COMMENTARY

MINING MELTDOWN JAMES ARVANITAKIS AND LEE RHIANNON

Resource riches can be an economic curse

The outlook for the Australian economy beyond the short term is, we believe, cause for concern. The answer can be found in this country's reliance on the volatile resources sector as the engine of economic growth at the expense of manufacturing and other valued-added areas.

Riding on the back of the Chinese boom, Australia has experienced strong economic growth for more than a decade. Like the state government's addiction to gambling revenue, the federal government is now addicted to revenue from mining.

While this reliance on mining has obvious environmental implications that should concern us, there are important economic considerations that are not so evident.

Australia has been blessed with an abundance of mining resources. This, ironically, creates a paradox for our economy.

The influx of income from our resources creates wealth in certain parts of the economy, driving up the exchange rate and inflating the domestic economy. The result is that, while Australia's headline growth rates may look impressive, we see the emergence of a two-tiered economy: one based on booming resources (as evidenced in Queensland and Western Australia) and one that is left behind (as in NSW and Victoria).

In other words, the demand for our resources pushes up our exchange rate. In addition, the demand driven by resources can drive inflation and, consequently, interest rates, which can further drive up the exchange rate.

The paradox is that our very success in producing low value-added resource outputs makes the other sections of the economy less internationally competitive and has the potential to retard our long-term prosperity.

This is a challenge that has emerged for a number of nations and is often referred to as "Dutch Disease" (from the experience of the Netherlands' initial economic boom from North Sea oil).

One of the dangerous consequences is that a country can de-industrialise. This comes about as it becomes far too expensive to export anything else, and imports become cheaper. This means that manufacturing and other value-added sectors begin to crumble.

An associated problem is a deskilling of the workforce. The exchange rate also means that it is increasingly appealing to import high-value goods rather than attempt to skill up a workforce to meet domestic demands. This does not mean that the net effect is a dramatic fall in employment but rather that the domestic demand for skilled labour falls.

The third issue that emerges and aggravates the problem is that governments respond to economic activity by moving more and more resources to where the growth is. Funds are moved to meet the demands of the resources sector at the expense of other sectors.

This trend has been of concern to economists for many years. The question is, what should we do about it?

We believe that the federal government must respond on two levels. To begin with, we need to counter the de-industrialisation effects of the boom. This abundance of resources has served Australia well, but it is time to think about a more innovative future. We have the chance to lead the world in innovative manufacturing solutions related to alternative energy resources, education and research, and development.

A resource rent tax should be implemented as a matter of urgency, with the money raised flowing to sustainable, low-carbon industries.

The second is for the government to take the likely recommendations from the Henry tax review seriously and combine these with an effective policy to decrease our reliance on carbon-emitting resource industries.

The Henry review will recommend a resource rent tax to replace the current mess. This should be implemented as a matter of urgency, with the money raised flowing to sustainable, low-carbon industries.

Such a twin strategy will both provide for our long-term economic health as well as be a real response to climate change.

Anything less means that we are likely to go backwards despite the good economic data.

And while doing so, we are likely to end up as the world's dirty hole in the ground. There is no good news in that.

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