THE RESOURCES BOOM AND ITS LEGACY

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Introduction

Australia is, by most accounts, experiencing what may well turn out to be the largest and most prolonged commodities boom in our history, driven largely by our capacity to meet many of the resource requirements associated with the industrialization and urbanization of the two most populous nations on the planet, China and India.

These two nations are now passing through a stage of economic development during which, as economic activity shifts away from agriculture towards manufacturing (and before it becomes increasingly dominated by services) and as the population moves from rural areas into cities, the demand for commodities of all types rises strongly.

I argue elsewhere that, on plausible assumptions (which entail some slowing from the growth rates it has recorded over the past two decades) China will remain in this stage until some time between 2019 and 2024; while India, which has only recently entered this stage of economic development, is likely to remain in it until at least 2037 (Eslake 2011).

In recent years, and at least for the years immediately ahead, the China and India commodity story is essentially one about steel and energy – which in turn means it is about iron ore and coking coal, and about thermal coal, oil and natural gas. We don't have any oil (or at least, none for export); but we are already the world's largest exporter of iron ore and coking coal, the second largest exporter of thermal coal (after Indonesia), and on present indications we will by the end of this decade be the largest exporter of LNG. Australia is the only major commodity-exporting nation to have all three of these commodities (iron ore, coal and LNG) in such large quantities, as well as a wide range of base and precious metals, other energy sources (such as uranium) and a broad spread of agricultural commodities.

Hence we are experiencing the most sustained upswing in what economists call our 'terms of trade' (the ratio of export to import prices) in at least 140 years, and the biggest expansion in resources sector capital investment in at least 160 years (Stevens 2010; Battelino 2010).

An economic management challenge

The experience of previous 'commodities booms' in Australia suggests that there is a high probability that this one will also end in a burst of double-digit inflation followed by a recession – as occurred after each of our last three 'commodities booms', the Korean War wool boom of 1951, the mining boom of the late 1960s and early 1970s, and the rather briefer resources boom of the early 1980s (prompted by the second oil shock).

To be sure, since the end of the last 'resources boom' there have been a number of important structural and institutional changes in the Australian economy which lessen the probability that we will repeat that history during the present episode:

- Since shortly after the collapse of the last resources boom we have had a floating exchange rate, which in the current boom has allowed the A$ to rise significantly, thereby helping to contain inflationary pressures by lowering prices of imported goods and services, and (by putting competitive pressure on other trade-exposed sectors of the Australian economy) helping to reduce cost and price pressures associated with competition for increasingly scarce labour and materials. In previous commodities booms, when the exchange rate was fixed, governments under pressure from manufacturing and farming interests were reluctant to let this happen.

- We no longer have a highly centralized system of wage fixing which more or less guarantees that the large wage gains procured by workers in the resources sector (where employers can afford to pay them) are also obtained by employees in sectors such as retailing, manufacturing or hospitality (where employers can't afford them).
- And we have an independent central bank, with the clearly articulated objective of keeping inflation at between 2 and 3 per cent 'on average over the course of the business cycle', and both the means and the will to achieve it – in contrast to the situation prior to the early 1990s when the Reserve Bank needed the express permission of the Government of the day to raise interest rates, or tighten monetary policy in other ways, and that permission was never given enthusiastically.

Even so, during what the Government now calls 'Mining Boom Mark I' – the period from about 2004 up until the onset of the global financial crisis, which initially appeared to have terminated the boom – the underlying inflation rate rose to a peak of 4.7% over the year to September 2008. Had it not been for the economic slowdown induced by the financial crisis, the inflation rate might well have been headed for – who knows? – 6% by now.

So the resumption of the resources boom – 'Mining Boom Mark II' as the Government calls it – raises some important challenges:

- first, how do we ensure that we *don't* repeat our history of squandering the potential benefits of our good fortune?
- second, what sort of legacy will we leave to future generations of Australians as a result of what is potentially the largest and longest such boom we have ever had, or will ever have?

The financial legacy

I've been arguing since around 2005 that Australia should establish some kind of 'stabilization fund' or 'sovereign wealth fund' similar (although not identical) to those which exist in countries like Norway or Chile. More recently, more influential authorities such as Glenn Stevens (2010) and the OECD (2010) have supported this proposition.

An Australian 'sovereign fund' wouldn't be created out of the revenue from State-owned commodity businesses like Norway's Staatoil, or Chile's Codelco. Nor would it be funded solely by specific taxes levied on mining companies (which, as currently envisaged at the Federal level, aren't going to raise much money anyway – and the money which they are supposed to raise has already been committed to other purposes).

Rather, an Australian 'sovereign fund' should be created from the larger budget surpluses which Australia ought to be running once the mining boom gets into full swing, and after the net debt which has been run up since the onset of the global financial crisis has been paid off – which on the forecasts contained in the most recent Federal budget will be by 2020.

An Australian 'sovereign wealth fund' would provide a means of avoiding what I argued (admittedly without much company at the time) was the mistake made by the Howard Government in its last term in office, and the Rudd Government in its first Budget, of being unwilling to contemplate running budget surpluses of more than the equivalent of 1% of GDP.

That was largely because, having by 2005 paid off the debt inherited from the Keating Government, the Howard Government couldn't find a politically saleable rationale for continuing to collect much more in tax than it spent, even though that's what good economic policy required. They were apparently also influenced by the experience of the Kennett Government in Victoria in bequeathing large budget surpluses to the incoming Bracks Labor Government in 1999, which the latter then largely spent.

However, in 'giving away' in the form of income tax cuts or untargeted welfare handouts any revenue which might otherwise have resulted in a forecast budget surplus of more than 1% of GDP, the Howard Government (and the Rudd Government in its first budget) added to domestic demand at a time when the Australian economy was already operating at close to 'full capacity' (if not indeed at something over that), and hence fuelled upward pressure on inflation and interest rates.

The present Federal Government's fiscal strategy, as enunciated in the most recent Budget Papers (Swan and Wong 2011: 3-4), says that the disciplines by which the Government regards itself as bound – to divert any unanticipated revenue gains to improving the Budget bottom line (a discipline which has been honoured more in the breach than the observance) and to keep growth in real outlays to less than 2% per annum – only apply until the Budget surplus reaches (yes, you guessed) 1% of GDP – which on the latest forecasts will be in 2016-17.

After which, presumably, the present Government, or whoever is in power after what will be the next two Federal elections, will free to repeat the mistake made by the Howard Government all over again.

A 'sovereign wealth fund' would provide a politically saleable rationale for running budget surpluses of a magnitude – perhaps as much as 3-5% of GDP – that may well be required in order to prevent the present resources boom from ending in the same way that previous ones have done, or to ensure that the burden of preventing that outcome doesn't rest entirely with the Reserve Bank.

Such a fund would desirably have two key features:

- first, very tight rules, similar to those governing the Future Fund established by the Howard Government to defray its unfunded public service pension liability, to prevent governments from touching the capital in (and perhaps also the income from) the fund until the resources boom is 'over' according to some objective criterion, such as the terms of trade falling below their 2005 level, or the average for the 20 years to 2005, for at least a full financial year; and

- second, divided into separate accounts (probably though not necessarily of equal size), for clearly designated purposes such as pre-funding some of the costs associated with population ageing; providing for the transport, health and education infrastructure of the future; drought- and disaster-proofing the nation (to the extent it's possible); addressing Indigenous disadvantage; assisting the transition to a 'low-carbon' economy; and providing for tax cuts and other forms of fiscal stimulus *after the mining boom is over*. (This list isn't meant to be exhaustive or exclusive).

A sovereign wealth fund would, in effect, convert at least some of the revenue from what is a finite and depleting stock of natural resources into a potentially permanent stream of payments from a stable or even growing stock of financial capital.

In that sense, it would provide a means by which the present generation of Australians – those of us who, by co-incidence rather than as a result of our own efforts, happen to have custodianship of the wealth which has been lying under, or around, this continent for millennia, at a time when the people of the two most populous nations on Earth are, as a result of their own efforts, willing to pay very high prices in order to procure the resources on which that wealth is based – can discharge the moral responsibility I believe we have to future generations of Australians to leave to them a greater inheritance, rather than expropriating all of it for ourselves.

The cultural legacy

The greatest resources boom in our history should also enable us to build, and to bequeath to our descendants, a better society.

As *The Economist* magazine wrote recently, in an editorial accompanying a lengthy survey of the Australian economy:

> "Australians must now decide what sort of country they want their children to live in. They can enjoy their prosperity, squander what they do not consume, and wait to see what the future brings; or they can actively set about creating the sort of society that other nations envy and want to emulate.
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> Such societies … cannot be conjured up overnight, least of all by government. They are created by the alchemy of artists, entrepreneurs, philanthropists, civic institutions and governments, coming together in the right combination at the right moment.
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> And for Australia … this is surely such a moment" (*Economist* 2011: 13).

What kind of society, what cultural legacy, will the beneficiaries of the present mining boom and the wealth created by it leave to future generations of Australians?

Americans of today remember the entrepreneurs of the late 19th and early 20th centuries – Andrew Carnegie, John D Rockefeller, Andrew and Paul Mellon, Henry Clay Frick, Henry Clay Folger, Samuel Guggenheim, Joseph Hirshhorn, Duncan Phillips, J Paul Getty, Charles Hackley and others - not for the steel mills, the oil companies or the banks and stockbroking firms which they created (although they did lay the foundations for the emergence of the United States as the world's most powerful economy after World War I), but for the galleries, libraries, museums and educational institutions which they endowed.

I suspect future generations of Americans will remember Bill Gates – and will only ever have heard of his wife Melinda – because of the work of the Foundation which they have established; and of Warren Buffet, because of the US$30bn which he has gifted to the Gates Foundation, rather than because they love Microsoft and its products, or because they have a clue what Berkshire Hathaway was. Ronald O Perelman is more likely to be remembered for his endowments, thus far totalling over US$200mn, to various health providers and for cancer research, than for being the largest shareholder in Revlon.

Today's Australians, if they know of Alfred Fenton at all, know of him not because of the businesses he founded, including the one which ultimately became ICI and part of which is now known as Orica, but because of the £378,033 bequest he left to the National Gallery of Victoria, which has been used to purchase over 15,000 works of art with a value most recently estimated at over $1 billion.

Similarly Sidney Myer is surely less well known today for the stores that still bear his name than for the Sidney Myer Music Bowl in Melbourne (something which, as a kid growing up in Tasmania, I could never figure out why was in Melbourne, rather than in Sydney), and for the generosity which has been continued by his descendants.

I would argue that the great mining companies of today, the BHP Billitons and the Rio Tintos and the Xstratas, won't be remembered in 100 years time for the holes they are digging now – and nor will their CEOs, or individual mining entrepreneurs like Clive Palmer, Gina Reinhart and Andrew Forrest.

We Australians like to think of ourselves as a generous people. And in some ways, we are. We have one of the highest rates of volunteering in the world. We give generously to appeals for the victims of natural disasters, both here and abroad. Thousands of Australians sponsor children in developing countries.

But our richest citizens, with some very honourable and outstanding exceptions, are not among them.

According to Australian of the Year Simon McKeon (who is one of those exceptions), of about 8,000 Australians reporting taxable incomes of over $1 million in 2008-09, more than one-third did not make a single charitable donation – or at least, not one for which they claimed a tax deduction (Elder 2011).

Taxpayers with taxable incomes of more than $1 million in 2008-09 donated 1.71% of their income (McGregor-Lowndes and Pelling 2011: 45). This is a considerably higher proportion than that given away by any other income groups (except, curiously those earning $6,000 or less). But affluent Australians are less generous than their counterparts in other countries, who (according to the annual Merrill Lynch Cap Gemini *World Wealth Survey* give away between 3% and 11.8% of their *wealth* annually (Scaife, McDonald and Smyllie 2011: 7).

There are now 860 Private Ancillary Funds in Australia, foundations which have to give away at least 5% of their assets annually in order to qualify for various tax breaks, with assets of a little over $2 billion. But according to Peter Winneke, Head of Philanthropic Services at the Myer Family Office, given the number of Australians earning over $1 million a year there should be at least 8,000 PAFs (Short 2011).

Private sector support for the arts has risen from $112 million in 2001-02 to $221 million in 2009-10 (AbaF 2011). That's an increase of 98%, and is in large measure a reflection of the efforts of AbaF in promoting greater private sector financial support for the arts. Within this total, the value of outright giving (as distinct from sponsorship) has risen by more than 161% over the past decade to $123mn, or 56% of total private sector support for the arts, up from 42% in 2001-02. Private sector support now accounts for 10.4% of the total income of arts organizations, up from 6.7% in 2001-02.

So the trend is in the right direction. But this has been a decade of extraordinary growth in income and wealth, notwithstanding the impact which the global financial crisis has had on sharemarket values. Aggregate personal disposable income rose by 69% over this period, while household net worth rose by 83%. As a proportion of GDP, which rose by 66% over this period, the increase in private sector support for the arts represents just 0.002 percentage points, from 0.015% to 0.017%.

That figure needs to increase if the arts in Australia are to flourish and thrive – especially given the increasing fiscal constraints under which State Governments, in particular, are finding themselves operating.

There may be some merit in suggestions that governments ‘match’, in some proportion, donations by individuals or small businesses to the arts, as happens here in South Australia through the Premier’s Fund, and also in Tasmania and Western Australia, as well as in Britain.

But it would surely be even better if, as an example to their peers, some seriously wealthy Australians made large and well-publicized donations to cultural activities and institutions, and encouraged or challenged others to do likewise (as Bill and Melinda Gates, and Warren Buffett, have encouraged their fellow rich Americans to do).

If those who have been and will be enriched by the greatest resources boom in our history (not, I don’t mean to suggest, without considerable effort and risk-taking on their part, in most cases) don’t want, in the words of Marc Antony in *Julius Caesar*, ‘the evil which they’ve done to live after them’, then leaving the kind of cultural legacy to future generations of Australians that so many Americans have done in similar circumstances will help to ensure that the good they do is *not* ‘interred with their bones’.

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