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*“Ending Australia’s Dog Days: Monetary  
Policymakers and other Performers in an Economic  
Policy-Making Orchestra”.*

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**This presentation to cover:**

- I. Australia's Dog Days, Pandemic Recession and Inflationary Recovery**
- II. Monetary Policy Contribution**
- III. The Economic Policy Orchestra**
  - a) Co-ordinating Monetary, Prudential and Fiscal**
  - b) The Full Australian Economic Policy Orchestra**
  - c) The Conductor**



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# I. Australia's Dog Days, Pandemic Recession and Inflationary Recovery





# Economic policy objective: full employment, rising incomes and right amount of debt

Full Employment with Lowest Possible NAIRU the pivotal objective:

Efficiency:

- Higher per capita and total output.
- Encourages higher productivity and incomes not employment creation
- Greater political support for productivity-raising structural reform

Equity:

- Largest benefits for marginal members of labour force.
- Less focus on wage regulation and unemployment benefits for equity.



# Inspiration and example from past success

I. Postwar Reconstruction 1945-1970

II. Reform Era 1983-2001

- Clear economic narrative with employment and equitable distribution centrally important, Public education on case for change.
- Policy innovation and structural change.
- Strong coordination of economic policy across all spheres.



# Australia's Dog Days, Pandemic and Inflationary Recovery 2013-23

- Stagnant productivity and real output per person.
- Real wages declined over decade for first time ever.
- Near bottom of badly performing OECD on output per person.

High terms of trade usually bring general prosperity

- Huge real wage declines through record high terms of trade in past two years.



# Unusual and difficult economic times

Economists' job:

- understand the changes
- explain the changes
- define policies for better outcomes



# Good outcomes require large changes in policy and much public education

Must debate detail of change.

Should be no argument about need for RESET to change approaches to policy.

Alternatives to considered reform are:

- populist reaction leading to counterproductive change, or
- policy responses driven by vested interests against public interest.



# Reconciling Poor Outcomes 2013-23 with 28 Years Expansion Without Recession

- Productivity Boom 1991-2001: Australia top OECD productivity growth.
- China Resources Boom 2001-2012: intermediate productivity, strong incomes growth.
- Dog Days 2013-19: low per capita output growth; high labour force from immigration.
- Pandemic Recession : buoyant incomes and employment from strong demand expansion.
- Post-Pandemic Recovery: sharing OECD low productivity and inflation; real public debt declining rapidly with inflation, high employment and strong terms of trade.

Pandemic aftermath threatens continuation of Dog Days.



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# II Monetary Policy Contribution

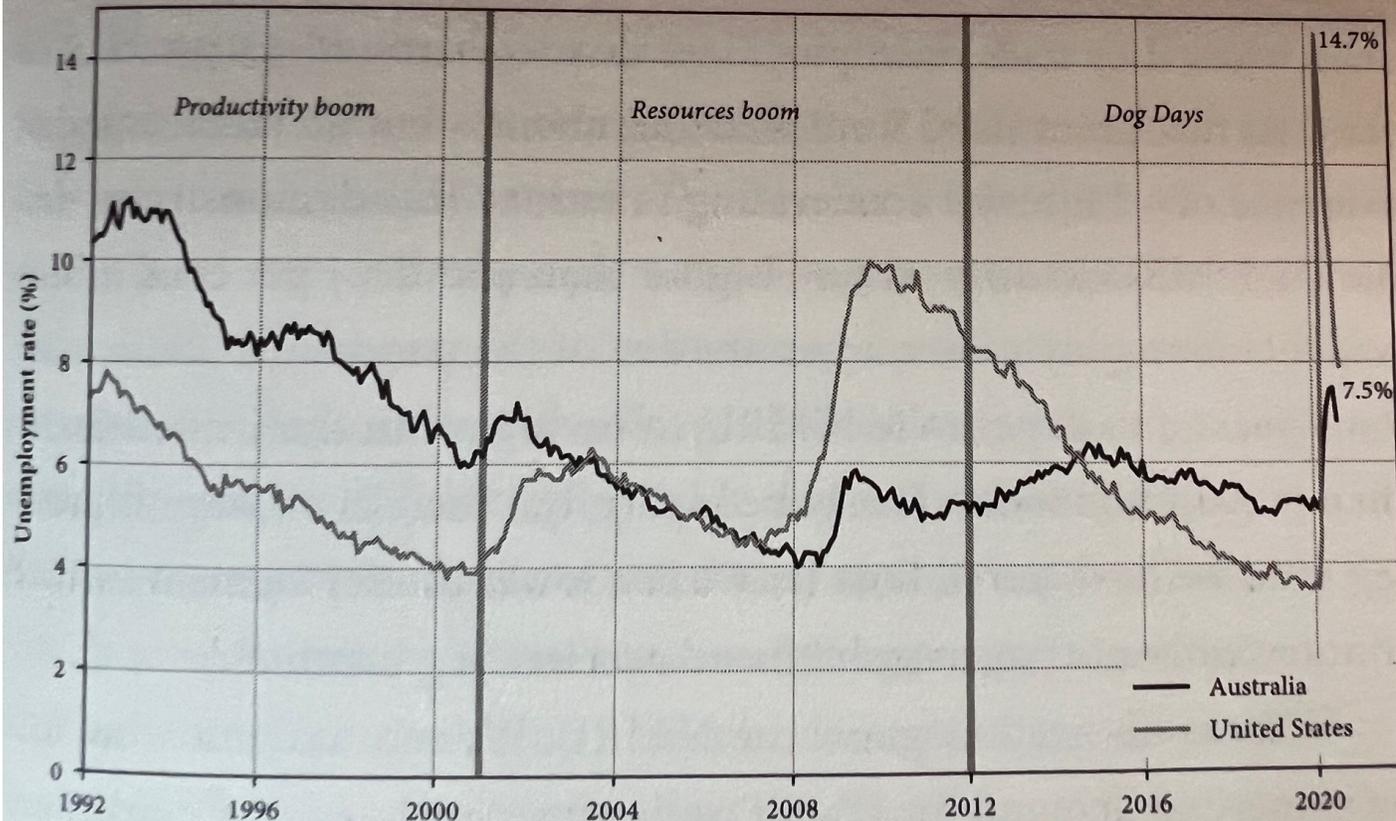


# Dog Days Unemployment and Post-pandemic Towards Full Employment

- Gross-Leigh estimate 2016-19 excess unemployment of 270,000.
- Gross-Leigh uses RBA Martin model with artificially high NAIRU, so underestimates.
- Similar excess unemployment 2013-16.
- Tighter money than rest of world meant lower employment.
- Policy emphasis on “Jobs, Jobs, Jobs” the reciprocal of productivity.
- High unemployment reduced support for structural reform and higher productivity.
- Pandemic demand expansion and low immigration moved towards full employment.
- Higher employment strengthened budget.

# Unemployment in Australia and the United States

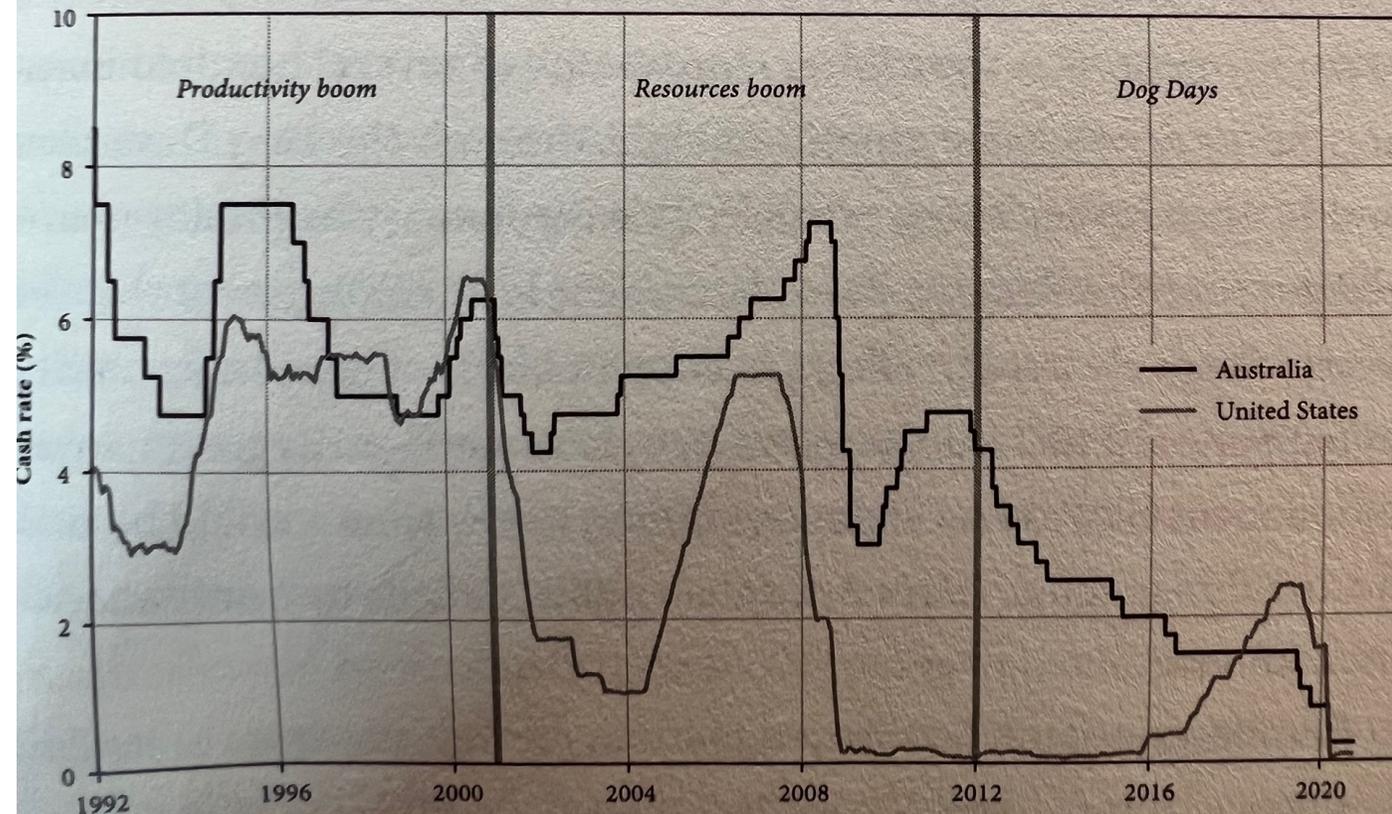
Chart 3.6 Unemployment in Australia and the United States



Source: Garnaut, RESET 2021

# Policy interest rates: Federal funds versus Reserve Bank cash rate

Chart 3.7 Policy interest rates: Federal funds versus Reserve Bank cash rate



Source: Garnaut, RESET 2021



# Monetary policy mistakes

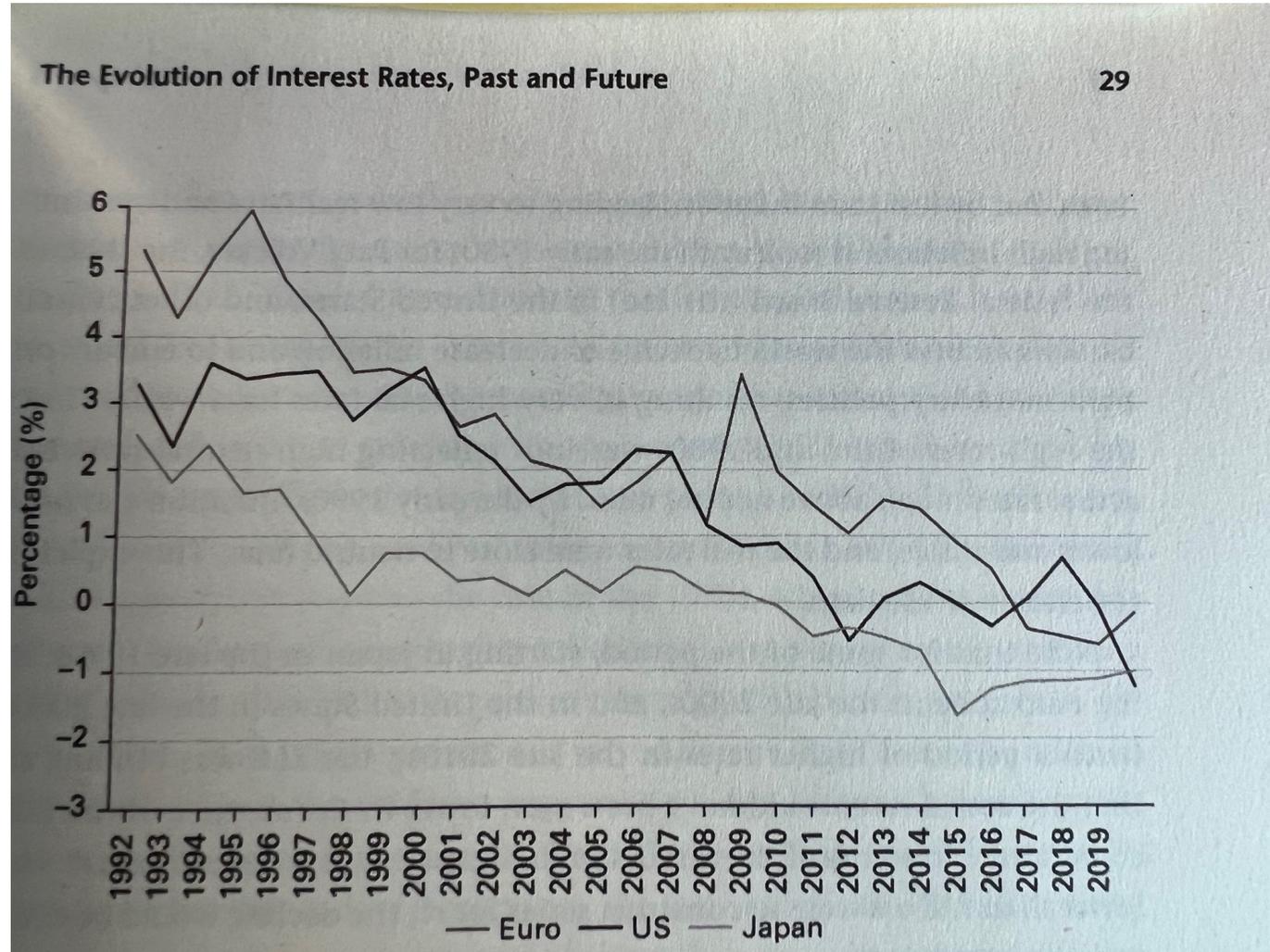
## In Dog Days:

- Missed and underestimated decline in NAIRU.
- Missed and underestimated decline in neutral rate of interest.
- Excessively tight money led to appreciated exchange rate.
- Excessively tight money and appreciated exchange rate led to high unemployment 2013-19.

## In Pandemic recession and recovery:

- Attempt to control medium terms bond rates during Pandemic Recession.
- Stating expectations on multi-year interest rates, both for cash and for medium term.
- Language suggesting high unemployment necessary to reduce inflation.

# Real Rates Steady Decline 1992-2020



Source: Blanchard, 2023



# Why does Australia have high inflation?

- Higher tradables prices—US expansion, COVID, supply disruptions, invasion of Ukraine.
- Wage increases a response to imported inflation partially restored real wage declines.
- Real wage catch-up likely without change in real economy.
- Can be postponed by unemployment above NAIRU.
- Tradables inflation stopping: energy prices to pre-invasion levels; OECD inflation moderating; zero inflation in Australia's main trading partner, China.



# Do we need high unemployment to end inflation?

- There is a path that does not require recession and higher unemployment.
- That would see gradual restoration of real wages over several years.
- Non-recessionary return to target may take longer than 2025.
- But why does time with inflation above target have to be shorter than below target during Dog Days?
- Suppression of real wage with unnecessary unemployment corrected later with inflationary impact unless unnecessary unemployment persists.



# Expectations Risk with Slower Return to Target

- Higher inflation raises expectations of future inflation.
- Relationship not simple and deterministic.
- WWII inflation and monetary overhang saw brief inflation above 25% followed by nearly two decades of 2 percent inflation and unemployment.
- High inflationary expectations of 1980s followed long period of rising inflation from 1969.
- Reform Era fighting unemployment and inflation at same time brought Inflation down before excessive monetary expansion after 1987 stock market crash.
- Much depends on explanation of policy and of path to inflation target.



# Would RBA Review Recommendations Make These Mistakes Less Likely?

- The RBA errors on NAIRU, neutral rate, not so different from majority economist opinion, so probably not.
- Joint research shared with Treasury would help, especially if shared across economic agencies and community.
- Improved communications would help.
- But biggest issues not much considered by Review: need greater co-ordination across monetary and other policies.
- Danger that in practice Review could leave more isolated focus on monetary policy.



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# III. The Economic Policy Orchestra





# Perfect Monetary Policy Would Achieve Better but not Good Outcomes. Need:

Close co-ordination of macro-economic policies (fiscal, monetary and macro-prudential).

Close coordination of macro with:

- Taxation and public expenditure micro-policy.
- Labour market (wage regulation, immigration, education and training, social security).
- Trade, competition (ACCC), other policy affecting productivity (and therefore Productivity Commission).



# Need monetary policy coordination with APRA and macro-prudential

- RBA inhibited by fear of housing boom from easing Dog Days money.
- Macro-prudential would allow monetary expansion without housing boom.
- Now, macro-prudential to reconcile higher interest rates with housing investment.
- Independent APRA outside RBA policy vision.



# Co-ordination of fiscal and monetary for full employment with right amount of debt

- Swan Diagram still relevant with floating exchange rate.
- Competitiveness and domestic demand jointly determine employment /inflation balance.
- Competitiveness and domestic demand jointly determine public and external debt.



# Mundell-Fleming with floating exchange rate

- Fiscal expansion with constant money increases demand, raises interest rates appreciates exchange rate, reduces competitiveness.
- Monetary expansion with constant fiscal increases demand, lowers interest rates, depreciates exchange rate, increases competitiveness.
- Competitiveness and demand together determine how much unemployment and how much debt.



# Energy and climate policies now centrally important

- Productivity Commission wants wider carbon pricing for efficiency, in place of myriad interventions.
- Current second best policies after carbon price abolition in 2014 should be guided by eventual return to comprehensive carbon pricing (2035?).



# Energy and Climate Policies now centrally important

- Prospect of long expansion of zero carbon goods and services exports.
- Main investment in tradables production for several decades.
- Prospect for sustained higher investment in industries with comparative advantage, increasing productivity over time.
- Building Zero Emissions Superpower central to general economic policy story. As well as to global decarbonisation success.



# Who is the Conductor of the Australian Economic Policy Orchestra?

Can be one of several places, but must be somewhere:

- Postwar Reconstruction was Department of Postwar Reconstruction during policy reform, later the Treasury.
- Reform era began with Prime Minister and Treasurer, their offices and Departments and Economic Policy Advisory Council, later the Treasury.



# If RBA independence and separation complete, RBA must be the Conductor

- During Dog Days, Governor called for larger budget deficit and higher wages; post COVID for productivity improvements.
- But RBA had neither capacity nor democratic legitimacy to play this role.
- A mistake to establish greater independence than under 1959 Act.
- Shared research and close interaction with Treasury recommended by RBA Review. A step forward.



# The Conductor today?

- Integrated Cabinet leadership, with States participation through National Cabinet.
- Rebuilt Treasury today the natural coordinator.
- administers ACCC, Productivity Commission.
- Treasury Secretary on RBA Board.
- Needs rebuilding of professional strength after arbitrary personnel cuts and out-sourcing of policy to commercial entities.



# Independent research capacity with public facing role helpful

- Recommended by RBA review for macro for joint use by Treasury and RBA.
- Better with wider scope covering all economic policy.
- Valuable for analysis and public education on integrated policy reform.
- Located administratively in Treasury like ACCC and Productivity Commission.
- Reporting to Cabinet Committee on Full Employment and Economic Growth chaired by Prime Minister.