Key Economic Considerations for Decision-makers in Regional Australia

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Abstract

Regional Australia is going through a period of significant change as it passes with the rest of Australia through a period of turmoil. Maintaining employment, continued economic growth and creating new opportunities in a changing economic environment are all challenges to be met. As we increase our efficiency at maximising capital productivity, one of the possible solutions is research to increase our social and human capital to extract the most we can from our finite economic resources. This paper examines the role and effect of monetary and fiscal management; consistent balance of payment deficits; and human and social capital in regional economic development. The focus of this paper is on what we can draw from the economics literature, which is applicable to Regional Australia and is likely to be most useful for decision making over the next five to ten years.

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1.0 Introduction

Australia has been embroiled in an international economic crisis the likes of which hasn't been seen for almost eighty years. This period of turmoil has struck at the tail end of a period of significant economic growth wrought in part by unprecedented changes to the labour market, trade liberalization and privatization that has seen Australia emerge as a more competitive and efficient economy (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). Within a very short period of time however, this growth has contracted significantly and attention now turns to the best means to stimulate recovery.

The first section of the paper examines monetary policy and fiscal policy in terms of the shifting emphasis in the literature regarding economic theory over the last thirty years and the merits and shortcomings of their use as economic stabilization tools. The different styles of economic management need to be objectively critiqued on their relevance and importance. The decision to use either is of great relevance and could affect the cash supply including private access to funds and interest rates, balance of payments and government debt. The appropriate level of government involvement and manipulation in the economy is also an issue that will be explored throughout the paper. These are obviously matters of interest for regional businesses, investors and government, especially regarding the degree of support regional producers can expect.

The second section of the paper examines Australia's balance of payments history particularly the question of persistent deficits and whether they are of major concern. Whether the recent government spending sprees will exacerbate this unduly will also be investigated. To put the Australian situation into perspective, a review of the comparative balance of payment history of some of our major trading partners will also be explored. The question of private debt and its contribution will also be examined.

The third section of the paper examines social and human capital in terms of their role in the development of economic theory. This is a subject of increasingly relevant importance to the study of economics that may allow much better utilisation of our existing resources. It will also be investigated as to whether it could provide improved outcomes for regional businesses as well as aiding in bridging the gap between research and industry.

It is argued that these three dimensions are critical influences on regional economic productive capacity. A good understanding of their role, effects and how to influence these forces is therefore arguably important to regional policymakers, businesses and investors.

The paper concludes by summarising key points of relevance at the regional level and key future action areas for Regional Australia over the next 5-10 years.

2.0 Keynesian and monetarist policy

The last hundred years has seen a waxing and waning in the influence of the prevailing economic doctrines with Keynesian fiscal management policies having a prevalent role in economic policy decisions for approximately half that period. The big failure of Keynesian policy (the stagflation of the 1970's) is one of the major recent examples of economic quagmire that presents a superb opportunity to contrast with the failure that has since occurred under the monetarist's influence (Collard & Dallas, 2008). This first section of the paper examines monetary policy and fiscal policy in terms of the shifting emphasis in the literature regarding economic theory over the last thirty years and the merits and shortcomings of their use as economic stabilization tools. The deployment of differing tools of economic policy may have a large impact on areas of regional Australia with insufficient capital or a reliance on the state for economic stimulus. Whether the government will be used as the primary means for priming the varied economies of regional Australia or it's left to its own devices to attract investment and growth should be an issue of importance for the many industries of regional Australia.

The first part of this section seeks to examine what initially happened in the 1970's with respect to Keynesian policy and its role in the economic stagnation as well as possible weaknesses with the theory. The second part gives examples of its successes and conclusions found in the literature that support its use. The third part looks at the deregulated decentralized polices that followed with Friedman (McCallum, 2008) and his monetary policy recommendations. Specifically we will be looking at times where it too has faced crisis as well as some inherent weaknesses with the theory and examples where it has been implemented with mixed outcomes. Finally, this section will conclude by looking at broader socio-economic problems associated with widespread changes in economic policy, merits of the two theories, what the best course of action is and what still needs to be addressed.

2.1 Keynesian policy

Keynesian policy grew out of the 1930's amidst the great depression and cries for better regulation and government intervention in the crises. The central tenet of Keynesian policy is the use of the government to better manage economic growth. The main means this is achieved is by aggregate demand management. What this entails is using the state to drive employment and production and manipulate the variables involved to better tailor the outputs (Mulhearn & Vain, 1999). Though this has the advantage of providing some degree of control over the economy, states that utilise fiscal policy are often inefficient and large generators of debt (Mulhearn & Vane, 1999).

Marginalized by turmoil

With respect to the period of the 1970's there is an abundance of commentary and discussion on the suspected causes of low growth, high unemployment and high inflation that contemporary Keynesian theory failed to predict (Mulhearn & Vane, 1999). One explanation indicates misperceptions or misrepresentations of rational expectations linked to a failure by the United States Federal Reserve Bank to anticipate the expected levels of inflation and overestimating the output gap, producing a self fulfilling prophecy of inflation, with consequent falls in output and employment (Collard & Dallas, 2008). Other more conventional theories emphasise state sponsored economic inefficiency and cost push wage spirals (Stanislaw & Yergin, 2002) as the main cause. The former could suggest a failure more on the part of monetarist policy makers controlling the money supply as opposed to any fatal flaw in fiscal policy but the latter explanation certainly implicates fiscal policy and there was little in fiscal policy to suggest a solution. These events in concert with other events such as the OPEC supply shocks, the demise of the Bretton-Woods system and unsteady markets were more than enough to undermine confidence in policy makers and economist's credibility (Collard & Dallas, 2008).

2.1.1 Weaknesses

The primary problem with Keynesian policy and fiscal management is a demonstrated difficulty to predictably forecast certain outcomes from fiscal changes, especially considering the lag times of fiscal policy compared to more rapid effects of monetary changes (Mulhearn & Vane, 1999). Neither monetarist nor fiscal policy is perfect however, with some arguing the response of inflation to monetary policy generally short-lived and of questionable value in its absolute importance (Collard & Dallas, 2008). Furthermore, controlling rampant inflation by tight monetary policy could be implicated in setting off or exacerbating the chain of events that followed in the 1970's, reinforcing the necessity of adequate information (Collard & Dallas, 2008).
In light of these sorts of observations, it will be suggested that it isn't critical that necessarily only fiscal or monetary policy is used but more importantly, more accurate information obtained about economic forecasting to better utilise both of them.

2.1.2 Examples of success

Malaysia's rise in economic strength and recovery after the Asian financial crisis is a prime case study for the Keynesians. Perhaps the biggest issue regarding the importance of fiscal policy in this case was whether it was more active government involvement, tighter regulations and pegging the currency or whether increased exports were primarily responsible for improved performance. The balance does seem to be in favour of the former based on the rate of recovery outpacing the region with similar export performances (Economic Planning unit [EPU], 2008). It is an interesting case of a newly industrialising country rising to prominence very rapidly with average growths of GDP by about 7% between 1970 and 2000 (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). Our growth hasn't been that much behind, perhaps by 2-3% (EPU, 2008) though until recently we have been going about improving our economic performance in a distinctly different manner. Whether we should re-consider fiscal policy will now be explored.

2.1.3 Relevance of Keynesian theory today

Going by recent government spending, the general consensus among policymakers is that we can utilize Keynesian doctrine to better our economic function. This is particularly the case when monetary policy fails, but where and when to apply it is the prime issue for dissertation. Indeed, there is much debate on the importance of fiscal management but debate over its place aside, it is still considered to be an essential tool, as recent government spending has shown (Tcherneva, 2009). This is especially considering the rate-limiting factor is the floor (0%) that the cash interest rate imposes – an effect that limits its usefulness and reinforces the need for other tools, such as fiscal policy. This could be seen in the liquidity trap in Japan for example where close to 0% interest rates did little for five years and interventionist fiscal policy eventually stimulated recovery (Tcherneva, 2009).

Thus in concluding Keynesian policy, it is a useful tool with some drawbacks and provisos attached. These include the afore-mentioned difficulty predicting outcomes and lag times associated with the implementation of fiscal policy as well as the inefficiency that often eventually blights state managed industry. As will be discussed further, it seems there is a time and place for fiscal policy. That place does increasingly seem to be second to monetarist policy. This may indicate that regional Australia can expect to rely less on the promise of the government to keep regional economies going and look more to entrepreneurship and an expanded skill set in human and social capital to attract investment. This is an issue that will be reviewed in depth in the third section.

2.2 Monetarist policy

Monetarist policy – Introduction

Perhaps the person most responsible for the monetarist surge was Friedman who spawned the first significant opposition to government management of an economy post-Keynes and who promulgated the use of monetary policy as the primary economic management tool (McCallum, 2008). It has come under attack recently due to the volatility seen in global markets conflicting with the Hayek/Friedman assumptions about markets being inherently stable (Mccallum, 2008). Markets may possibly be relatively stable but opportunistic factors such as huge movements in currency and speculation that act without regards to consequences beg the question of tighter regulation (Saul, 2004). In its original form, monetarism, the school that stressed the importance of the money supply and monetary aggregates as the crucial factors of economic function has been largely discredited and exists now with Keynesian theory in a hybrid, heavily edited state (McCallum, 2008). The existence of a New Economic Consensus has replaced Friedman’s ideas that money is exogenously supplied and the most important factor with respect to inflation is interest rates not monetary supply (Tcherneva, 2009). These changes in the foundation aside, it can be argued that monetary changes alone can now sufficiently manipulate aggregate demand under normal economic function (Tcherneva, 2009). Though this seems to marginalise fiscal policy, the merits and drawbacks of both are just more clearly understood now.

The argument made here and by others is that well implemented monetary policy could possibly minimize the role that fiscal management plays under the normal function of the economy and it is only called into action when first line monetary measures fail (Tcherneva, 2009).

2.2.1 Weaknesses

Monetary policy has emerged as the status quo for most of the world's developed economies. During this time, it has undergone several periods of trial. These include tightening of cash supply in the early 1980's in Britain and the USA to combat inflation and Australia in the early 1990's to offset spiralling private spending and debt, which caused drops in output and slowdowns or recessions (McCallum, 2008). Where it could be argued this helped precipitate the low rates of inflation that followed, it's hard to balance this against the wayward finance markets and uncertainty that eventuated (Stanislaw & Yergin, 2002). This did however contribute to heavy revisionism of the theory that arguably produced a much better tool for economists and policymakers. Presence again of an underlying theme within economics of evidence that neither is a bad method of management (following testing and revision) but both need to be utilised by informed policymakers.

2.2.2 Practical example with mixed success

For an example in which monetarist led changes didn't fare as well as Australia, one needs only to look to New Zealand where reforms took place regarding the job market deregulation and privatization but unemployment rose and real wages stagnated. How even today, over 20 years after the changes were made, the results seem mixed at best (Saul, 2004). It could be argued here that the changes were made too rapidly or based on flawed theory and the theory today is much more complete. This could be justified by looking to various parts of Europe, Asia and Australia who made similar reforms to their labour market, government ownership and finance market to much better effect (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006).
Though there has been a widespread revivalism of Keynesian policy and heavy criticism of monetary policy, this was primarily of a theory undergoing empirical testing with inadequate information. Under normal economic function, central bank monetary controls are still the most rapid predictable and effective method in stabilisation policy (Tcherneva, 2009).

2.2.3 Conclusions

Thus in concluding, the role of monetary policy, we will again focus on the issue at hand which is the relative merits of monetary and fiscal policy as economic stabilisers. Monetary policy has an important role to play in managing instability caused by domestic and foreign demand and interest rate shocks (Buncic & Melecky, 2007) as it is frequently the only one that can act rapidly enough in response to changes. This and its general predictability and quick onset reinforce its position as first line management. The general banner of monetarist policy is quite removed from its original inception but the general use of monetary policy as first line therapy in economic stabilization still seems secured.

2.3 Wider problems associated with the deregulated/privatized age

That the free market coupled to monetarist policy making has had relatively ample time to show improvement over the failures of the 1970's (which it has) is beyond doubt. That it has also been hindered by recessions, crises, speculation, unscrupulous CEO's, short selling and a lack of real investment and growth relative to the cash involved in finance markets (Saul, 2004) indicates there is much more yet to be worked out in the broader socio-economic sense. As an extension of this reasoning, while government intervention may distort market processes, their responsibility isn't to shareholders or finance markets (which we undeniably rely on) but to a wider picture than economics alone. The markets under the monetarist's watch have been shown to cause growth with instability, stable inflation rates with ever-present unemployment and fluctuations in government's ability to function on accurate predictions (Mulhearn & Vane, 1999).

This doesn't mean that the poor performance of government regulated industry should be forgotten as it lives with us. The well publicised existence of wine lakes and butter mountains in the European Community demonstrates the failings of relying on government intervention to support regional economies and demonstrates that these markets are overpriced, inefficient and that extensive protection has lingered too long (Mulhearn & Vane, 1999). Where local agriculture to a large degree is now globally competitive it is excluded from trade, amounting to billions a year in lost trade in exclusionary practices. Pressure by groups such as the Cairns group needs to be applied to erode these barriers and assist many areas of regional Australia that rely on exports to thrive.

The social costs of unbridled free markets and all of its associated issues needs to be addressed (Saul, 2004). Though this is an issue that is outside the scope of this paper, it is something that will continue to crop up with the increasingly deregulated markets and policies found around the world. It is an issue that threatens to blight the good in the theory and the wider free market if not addressed. To better serve the function of the free market, attention must be paid to its shortcomings, and the externalities it generates. This reveals itself regularly through the many small scale regional and rural primary producers continually up in arms over increased competition from imports. The ever present risk of reduced export and employment is played in a global game and can affect smaller population centres more than metropolitan ones. The tightrope that is de-regulation must be taken steadily allowing means of production to re-allocate and leaving some room for local industries that aren't perfectly competitive.

The huge transition wrought by changes in economic management from tariff based local production to necessarily globally competitive exporters has had a huge impact. This is especially true for those in regional Australia who within a generation or two have seen a much more competitive vista dawn. These changes in economic approaches highlight a gap between the cold science of economics and the human reality of the economic agents involved. A higher degree of unity between sociological theory and economics would be admirable to move the theories forward, making them more complete and applicable. This will be discussed later in the paper with reference to human and social capital.

2.4 Best use of monetary and fiscal tools

Though fiscal policy has its own problems, it is a useful (and widely used) tool that shouldn't be neglected, especially considering the limitations of interest rates and their floor of 0% (Tcherneva, 2009). It must be remembered that Keynesian mixed economy policy did contribute to the high inflation and overly sluggish performance in the 1970's and its presence at the centre stage of economic management needs to be treated cautiously (Stanislaw & Yergin, 2002).

The place of monetary policy then is secured but it must also make room for fiscal policy as the second fiddle as it did provide fertile ground for growth following world war two (Stanislaw & Yergin, 2002). The use of central banks in managing interest rates, inflation and other macroeconomic variables such as unemployment is well established. Where these measures fail to stabilize or induce recovery, intelligent fiscal spending is the next best bet.

2.5 Concluding remarks – monetary and fiscal management

Thus in concluding, increasingly the literature does support the idea that instead of opposing views, monetary and fiscal policy can be used concomitantly to good effect when for whatever reason the function of one is impaired. The usefulness and rapid nature of monetary policy reinforces its position as number one with its limitations underling the necessity of a plan B. It is up to well-informed policy makers to judiciously decide which is more appropriate when. The general theme of monetary first line and fiscal management second line has been addressed but the larger question of when and precisely how or where to intervene with fiscal management is still wide open. The idea that both can be used concomitantly can be seen in abundance in this time of crisis and elucidating where and to what degree to use them is a matter for further investigation and continued observation.

Where this leaves Australia in the next five to ten years then is a subject of considerable speculation. Having just committed to considerable expansionary fiscal policy, if as explored next, we recover as exemplified in recent history then there is little concern (Di Marco, K. Pirie, M. Au Yeung, W, 2009). The forecast is for recovery as soon as 2010 and as such the outlook beyond that seems bright (Di Marco, K. Pirie, M. Au Yeung, W, 2009). The seductive role of fiscal management should be relinquished as soon as is prudent however. The private sector of the economy must be allowed to flourish to pay back government debt and assist in recovery.

Appropriately this is an issue bound to debt levels, which is debatably one of the biggest risks to the Australian economy and will also be explored next. In summary, if the 1970's taught us anything it is that there is a role for state but it is not as primary controller of the economy. The precise level of regulation and intervention necessary is an issue wide open for discussion though the literature and evidence suggests it should be as low as possible wherever possible – agriculture perhaps, the finance sector perhaps not (Stanislaw & Yergin, 2002). The use of much less invasive monetary policy with interventionist fiscal policy utilised only when necessary it would seem is the best way to proceed from this slump (Stanislaw & Yergin, 2002).

3.0 A historical view of the balance of payments in Australia

When analysing the balance of payments deficit it is common practice to examine both the public and private contributors to that debt. In contrast with other OECD countries, the Australian Government's spending isn't as drastic as it seems. With a 22 billion dollar cash deficit correlating to an increase in the cash deficit as a proportion of GDP from 1.9% to 2.9% it is an easy thing to put into perspective (Commonwealth of Australia [COA], 2009). Though this will increase, the general consensus seems to be in line with other developed economies. That is that for the gains associated with expansionary fiscal policy in this period of crisis, it is an acceptable price to pay. With the government confident of recovery to economic growth within a few years, they have a good historical record to reinforce that assumption (COA, 2009).

That said, some commentators describe the contribution of the government deficit to the consistent deficits we have in our balance of payments history as the twin deficit hypothesis. This issue of consistent deficits is an ongoing cause for concern for Australians and an issue that needs addressing (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006).

The first part of this section will examine the immediate situation that Australia finds itself in and examine other periods in recent history. Following that, the response by policy makers and to what effect will also be investigated. This second section of the paper examines Australia's balance of payments history in terms of the question of persistent deficits and whether they are of major concern and whether the recent government spending sprees will exacerbate this unduly. The Australian situation will also be put into perspective with a review of the comparative balance of payment history of some of our major trading partners.

Finally, we will also cover the impact of private debt before summarizing the threat of debt and whether it is a cause for concern. This is of particular relevance to the agricultural and mineral sectors that contribute little to the GDP but are the major participants in our export earnings and if either goes into decline we can expect to see a poor balance sheet worsen (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006*)*.

3.1 Australia's deficit

When contrasted with similar situations, as will be shown below, periods of expansionary fiscal policy followed by debt consolidation is a common theme in the Australian government's balance sheets (COA, 2009). Furthermore, it will also be argued that managing the budgetary deficits will aid in managing deficits in the balance of payment history though isn't the whole picture. Finally, other aspects will also be taken into account including the declining rate of saving and investment and increased private borrowing all impacting negatively on the balance of payments to a much greater extent than government debt does.

3.1.1 Australia's deficit – Public debt

It is readily accepted that the level of public debt is a good indicator of the competence of public finances and the level of public borrowing fluctuates with the relevant position of the economic cycle (Di Marco, K. Pirie, M. Au Yeung, W, 2009). Though times are dire and public debt will rise, the levels typically fluctuate accordingly and this can clearly be seen in Australia's history (Di Marco, K. Pirie, M. Au Yeung, W, 2009). Higher unemployment stabilizes or even reduces prices and allows a period of saving and consolidation. Furthermore, it is a good opportunity to contrast 25 years of neo-liberal monetarist and deregulatory changes that have managed reasonably well to grow the Australian economy (not forgetting some deleterious digressions) with the prospect of renewed interest in interventionist fiscal policy. It can be correlated with the circumstances of economic slowdown and recovery seen from 1982 to 1983 and again from 1990 to 1991. It should be noted that in both instances, benefits were wrought from state spending and reform and the recoveries bought growth (Di Marco, K. Pirie, M. Au Yeung, W, 2009). It should also be noted that a better job could have been done of the monetary management by the governments of the time (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006).

Historically Australia has for decades now been undergoing some general trends. Saving and investment have been falling and deficits have been consistent and growing in every year bar one since 1960 but despite this, Australia has generally had positive economic growth outpacing other OECD countries. The drivers of this change, positive and negative, include reduction of trade barriers, financial deregulation, labour changes and the floating of the exchange rate (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). Though the looming spectre of market failure is ever present, all isn't quite as bad as it seems as despite these handicaps, economic growth has very rarely been negative and we still maintain a high quality of life.

3.1.2 Public debt - Conclusion

That our levels of government debt are low is a good thing, allowing spending at times such as this when it may be necessary and our economy is also well enough insulated against external shocks that it is affected but not as much as others (Di Marco, K. Pirie, M. Au Yeung, W, 2009). That coupled to a usually pretty efficient recovery process by the state and the markets means that debts and deficits made should be recovered within a few years as long as mistakes such as the severe contractionary measures of the early nineties aren't repeated (COA, 2009). Reinforcing this are other OECD countries where levels of net debt are far worse than Australia and where state spending is much higher, giving Australia room to move in terms of debt and a chance to improve state spending in positive ventures such as infrastructure development (Di Marco, K. Pirie, M. Au Yeung, W, 2009).

In summary, the main thrust of the first section of the balance of payments deficit concerning the government's budget is this. The contribution to the balance of payment deficit by the government is currently quite small. Further where the twin deficit hypothesis tends to imply that budgetary blowouts exacerbate our balance of payments deficit further analysis undermines this. Where the public debt has been reduced, increased private spending of an almost paradoxical nature has blown out the balance of payments further. As will be discussed, prudence does need to be exercised in both sectors to see an improvement in the whole. With regards to regional Australia, reduced government spending and diversification to reduce reliance on regional exports to prop up the balance of payments are priorities. For the time being however, this emphasises the importance of the export sector, for the Australian balance sheet and reinforces the necessity of ongoing support and investment for these important regional sectors.

3.1.3 From public deficit to the broader picture

Moving on from the question of government debt, it is clear that in the broader sense we are large generators of deficits in the balance of payments (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). This can be seen in a progressive increasing of our balance of payments deficit, which has seen Australia leaking money and increasingly borrowing money from abroad. Again, it is commonly seen that the private sector tends to borrow more when the government is borrowing less. Realistically, it is impossible to avoid any sort of external borrowing. The spectrum of reasons ranges from fluctuations in tax income for the government and changing fiscal demands at a macro level to opportunity cost decisions at household unit levels (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). The important point here is to reduce debt levels to their most sustainable and avoid excessive spending. Until just recently, this is just what the government had been doing and private debt will be discussed presently.

3.2 Australia's deficit – Introduction to the private sector

Reducing private sector debt then is a further priority, a far larger proportion then the public sector's share comprising over 85% of our balance of payment deficit (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). The idea that more saving should create less of an interest burden with more self-reliance is an obvious one and one that reduces consumption fuelled economic performance but adds to the long-term plan. Likewise, while less borrowing indicates less investment and growth, it does positively affect the balance of payments.

3.2.1 Private sector debt – Where to from here

An adjunct to this is that a reduction in excessive consumption is yet another priority. Less frivolous behaviour with finances and more saving and investment in the growth sectors of the economy should aid the positive re-investment in local economies and continued stable growth. That includes infrastructure, which can be shown to be privately run, publicly monitored and often shown to reduce fees (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). It is proposed this will improve competitiveness and open new avenues of external trade as well as examining the current business structures for microeconomic adaptation. A further factor that commands an important place in economic development is continued research and development on social and human capital, which will be followed up next.

As such it can be reasonably concluded that recently Australian government spending has been well managed, especially by OECD standards. Even when the deficit has been as high as 17% of GDP fifteen years ago it wasn't catastrophic (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). While the recent spikes in spending negate the almost neutral footprint of recent government budgets, they serve a purpose that has typically been successful when utilized prudently. This should also be contrasted with the broader picture taken into account and when the private sector is considered, the net foreign debt has grown from less than 5% of GDP at the start of the 1980's to over 50% in 2005 (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006).

3.2.2 Private sector debt – Concluding remarks

The point made emphatically by some is that even this level of debt remains acceptable as long as it remains sustainable though defining sustainable is a challenge at best. This doesn't however remove the need for prudent management and containing the levels should continue to remain a priority. Arguments have been mounted that it is of little policy concern that we have a large private debt but it cannot be denied that it is still disproportionate, sitting at around 4th worst in the world (International Monetary Fund [IMF], 2008). Australia has managed to see consistent economic growth despite these burdens but that isn't to say it couldn't have done better with more domestic investment, saving and less spending and borrowing. It is easy however to counter-argue the debt was necessary to finance that economic growth.

3.3 Global comparisons – Our trading partners experience

This can also be put into perspective by looking to the records of some of our major trading partners. First and foremost, it is important to note that Australia's current account balance compares very poorly with the rest of the world having a 2005 deficit of over fifty billion dollars which pales in comparison to America's then $730 billion (IMF, 2008). That said it is at least comparable to other developed countries such as Italy, Spain or Greece and this has gone on to improve for Australia and worsen for many of our trading partners (IMF, 2008). South Korea slid from a $5 billion surplus to a twelve billion dollar deficit, United Kingdom $100 billion and America's incalculably large by now (IMF, 2008). This compares very poorly to countries such as Germany with hundred billion surpluses let alone China and its amazing four hundred billion (IMF, 2008).

3.4 Balance of payments – What can we do?

Though certain sections such as the budgetary deficit have improved, from $96 billion thirteen years ago, (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006) it has been offset elsewhere. The balance of state funding for growth and debt accumulation should be played as befits the economic situation and here increased spending seems to be acceptable as long as it is done prudently. Other areas such as continued emphasis on improvements in our export performance abetted by a weakened dollar and adjusting to tighter lending criteria with more saving should help improve our rampant debt. There is a full continuum of economies with varied taxation, regulation, intervention, unemployment, current account balances, and comparative advantage. All of these performance variables are influenced by checks and balances such as floating exchange rates and credit ratings that correct imbalances or penalize poor performance in certain areas (Mulhearn & Vane, 1999). These can include excessive borrowing, lacklustre export performance, poor state spending on health or infrastructure or extremes of financial regulation. Our trading partners and we exist on this range and finding the right mix of macroeconomic variables is the cornerstone of good policy. As mentioned Australia's overall performance has been good but difficult times are ahead and a long-term plan is necessary for recovery.

3.5 Balance of payments – Concluding remarks

Thus in concluding, the twin deficit hypotheses as a concept isn't too sound with blowouts of the balance of payment recorded regardless of government spending. Though adjustments to the floating exchange rates and interest rates ameliorate foreign debt and foreign direct investment helps mobilize an undercapitalized economy, it leaves us more exposed to global forces (Mulhearn & Vane, 1999). Managing public spending has been covered at length with private spending, decreasing savings and investment under-addressed issues that need more attention. It must be remembered that this is effectively a drain on our income and as such should be redressed be it with restrictions on finance or better incentives to save. Particularly during times of drama and upheaval, self-reliance and attention to surpluses and growth need to be met if the economic engine is to turn and unemployment is expected to remain low.

Lower values for the Australian dollar make exports more attractive and aid in redressing the balance of payments along with reduced borrowing, spending and less imports (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). It must also be taken into account that when the dollar rises it may impede our export performance, worsening our deficit further. Better utilization of local capital, focus on wealth creation and saving with fiscal restraint exercised are all-important if we are to continue to grow economically, necessary for meeting repayments (Stanislaw & Yergin, 2002). Reducing debts where possible should be a priority and the changes threatened by carbon trading or economic situations such as this means having reserves when necessary is very important. That said, with a return to surplus and positive economic growth within two years, (Di Marco, K. Pirie, M. Au Yeung, W, 2009) the outlook is positive though it may be a long, soft recovery.

4.0 Social and Human Capital

4.1 Social and human capital - Introduction

Social and human capital are integral parts of the economy. The latter describes the labour expected of a nation's economy, along with its earning power, making it an essential, fundamental component of any economic study and the latter is a concept that influences the potential human capital of an economy (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). This in itself is a gross oversimplification of course, with social capital a wide and debated subject of importance to economics and sociology. In times of crisis, such as this, the importance of these two ideas comes to the fore. Just how important, quantifiable or measurable social capital is, particularly when linked to its influence and output in human capital, is a question that must be addressed.

This third section of the paper examines social and human capital in terms of their role in the development of economic theory. The first part of this section focuses on the economic relevance of social and human capital respectively and their current place in economic theory. For the former, a summary of the major points regarding the theory will be made with particular attention paid to its relationship with human capital and in turn, economic performance. For the latter, a much more clear-cut relevance to economic theory has been established and details of its documented success will be the focus. A summary of the interwoven concepts will then be presented in the conclusion.

4.2 Social capital – Introduction

As mentioned, social capital is a nebulous concept with its origins firmly planted in sociological theory. Though defining it can be difficult, a formal definition of the components of social capital includes the formal and informal institutions that generate social capital and personal attitudes that result from this (Faricy & Hoyman, 2008). In recent times it has been expanding its influence in economic theory, primarily in its role in support of human capital. In its simplest form, the relationship between the two can be reduced to social capital being a quality created between people and human capital a quality of individuals (Burt, 1997). Due to their position relative to each other the two concepts could be erroneously lumped in the same basket but the investment in stimulating both is not one and the same. The creation of opportunities and other aspects discussed below are central to positive social capital and it is hypothesized that this in turn stimulates the positive growth of human capital (Burt, 1997). We will now attempt to disentangle the two and find their economic relevance. This will become increasingly important for social capital as its role in regional economic development becomes clearer.

4.2.2 Social capital - Concept

The theory in its entirety is outside the scope of this paper and like its concepts, has a difficult to define inception with Putnam widely credited as formulating the first credible debate on the subject and goes on to say the best work generated on the issue quantifies it as sociological quantity (Faricy & Hoyman, 2008). Needless to say, this in itself makes incorporating it into a wider framework difficult. The ideals of democracy, civil liberty, altruism and trust seem to be central to the development of positive social capital but this must be juggled with a period of increasing police controls and their unknown effects. Will people feel safer and more trusting or coerced and fearful? More likely to spend and consume or save and possibly, invest? Coupled to the nebulous concepts mentioned before and the changing zeitgeist of a society with all its multifaceted influences, can we really hope to influence it for the better or would we simply be misplacing resources in a misguided attempt at social engineering?

4.2.3 Social capital – Economic relevance

Some scholars argue it can be demonstrated that the components of superior social capital (stronger community relationships, trust, sense of civic duty and so on) could be used to differentiate regions of similar economic status but varying productivity (Faricy & Hoyman, 2008). An example of this could include areas of northern Italy with more developed civic communities developing faster following WWII through to the 1990’s (Faricy & Hoyman, 2008). It can also be argued that different areas and periods have produced different output with different social capital and the effect can be deleterious such as in organized crime, ironically more widespread in southern Italy. This is the difference between bridging and bonding broadly inclusive and exclusionary in nature respectively (Faricy & Hoyman, 2008). How best to approach this issue and foster a positive social capital is the question. As will be discussed next however, we cannot ignore the possible implications for regional Australia with organizations such as Desert Networks already alive and fostering social capital in areas of regional Australia.

The findings in Italy were reinforced by studies of nascent entrepreneurs that social capital outperformed human capital as a variable in increasing success of a start up (Davidson & Honig, 2003). Interestingly, the importance of social capital was present from the gestation of the business and only increased in the ongoing promotion and development of the businesses, outperforming knowledge and human capital in several areas (Davidson & Honig, 2003). Entrepreneurs with close family and friend ties as well as networking abilities increased probability of entry and chances of sustaining the business (Davidson & Honig, 2003). This is a crucial finding that should be on every business’ radar and for small and businesses with limited support, could be the difference between thriving and failing. This should be an area of huge attention for policy makers aiding small business start ups and a great means to improve regional outcomes.

Some of the recent investigations into social capital reveal a very interesting picture. Not just that it is an important issue of itself but is also equal to or more important than human capital in maintaining commerce which would come as no surprise to any businessperson. The general consensus seems to be that the concept of social capital appears to be an important tool in economic discussion, refining the concept of capital while remaining separate to it in several areas (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006). Higher levels of social capital (positive bridging more prevalent than negative bonding) have been shown to positively correlate with economic growth (reducing transaction costs, increasing trust and confidence as well as the obvious business networking) though the real question remains how do we cultivate it (Faricy & Hoyman, 2008).

Improving the environment with which small business operates and fostering these is possibly an area of un-investigated study. Extra emphasis on social capital in the form of networking and professional organization incentives as opposed to strictly funding or training initiatives seems a good place to start. An improvement in our understanding of social capital may allow us to better bridge the gaps between research and industry and provide a more cohesive function for these cornerstones of our economy. The subject should be increasingly accepted into mainstream economic though as an important variable with increased investigation into whether we can manipulate it and to what degree.

4.2.4 Social Capital – Where to from here?

Though there is a wealth of sociological data regarding the issue, the idea is a diverse one that details positive and negative effects in the world of commerce with much debate on its application. Though the sociological argument that it is necessary to foster social capital for the growth of human capital is consistent, it is of its own a valuable tool of economic growth. Without adequate social capital, human capital (knowledge, skills, training) can be insufficient to succeed and vice versa (Davidson & Honig, 2003). There is now emerging important economic studies that are detailing the relative importance of the two concepts and with increasing cooperation from sociological circles, its full potential can increasingly be realized.

Extra emphasis on social capital in the form of networking and professional organization incentives as opposed to strictly funding or training initiatives seems a good place to start. A better understanding of social capital and its implementation could lead to better utilization of our other capital, human and otherwise, and may become a larger player beyond the next ten years as we seek to extract whatever we can to improve economic performance. This should be viewed with increased acceptance by rural Australians who suffer more isolation then their metropolitan counterparts and should provide a useful tool with which to augment their business functions.

4.2.5 Social capital – Concluding remarks

In concluding, social capital is certainly an area of particular interest that will require more study before it can be fully utilized as a policy tool. This could be a problem considering sociologists such as Putnam imply a monopoly on its ideas (Faricy & Hoyman, 2008). This is a shame as the idea of encouraging an environment for business to thrive, to allow regional businesses the same advantages that their metropolitan counterparts have in networking and to aid integration and communication between research, government and industry is imperative. For social capital to be more fully appreciated it needs to be increasingly incorporated as an economic variable, an idea which would help regional areas as much or more than their better networked counterparts.

For social capital theory to really shine it needs to move from the nebulous world of theory and definition into working frameworks that can postulate working solutions to an area that can be identified as having inferior social capital to aid in improving its socioeconomic performance. Differentiating it from the more established theories of human capital would be essential to furthering our understanding of the idea – as mentioned earlier the influence that it has over an areas human capital is undeniable and of great importance (Faricy & Hoyman, 2008). With a better understanding of the catalytic nature of social capital and its nurturing effect on economic growth, we potentially have a very important tool with which to aid regional economic growth.

4.3 Human Capital – Introduction

Human capital is much more clearly defined and has a more quantifiable and concrete position within economic theory. It can be defined as simply as the earning power that labour households supply and expect to supply (Garnett, A., Hawtrey, K, Lewis, P, Treadgold, M, 2006) though this can be expanded to include the constituent education, training, experience and so on that constitutes the stock of human capital. Furthermore, as will be seen there is extensive recent historical evidence to positively correlate increased concentrations of human capital with superior economic performance (Nardinell & Simon, 2002). The positive feedback loop with social capital will also be discussed and concluding remarks regarding where to from here will also addressed.

4.3.1 Human capital – An easier task

A wealth of human capital (skills, education, innovation etc) has been positively correlated with superior economic performance in many studies and a higher proportion of tertiary education has frequently been shown to increase productivity and provide better economic outcomes (predominantly in higher wages) (Faricy & Hoyman, 2008). In this case, government can have much more measured, quantified and objective policy positions. Increased funding for education, literacy requirements, education standards and goals and so on are easy recommendations. Moreover, investment specifically in intellectual capital has also been shown to improve economic performance with higher average wages associated with increased research institute density (Faricy & Hoyman, 2008). In this case, though it is clearly a long-term objective, increased expenditure and focus on education while being mindful of the demand for educated labour is a priority.

These investments have been shown to reap handsome rewards economically though these do tend to predominate over the long term. A study observing the last century in America found elevated levels of training, education and skills produced, on average, a

38% increase in average employment growth over cities with poorer human capital in the years between 1900 to 1986 (Nardinell & Simon, 2002). That higher concentration in human capital generally indicates higher average wages is taken as a given. Even change in demographics such as a rise or decline in manufacturing tends to vary the need for elevated human capital but at some point, knowledge, training, expertise and experience are required to manage or participate in increasingly complex economies (Nardinell & Simon, 2002).

In a long run scenario, skilled labour is either initially or eventually needed (Nardinell & Simon, 2002) to participate in the many and varied attributes of a developed economy; engineering, medicine, retail, law or the coordination and organization of manufacturing, mining or agricultural extraction, production and distribution. Australia possesses a large proportion of higher educated citizens, a high proportion of scientists and contributing writers, a strong skills base and generally good employment and productivity factors (OECD, 2008). We are well placed to take advantage of these resources and plans to better utilize our human capital should be explored.

4.3.2 Human capital – Concluding remarks

It's easy to put too much emphasis on human capital. It's a subject that has been covered quite comprehensively and the obvious factors such as training and education are easy to monotonously intone again and again. On the contrary, it is easy to over invest and create an oversupply of skilled workers deflating wages, creating a brain drain or contributing to an over skilling problem (Mavromaras, K. Mcguiness, S. Yin King, F, 2009), a poor utilization of our resources. As such, it is certainly an issue worth attention but one well covered already. That said, even a saturation of skilled labour is better than a deficiency of it in the same way that excess capital or saving is preferable to accumulating debt and borrowing.

Finding a balance in the allocation of labour or resources studying social and human capital is an important task. As mentioned earlier, human capital is a relatively well studied and reasonable well understood phenomenon. More emphasis needs to be applied to the study of social capital while ensuring that it is not forgotten how central human capital is to the economic framework. This is particularly the case in regional areas where there may be a deficiency in human capital due to the often great distances to colleges and universities. Programs in place at regional universities are already working to try and retain skilled workers in regional areas so time will tell as to their effectiveness. Continued emphasis on human capital, especially education and training, shown to reduce wage inequality and improve wage outcomes (Giorgio, B. Margherita, F. Weber, G, 2009), should remain a priority balanced against the necessity of better utilizing other forms capital.

4.4 Social and human capital – Where to from here

Australia could be said to be lacking in necessary human capital qualities such as innovation and lags relative to other OECD nations in areas such as gross and business expenditure on research and development though these have been improving (OECD, 2008). This is unfortunate as Australia has a large skills base as well as good contributions to scientific literature implying there is definite room for re-allocation of funds to their better application. The recommendations made include building on steps taken such as the establishment of the Department of Innovation, Industry, Science and Research and expanding their role. Better integration of scientific research with innovation and business, better funded business and research development and better utilization of local funds are all priorities to improve the economic outlook of rural Australia over the next five to ten years. This should help to maintain competitiveness and provide regional businesses with better tools to survive increasingly difficult and exposed economic environments.

As we progress down our checklist in improving efficiency, more accessible finance, leaner government function and other structural changes, we come to the human aspect. For regional Australia to weather the storm and thrive in the aftermath and to exploit the changes and challenges being made in this increasingly global economy, we must better utilise our human capital. It is one thing to have an economy well endowed in human capital (which Australia does) but another entirely to have the social and institutional measures in place to encourage investment, small business growth and job creation (Stanislaw & Yergin, 2002). A positive, supportive and increasingly developed social capital will become increasingly critical to the survival of business in regional Australia as we squeeze what we can out of the known factors of economic growth and look to new ways to continue economic growth.

4.5 Social and human capital - Concluding remarks

With a large, well-documented body of evidence in the economic literature regarding human capital and its integral role in studying economic function, we need to expand our study of human resources. A wider field of research incorporating sociological data is as a result, essential. Particularly when studies stressing the importance of social capital in business function, a rather obvious observation, have recently emerged (Davidson & Honig, 2003). The importance of networks and the interactions between the players within commerce are increasingly being seen as equally important as the study of these players (Burt, 1997). This doesn't mean we should neglect the knowledge we've obtained on the importance of human capital. A better understanding of the former and continued investment in the latter is necessary, particularly in better mobilising our existing human and other capital.

The outlook for Australia over the next decade or so hinges on the outcome to several important questions regarding the place of human and social capital. Assuming that both concepts have central and important roles in an economy's performance, what do we see? For social capital the consensus is that we will probably increasingly see this incorporated into more formal frameworks within economic theory particularly in its role supporting and enhancing human capital. Better cooperation between the disciplines to better elucidate where we can improve our social capital is critical. As this emerges, we should examine how best to exploit the phenomenon and at the very least consider how best to manipulate what we can. For human capital, increased utilisation of our skilled workforce combined with increased innovation and development of ideas, increased applications for patents and general improvements in research and development application are all vital. Crucially, the relationships required to do this require an increased cooperation and understanding between the disparate areas of research, industry and policy-makers. As such, improving the ability to network and cooperate, particularly between the former two are vital to better exploit our human capital.

5.0 Conclusion

This paper concludes by considering the significant points of interest of each section and raising the most important questions that must still be pursued in terms of a better understanding of and a better utilization of the forces at work and resources at our disposal; and especially as to their relevance to the issues of economic management using fiscal or monetary policy, public and private debt and the question of human and social capital.

In summarising the first section of the paper, the next five to ten years will test the effectiveness of fiscal management in a new light. Will we see a reflection of the 1970's example with little to show but debt or inflation or is leaner government function and a good record of recovery enough to see us through? How the Australian economy responds to these fiscal injections is crucial to the survival of the idea that fiscal management still has an important role to play. If growth does return, will the reins be handed back to monetary management or will the government be tempted back into the economic arena? The fact that that the Queensland government is looking to a renewed asset sale is a good indicator it is otherwise business as usual and as long as the sale is fair and the money wisely dispersed this is a good thing.

It has taken years of careful management and upheaval to bring the budget to a surplus and it is perhaps only with that that the government had a springboard with which to launch a stimulus package. The death knell of state-planned economies in the 1970's was their inability to manage all aspects of the economy and the resulting debt and stagflation was crippling. Ongoing government involvement and spending will detract from the ability of private commerce to flourish and should be avoided. A return to minimalist fiscal intervention with monetary management as the economic tool of choice on a return to growth in the next couple of years would be ideal. An emergent issue not just for government but also for the private sector is that the outlook for Australia is still positive as long as our level of debt is sustainable, a factor completely reliant on economic growth. For the former, a return to balanced budgets then is a priority.

Moving from the government's responsibility in reducing its debt we come to the wider question of how much is too much for the wider economy. Just how important it is and what levels are acceptable is a question that continues to dog economists and a slump such as this places further emphasis on the subject. Australia's situation seems to be sustainable but that shouldn't belittle efforts to further reduce foreign borrowing and debt.

Better utilization of our own resources is crucial to better economic function. It is also important to note that to stay ahead of the repayments means continued economic growth so a slump such as this could well put us at risk of defaulting.

In terms of our situation and where we expect our economic position to evolve into over the next decade, several factors such as debt will be an omnipresent force. As part of the ongoing debate regarding this issue is the fact that Australia consistently finds itself towards the bottom of balance of payment rankings. Ongoing attention to this and how we best maintain it by reducing excess consumption and increased local investment and export performance are critical. Time will tell how successfully we negotiate this though we have after all survived a long history of debt and our management remains quite prudent.

Perhaps most importantly of all though as this unfolds are other methods of managing a constantly changing economic reality by addressing variables less often covered in the literature or media. As discussed, human capital is a well studied and quantified variable of which there is no doubting the ongoing investment in and importance of in economic performance. Social capital on the other hand is emerging to be a variable that may be as or more important than human capital. It is much more difficult to define precisely with a full range from civic spirit to relationships and trust between individuals to networking and many other positive attributes in a healthy socio-economic environment. The latter treads heavily sociologically but as a critical economic variable, it has only recently been addressed and seeks to be formalised and better studied.

The next five to ten year will see a need for exploring new avenues of economic management. Ongoing investment in human capital to sustain growth is imperative but to better utilise it and further investigate its close counterpart social capital is another priority. As its exposure in the economic literature increases its position and utility needs to be explored and defined. With completely objective means of defining and evaluating the concept and performance of social capital with positive correlation to economic performance it is definitely an emerging field. As regional Australia increasingly tries to compete in a challenging, exposed environment finding new avenues of investment to aid in business growth is important. Better utilisation of our existing resources through better networking, reduced obstruction and cost, better implementation and capitalisation of human capital are all proposed under improved social capital. How best to achieve it is another matter for discussion.

With a return to growth within two to three years expected the five to ten year outlook is good. How best to proceed from this is a combination of tacts. These include working with the current systems of management to guide the economy to the best of our limits today and the ongoing issue of managing debt should also play an increasing part in this. Most of the sudden growths or resuscitations in economic performance since the great depression have been mediated by revelations in economic study and new cornerstones of knowledge. One of the emerging factors is social capital, a potentiator of human capital and important economic player in its own right. Better study of this and its outcomes if developed and exploited could be a valuable aid to recovery over the next decade.

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