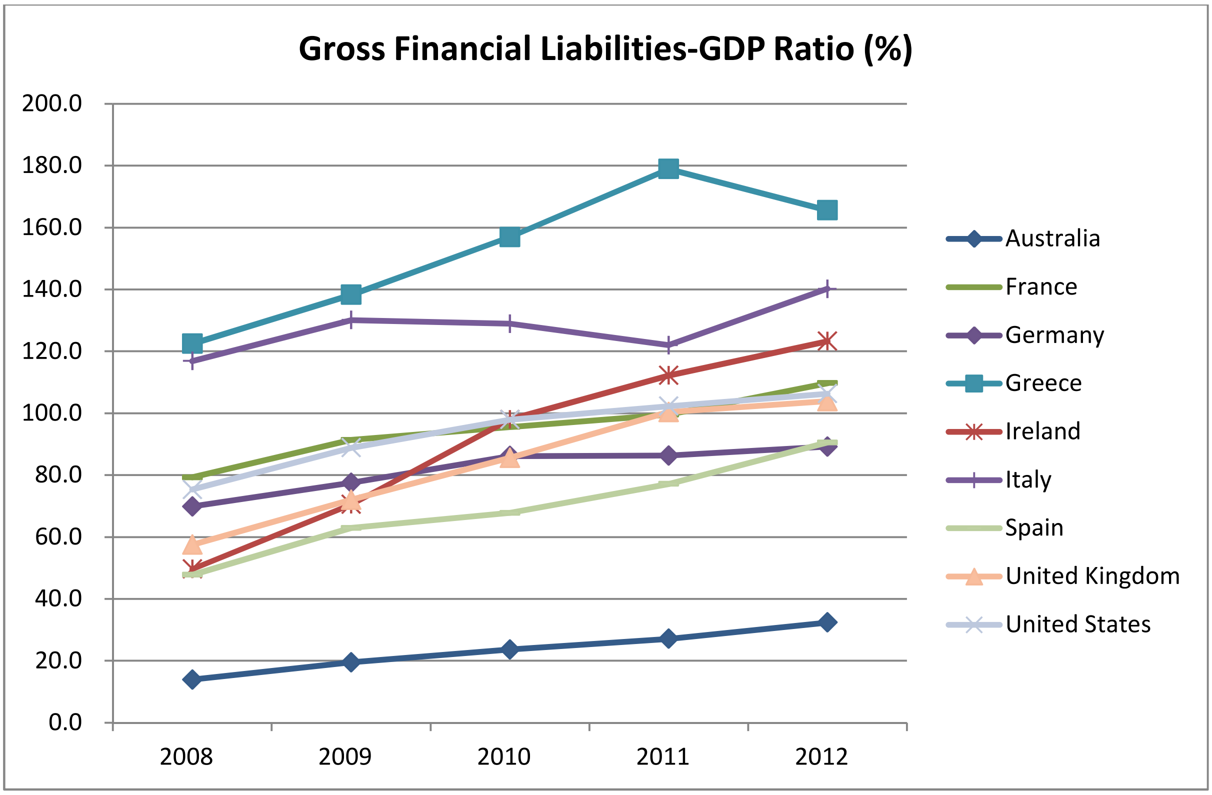
Figure 5: Budget Deficits



Source: OECD

Figure 5 shows that Australia has a relatively low Budget Deficit to GDP ratio compared to most other countries, with only Germany and Italy doing better. Given that Australia had invested in a massive stimulus package it is not surprising that Australia had an increase in its budget to GDP ratio but it has been declining slowly. If we now look at the Debt to GDP ratios (Figure 6) we see that Australia has the lowest ratio. Even Germany, the country that is imposing austerity on the Eurozone countries, has higher debt ratios.

Figure 6: Government Debt to GDP Ratio



Source: OECD

Note: Germany: Includes the debt of the Inherited Debt Fund from 1995 onwards.

7. Discussion

We have seen that when we look at the macroeconomic performance of the Australian economy compared to some OECD countries we have done spectacularly well, so it seems odd that we have politicians who are beating their breasts and threatening gloom and doom. On all measures Australia appears to have outperformed the OECD countries. For some reason, the Australian government kept repeating the *mantra* that we would return to a budget surplus in year "X". Eventually what society is interested in is whether the economy is growing, whether unemployment is low and falling, and whether inflation is under control. Of course there are important distributional issues about how the gains of economic growth are distributed amongst the population. Given our excellent growth record we can afford to look after the poor, the unemployed, the homeless, the sick and needy. Unfortunately, unemployment benefits (New Start Allowance) in Australia is so low that it is below the poverty line.

The OECD, not a radical organisation, had repeatedly stressed the stellar performance of the Australian economy. For example, in its recent report on the Australian economy (OECD *Economic Surveys: Australia* (2012)) it said:

> "*Australia has continued to weather the global economic crisis well reflecting sound macroeconomic policies and strong demand from China. Growth temporarily slowed in 2010 and 2011 as stimulus was withdrawn and households became more cautious. Non-mining tradable sectors have struggled with the strong exchange rate driven by the mining boom. However, fundamentals remain solid with the unemployment rate close to its structural rate and inflation and public debt low. Growth strengthened in 2012, and the outlook is positive, even though there are mainly negative risks stemming from the external environment, to which Australia is however less vulnerable than many other OECD countries.*"
>
> *"With 21 years of uninterrupted growth Australia stands out among OECD countries."*

The Financial industry's *gurus*, the Ratings Agencies, have continued to give Australia triple A ratings, just as Moodys in its recent report[3]. It is clear that the finance industry, the OECD, and the IMF are not worried about the health of the Australian economy or its budget deficits or debt. Why, in that case, do the politicians both on the right and the left mouth these words of "budget responsibility" and "budget surpluses"?

8. Conclusions

This brief paper has focussed on the main macroeconomic indicators of the health of an economy. We found that the behaviour of the Australia economy is miraculous! However, the miracle is not based on some supernatural forces but on good management by the government after the GFC and the "tyranny" of having such rapidly growing neighbours as China, India, and Indonesia.

[3] It is not clear why anyone should be concerned about the ratings of these agencies, as they clearly let the world down by giving triple A ratings to some very dodgy assets just before the GFC!