Ross Garnaut, *Dog Days: Australia after the Boom*. Redback: Collingwood, VIC, Australia, 2013; 293 pp.: 9781863956222, RRP AUD17.99.

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> *Capitalism doesn't work if all of us seek to maximise our private interests in every interaction with society.*
>
> p. 18

This is a controversial book written by a former Labor Party adviser to Australian Prime Ministers Hawke and Keating. As someone who has extolled the neo-liberal virtues of deregulation and privatisation, it is not surprising that he recommends a 'reform' of the labour market. However, there is much in it that would be agreeable to many people sympathetic to a critique of the power elite, such as his critique of the influence of media moguls and the big miners. His account of impending doom for the Australian economy caused by the end of the China boom is questionable (see Edwards (2014) and Gruen and Wilcox (2014)).

It is easy to summarise the book: The golden years (the 'salad years') were during the Reform era of Hawke–Keating when the economy was deregulated and public sector enterprises were privatised. The mining boom has led to an increase in the exchange rate that has caused a decline in the manufacturing sector. The benefits of the mining boom have been wasted by the Coalition government by providing tax cuts, rather than saving the increased incomes in a sovereign fund. With the end of the mining boom, Australia is heading for worsening income and employment (we are entering the 'dog days').

What should be done? Policies need to be introduced to lower the real exchange rate, make the economy more productive, tighter fiscal policies (budget surpluses), reform the tax system (increase the goods and service tax (GST)) and change industrial relations regulation to make labour more competitive with foreign countries.

Garnaut writes from a magisterial height: as an Economic Adviser, as a former Ambassador to China and as a professional economist. However, there is much in the book that has been and will be contested and contradicted by evidence and research.

After an introductory chapter, Part 1 of the book outlines the economic problem faced by Australia; Part 2 discusses how to maintain living standards and full employment in the face of the end of the China boom; Part 3 discusses public policy issues of the 21st Century; and there is a final concluding chapter.

Part 1 provides a synoptic economic history of Australia's integration into the world economy and increasing dependence on Asia, especially China. Garnaut argues that after a period of reform under Hawke and Keating, Australia went through a 'Platinum' age of growth (except for the 'recession that we had to have' of the early 1990s) which ended with the Great Crash of 2008. Chapter 4 of Part 1 contains the main thesis of the book. Here, Garnaut argues that the resources boom led to a rapid growth of the economy, but the increase in the real exchange rate (via the 'Gregory thesis' or Dutch Disease)[1] led to a slowing down of the manufacturing sector. The increased revenues from the boom were 'wasted' by giving tax cuts rather than saving them like the Norwegians.

Chapter 5 (Part 2) discusses necessary reforms for full employment, and they include a low interest rate, a real depreciation of the currency, a government stimulus by investment in infrastructure and productivity raising reforms. Chapter 6 discusses reforms to increase productivity that include increased competition in trade, reform of pricing of natural monopolies (utilities), removing trade barriers and completing a free trade agreement with China (deal to be signed now), tax reform, controlling the power of monopolies and industrial reforms (holding minimum wages constant). Chapter 7 discusses population and participation issues while concerned about equity. However, Garnaut again repeats the Five Economists' proposals of yesteryear to hold minimum wages constant to (apparently) increase low-skilled employment. Chapter 8 discusses Federal issues and policies to reform the income shares of States. Chapter 9 concerns itself with the problem of climate change and the importance of mitigation by an emissions trading scheme, not the Coalition policy of 'direct action'.

Chapter 10 provides a thoughtful discussion about the changing political scene with the focus on media and polling. Chapter 11 is an important discussion about the power of the private sector in influencing political decisions. 'The big question … is whether changes in the way private forces seek to influence policy has removed the possibility of governing in the public interest in the twenty first century' (p. 234).

The concluding chapter reiterates policies to help Australia to move out of the 'dog days' including a real depreciation, increasing productivity, holding down minimum wages and controlling the power of the private sector.

A major criticism of this book is that Garnaut has mis-diagnosed the problems of the Australian economy.

The premise of the book is that the end of the China Boom is going to lead to a slowing of the Australian economy and a growth of unemployment unless the government introduces policies to counteract this tendency. Garnaut argues that this requires a real depreciation of between 20% and 40%! This would imply a fall in real incomes depending on the proportion of consumption of tradeable goods. However, Edwards (2014) points out that the Australian economy was, in fact, growing *more* rapidly before the China boom than after. In Table 1, we show that the average gross domestic product (GDP) growth rate was 3.77% per annum for the period 1992–2002, while it fell to 3.03% per annum from 2002 to 2012. Of course, the latter period was affected by the Global Crisis, but even allowing for that, the growth rate from 2002 to 2007 was 3.50% per annum.[2] However, the growth of Real Gross Domestic Income (RGDI)[3] was higher during the China boom as the rapid increase in the terms of trade provided a boost to real incomes. As Gregory (2012) points out, the China commodity boom was due to an increase in export prices, not export volumes and hence was different from the export boom of the earlier period that led to the original 'Gregory thesis' (Gregory, 1976). However, as the mineral resources were mainly foreign owned (about 80%), much of the profits were repatriated overseas. As a result, the RGDI does not take account of this problem. As the terms of trade improved, all consumers of imported goods benefited, as did producers (corporations) that imported intermediate and capital goods.

What if the terms of trade were to decline to those of the pre-China boom days? Would the Australian economy (GDP) collapse? Would unemployment rise significantly? Would the Australian economy increase mining exports significantly (after the

Table 1. Average growth rates, Australian Economy, 1992–2013.

	March 1992–March 2002	December 2002–December 2012	December 2002–December 2007	March 2008–December 2013
Average growth GDP	3.77	3.03	3.50	2.51
Average growth real GDI	3.85	4.13	4.87	3.03

Source: Australian Bureau of Statistics (ABS) (2014), Table 1: Key National Accounts Aggregates.
GDP: gross domestic product; GDI: gross domestic income.

period of investment in mining)? Would most of the profits be repatriated to foreigners? What would happen to the exchange rate? Garnaut seems to believe that the exchange rate would have to fall very significantly. Both Garnaut and Bob Gregory believe that a slowing down of the China boom is likely to lead to a recession with a significant increase in unemployment unless new policies are introduced to counteract the fall.

Did Australia waste its resources during the mining boom by lowering taxes? Edwards (2014) disputes Garnaut's analysis and shows that consumer expenditures were growing modestly and the household saving ratio moved from being −0.3% of GDP in June 2002 to 5.1% just before the Global Crisis hit in September 2008.[4] Nevertheless, there is certainly an argument that the increased revenues from the China boom should have been spent on infrastructure investment rather than in providing tax cuts.

Although Edwards is optimistic about the future trends in GDP and employment, it is clear that the Australian economy has slowed down and unemployment has started climbing. It is surprising that Garnaut seems to ignore the continuing impact of the global crisis. The world economy is on very shaky grounds: many of the European Union countries are still in a recession with their GDP still to return to pre-crisis levels. Even Germany faced negative GDP growth in the first quarter of 2014, and the Japanese economy is in recession. There are fears of a double-dip recession in Europe. In the present uncertain world environment, it is likely that investment generally (not only in mining) will fall, leading to slower growth in the economy. Under these circumstances, it is very likely that the Australian economy will face significant difficulties with slower growth and a weakening labour market.

Garnaut recommends that we should keep interest rates low and try to have a real depreciation of 20%–40%! Although he knows that lowering the interest rate would affect aggregate expenditure, he does not seem concerned about rising house prices. In fact, Australia has historically low interest rates, although much higher than those applying in the European Union or the USA. He argues that we should increase productivity and hold minimum (real) wages constant. There is much evidence from Britain that minimum wages do not harm employment: see Manning (2003, 2010). Garnaut claims that Australia was becoming uncompetitive owing to increasing labour costs (p. 89). However, a look at the data for real unit labour costs (RULC) shows that RULC were declining almost continuously from 1991 until the Global Financial Crisis (GFC) (see Figure 1). If exports were becoming uncompetitive, it was not because wages were too high, but because of the sharp rise in the exchange rate.

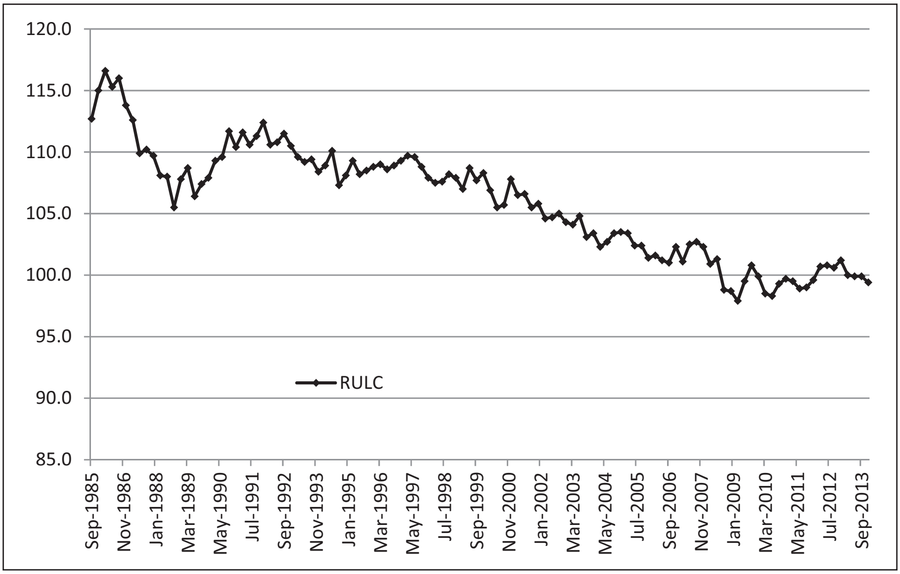

Figure 1. Real unit labour costs, Australia, 1985–2013.
Source: Australian Bureau of Statistics (ABS) (2014), Table 38: National Income Account, Current Prices, Annual.

The real exchange rate (reflecting Australia's purchasing power relative to the rest of the world) increased by 40% from June 2002 (the beginning of the Chinese boom) until September 2008 and then fell spectacularly with the GFC by 20% from September to December 2008. It then rose again by 46% until March 2013 and then fell again by 8% to September 2014 (see Figure 2). It is clear that the rapid increase in the real exchange rate since 2002 led to a decline in the manufacturing sector (the Gregory thesis or the Dutch Disease). The fall in the exchange rate in 2008 was a brief respite before the exchange rate continued its increase, perhaps fed by Quantitative Easing (QE) by the US. In an open globalised economy, Australia is like a small yacht in a stormy sea buffeted by international headwinds!

The Australian exchange rate was obviously influenced by the China resources boom, but since the Global Crisis, QE by the US and UK has resulted in raised exchange rates in many countries in the region. As the US has slowed down its QE, the Australian exchange rate has drifted down.

Would Garnaut's policy recommendations work? First, how can we manage a fall in the real exchange rate to 83 US cents? In a world of floating exchange rates, we have limited control over the exchange rate. In recent years, the Governor of the Reserve Bank of Australia (RBA) has tried to 'talk down' the exchange rate without any success. By 21 November 2014, the Australian exchange rate had already fallen to 86 US cents, as commodity prices fell and the US stopped quantitative easing. The RBA could lower the interest rate below its historical low levels, but that might lead to inflationary pressures, especially in the housing market. A fall in the real exchange rate would lead to a higher rate of inflation and lower real wage rates. As a result, there would be pressures to increase

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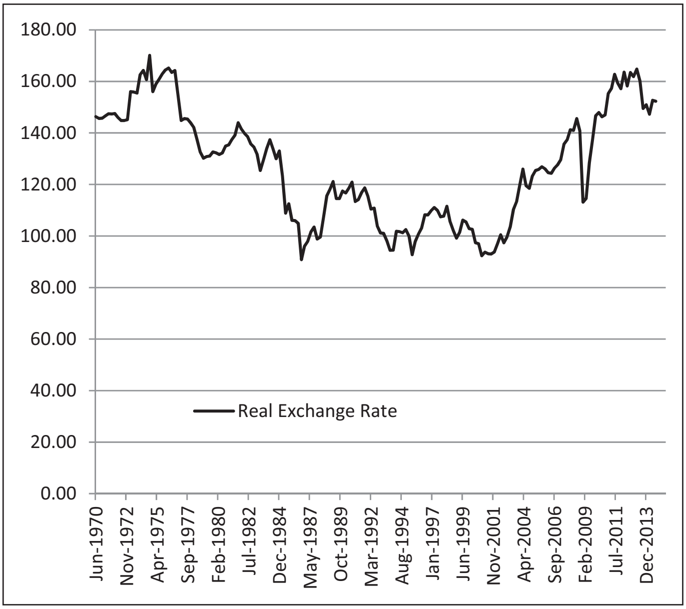

Figure 2. Movements in the real exchange rate, Australia, 1970–2013.
Source: Reserve Bank of Australia (RBA) (2014), Table F15: Real Exchange Rate Measures.

nominal wage rates. Garnaut would like to introduce 'industrial relations reforms' to weaken the power of the workers and hence to control wages more tightly. As mentioned earlier, however, RULC have already been falling for over a decade: in other words, the share of wages in GDP has been falling and the share of profits in GDP has been rising.

For a book on economic history and economic policy by an economist, it is curious that Garnaut rarely uses data to support his arguments, except for some selected statistics. There are only five graphs in the whole book: (1) Monthly hours worked per person, (2) Net exports of Beverages[5] as share of GDP, (3) Tourism Arrivals, (4) Real Exchange Rate and (5) Terms of Trade. Curiously, he does not analyse the movements in GDP, labour costs or exports.

There are some really good sections in the book. The discussion of the Garnaut Climate Change Review (2008) and the analysis of Public Policy provide food for thought.

Overall, the book provides an overview of recent developments in the Australian economy from an essentially neo-liberal perspective. It argues that unless there are significant changes in policy, the Australian economy is doomed. Forecasting the future is always difficult; it is easier to forecast the past! The policies recommended by Garnaut are unlikely to be followed by either the Coalition Government or a potential Labor Government. Nevertheless, the book should be essential reading for undergraduate economics students and for public policy students.

Notes

1. Named after the effects of a large Dutch discovery of natural gas in the 1960s–1970s, the 'Gregory effect' refers to the impact of an appreciation in the exchange rate following a

resources boom with a rapid growth in mineral exports. This adversely affects the competitiveness of export- and import-competing industries, causing their contraction and leaving the economy's manufacturing base weakened at the end of the boom (see Gregory (1976, 2012)).
2. The growth rate from 1992 to 2002 was affected by the fact that the economy was just coming out of the early 1990s recession.
3. RGDI measures the purchasing power of total incomes generated by domestic production by including the impact of the terms of trade on GDP.
4. In December 2013, household saving ratio (seasonally adjusted) stood at 9.7%.
5. As if beverage exports are going to solve the balance of payments problems!

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Geoffrey M Hodgson, *From Pleasure Machines to Moral Communities: An Evolutionary Economics without Homo Economicus*. University of Chicago Press: Chicago, IL, 2013; xvi + 305 pp.: 9780226922713.

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In this book, Geoffrey Hodgson presents his thoughts about the relation between economics and morality. The Preface and Introduction are followed by two chapters that underscore Hodgson's main starting point that modern economic approaches to modelling human motivation do not adequately consider the social nature of human beings, which he claims has played a central role through individual and group evolution in the development of non-selfish motivations. Two chapters follow that define and discuss possible evolutionary underpinnings for morality, forming the intellectual centrepiece of