Mining boom can lift whole economy

Supply side reforms are needed to boost productivity and ensure faster economic growth, writes **Ed Shann**.

Rapid Asian growth could transform the Australian economy. We need to maximise growth, yet we seem to be arguing mainly about distribution and the sector winners and losers.

Faster growth is needed to spread the mining boom's benefits. In the short run, this means cutting interest rates to allow above-trend output growth. In the medium term, supply-side reforms are needed to increase the economy's speed limit by encouraging resources to move from low to high value-added uses.

The Reserve Bank of Australia does not think output can grow faster than trend without inflation rising. In the midst of the greatest mining investment boom in a century that would be depressing if true. However, both theory and recent experience suggest it is too pessimistic. The mining investment boom means the business capital stock will grow near 6 per cent per year, much faster than its long-run average. The labour market might still constrain economic growth. But mining has high productivity and employs few people directly. If national output grows at its trend rate and most of that growth is mining-related, then employment will grow well below trend.

In any case, we have spare capacity. While unemployment is only 5.2 per cent, adding those wanting to work longer hours and discouraged workers, means underemployment is near 15 per cent. There may be skill shortages and labour may need to move to where the jobs are, but we can address these problems by skilled immigration, fly-in workforces and accelerated training. With appropriate policies, output should be able to grow above trend.

Recent experience suggests it can. After allowing for a rebound in business investment, output is probably growing just below trend. Yet employment and hours worked have hardly risen nationally. Employment is rising in resource-blessed Western Australia and Queensland, but falling in NSW and Victoria.

The only reason unemployment has not risen more is that participation has fallen. Wages are well behaved and underlying inflation has been falling, implying faster output growth is possible without inflation rising.

Treasury estimates mining-related sectors produce 20 per cent of output and are growing 15 per cent a year. The mining-related sectors can generate near-trend output growth for the whole economy, even if the non-mining sectors do not grow at all. That is exactly what is happening. We have near-trend national output growth, with little employment growth and declining underlying inflation.

The Reserve Bank must lower interest rates to generate faster non-mining sector employment growth. The aim would be above-trend output growth and near-trend employment growth, so underlying inflation could stay low.

We will only know how fast above-trend output can grow, by cutting rates gradually to ensure wages growth and inflation do not rise. However, first the RBA must accept that the productivity boost from mining means above-trend output growth is possible.

The Treasury, the Productivity Commission and the Reserve Bank have pointed to the supply-side reforms needed to increase the economy's speed limit. We should not subsidise uncompetitive firms, as that lowers our growth speed limit. Instead, we should help people move to where new jobs are available and retrain. We need to increase the flexibility with which resources move from low to high value-added uses and make it easier to improve productivity within firms.

As Asian income rises, agriculture, education and tourism can benefit. While some manufacturing firms suffer, others benefit from mining growth.

We must aim for faster growth. Current policies assuming output can only grow at trend are too pessimistic. They risk rising unemployment and encourage political pressures for subsidies to uncompetitive firms and discourage the supply-side reforms needed to boost productivity and our sustainable growth rate.

Current rapid mining growth is forcing supply-side changes, but supply-side reforms are needed to both maximise the mining boom's benefits and to minimise the pain for other sectors.

■ *Ed Shann is a director of Prime Value Asset Management. This article is based on a paper written for the Minerals Council of Australia.*