**A Prosperous Future for Australia?**

This paper sets out evidence that setting up Australia for a prosperous future must start with market based policies for interest rates and banking, and with policy encouragement for job makers. The Government, especially the central bank, must get out of the way of setting interest rates and bailing out banks. Of course this must be done in an orderly way. Those who generate most new jobs and build businesses must be encouraged. They are predominantly small and medium sized and family businesses. Only by encouraging small and medium business, families and regular wage earners to create jobs can we assure a prosperous long term future. Otherwise we risk falling into a very severe depression. Less reliance on government, not more government, is the solution.

Central Bank to be Blamed?

The independence of Australia’s central bank is seriously threatened by its policy actions over recent years.

The evidence is before our eyes. For sale: a regular size block around 700sqm, a 4 bed home maybe 20-30 years old, a lovely view of the sea.[[1]](#footnote-1) I was shocked recently to see the asking price of $6m plus for this beach house. Who buys a $6m plus beach house in a small seaside town about 2 hour’s drive from Melbourne?

Either the purchasing power of $6m is much less than it was awhile back, or the rich in our society have made a ‘mozza’ and are fleeing the city, perhaps partly because of the virus. Such prices certainly are way out of reach of even the top end of regular wage earners.



This sort of thing is hard evidence that the policies of the central bank appear to have dramatically increased the gap between the rich and the rest, with the rest being middle income or regular wage earners.

This gap is increasing due to central bank policy. It has and will cause political upheaval. It is a global thing.

The signs of this are in the 74 million people who voted in late 2020 for President Trump. They voted for policy, and for better wages, not personality, I suggest.

Other signs of widespread public disillusion with the gap between the rich and regular wage earners also were seen with Brexit, and the wealth and wages disparity between North and South in the UK.

The same or a similar gap exists in Australia, between the returns to wages and the returns to capital. The labour or wages share of Australia’s income has declined pretty consistently since the late 1970s, from around 63% to around 53%. Much the same has happened in the U.S.A. [[2]](#footnote-2)



**Short term policy has become long term ‘addiction’.**

Short term emergency policy solutions by central banks, including recently for the Global Financial Crisis and the virus, have become long term policy.

Nations seem to have become addicted to low interest rates and easy cash availability policies, with potentially very dangerous consequences.

Low interest rates and increased liquidity, or easy availability of cash money, together have caused a massive increase in the wealth of asset owners. House prices, commercial property and share prices have skyrocketed. Regular middle income wage earners and younger people without much in the way of assets have largely missed out on this bonanza.

**CEO and shareholder ‘bonanza’.**

Many CEO’s and owners of shares in company’s have made mind-boggling wages and huge fortunes, while ordinary, regular wage earners and younger workers have struggled.

Regular wage earners and younger workers have received comparatively small increases in wages; as witness the relative rate of wage increases compared with asset price growth, and as witness the wages share of Australian factor income (the latter defined as GDP less taxes on production and imports) compared with the growth in company operating surplus or profit share of factor income.[[3]](#footnote-3)

**Are official measures of inflation misleading and deceptive?**

Regular wage earners and younger wage earners also could be forgiven for seeing the official reports of low inflation as false and misleading. The measures of inflation used by the central banks and wages systems have helped keep wages low. At the same time as official inflation measures have stayed low, there have been massive gains in the value of assets owned by the asset owners, assets like shares and houses and commercial property.

The actual level of inflation if measured by including the increase in asset prices is much greater than most official measures. Wage rises have been judged as fair because they have been compared with official inflation measures which generally exclude asset price inflation.

**Regular wage earners locked out of the ‘magic pudding’ [[4]](#footnote-4) economy**

The purchasing power of regular wage earners’ money has been dramatically eroded by the huge increases in asset values. Their wages cannot buy what they could. The houses they need to live in, and the shares, bonds and real estate they want to own to fund their retirement are way, way more expensive in terms of the wages earned by most regular wage earners. Wages have not kept up with asset prices. If you don’t own assets you are effectively locked out of our ‘magic pudding’ economy.

**Central banks likely will take the blame for this.**

Low interest rates and ready availability of cash money have brought this about. The central bank has administered these policies in good faith. Nonetheless unexpected outcomes now are clear. Regular folk have had enough. The politicians will make the central bank the patsy for this, unless the central bank acts in an orderly way to restore a ‘fair deal’.

Australia’s major banks also are under serious challenge because central bank policy makes it harder for them to lend money, and because the major banks have a history of charging much higher interest rates to small businesses, who in turn are Australia’s largest creators of new jobs.[[5]](#footnote-5) These higher interest rates are now under challenge, by central bank policy for lower rates, by higher capital requirements for banks and by new technology.

**Australia’s Banks are being ‘hog tied’ by these policies.**

Fundamental signs of central bank policy failure are in the weakness of local and global banking systems: large banks profitability and their ability to help build the economies they serve now are lower than almost ever. The banks’ net interest rate margins are at all-time lows because interest rates are so low. The banks’ capital requirements have more than doubled. They may survive a GFC mark 2,  because they have more capital to absorb losses, but as a result they are now and will be much less profitable. As a result they will be much less able to lend money to business and drive economic growth. They simply cannot make reasonable profit margins while interest rates are so low and while regulators require that they hold more and more capital to support their banking business.

Is policy administered by central banks and regulators forcing banks to slow lending and take less risk, and thereby making it harder for regular wage earners and small business to borrow?

For centuries banking has been the ‘golden goose’ of wealth creation. It will be very hard for the goose to take off and strongly support economic growth while it faces the headwinds of low interest rates and higher capital requirements.

**Small and family businesses are paying for the lower interest rates enjoyed by the big end of town.**

The banks also face dynamic change and significant competitive threats. For so long the banks have profited by charging small business higher interest rate margins than big business.[[6]](#footnote-6) This higher cost of funding imposed on small business has increased recently and is entirely contrary to the role of small, medium and family business in providing employment, which on some measures exceeds 60% of total private sector jobs and jobs growth economy-wide. Big business again is the beneficiary. Lending costs and margins for big business are way below the rates charged to small business. Regular small business people who provide most jobs in the economy are ripped off. Is this nation building policy, or a big-business-profit building policy?

**New players are eroding banks’ competitiveness.**

New technology likely will make it increasingly difficult for banks to keep margins high for small business lending. The new buy-now-pay-later lenders and others are using digital platforms, big data and artificial intelligence to take market share from banks. This pressures bank profit margins and likely will accelerate. An orderly transition to a new lower margin structure of banking will be challenging, especially in a concentrated banking market like Australia’s where four major banks have some 80% of the market, and especially with low absolute rates. The potential for slower lending by major banks and structural problems is clear.

**What can be done?**

Central banks might be advised to act now to help ensure their survival as independent supporters of long term stable growth in employment, prices and wages: sustainable long term prosperity.

Inflation already is rampant, if asset prices are included in measures of inflation.

Asset price gains are way out of line with wages gains, and thereby are damaging the social contract.

Jobs and investment are needed, yet policy is harming the largest source of jobs and investment in the country: small, medium and family businesses.

So it seems we may face two or three structural challenges. The gap between the rich and regular or middle income earners is out of control, and it seems we face a massive change in the capacity of major banks to support growth. – from policy and from competition. And we need more jobs, and policy to support rather than hold back the job makers.

There will be consequences. Central banks will be in the firing line.

The fundamental problem is over-reliance on government and central authority, like central banks.

**Central banks must once again allow the market-place to set interest rates.**

Central bank intervention to force lower interest rates and make cash readily available may be important during a crisis. They are a bargain with the devil if allowed to continue long term. Orderly transition back is vital.

**Governments must stop bailing out banks**

Governments must let the stock markets recapitalise failing banks, and stop using taxpayers money to bail out failing banks. The too big to fail argument is wrong. Australia now has a large base of private capital including superannuation savings which can do the recapitalisation job once done by government. Let the market do its job. Failing banks can be bailed out by the market. Again an orderly transition is important.

**The creators of jobs must be encouraged: the forgotten people must be encouraged.**

Small and medium business capital formation and investment must be a very high priority, to drive long term productivity and jobs.[[7]](#footnote-7) Small business and aspiration must be rewarded and not penalised. Small business is the main source of jobs growth in Australia.

Regulation and the power of the state over individuals must be wound back to free up small business innovation, jobs growth and prosperity. The presumption of innocence must be required of all legislation, regulation and government action.

No one in this country, especially small business owners and directors, should be held guilty by the law unless they can prove their innocence. This reversal of the onus of proof is but one horrifying example of the regulation we must change in order to reignite our economy.

The forgotten people, the regular wage earners and small business people must rise again and become the main focus of supportive government policy. The government imposed costs of doing business and creating jobs must be wound back.

The government and tax office must become the friend of small business and not the enemy.

Job and wealth creation over time will drive a much bigger tax base, and pay for much needed and ever growing social welfare. Regular people must be encouraged to believe they can build a great future for themselves and their families and their community, and not rely on government and central banks to do it for them.

**A Prosperous Future?**

This must start with market based policies for interest rates and banking, and with encouragement of job makers. The Government, especially the central banks, must get out of the way of setting interest rates and bailing out banks. Those who generate new jobs and build businesses must be encouraged. They are predominantly small and medium sized and family businesses. Only by doing so can we help small business, families and regular wage earners to create jobs and assure a prosperous long term future. Otherwise we risk falling into a very severe depression. Smaller government not more government is the solution.

1. https://www.domain.com.au/145-point-lonsdale-road-point-lonsdale-vic-3225-2016707912 [↑](#footnote-ref-1)
2. See https://www.rba.gov.au/publications/bulletin/2019/mar/the-labour-and-capital-shares-of-income-in-australia.html [↑](#footnote-ref-2)
3. See https://www.rba.gov.au/publications/bulletin/2019/mar/the-labour-and-capital-shares-of-income-in-australia.html [↑](#footnote-ref-3)
4. The Magic Pudding children’s story by Norman Lindsay featured a pudding which magically grew back, and restored itself to full size after each slice of the pudding was cut off and eaten. [↑](#footnote-ref-4)
5. “SMEs account for 99.8% of all enterprises in Australia and employ more than 7.6 million people, which equates to around 68% of employment in the private sector.” See <https://www.oecd-ilibrary.org/sites/2bf6bc72-en/index.html?itemId=/content/component/2bf6bc72-en>

“Employment in small businesses accounted for just under 60 per cent of total employment growth in the private sector during this five year period [2013-2018] and 56 per cent of employment growth in the 12 months to June 2018.” See <https://parlinfo.aph.gov.au/parlInfo/download/library/prspub/7117046/upload_binary/7117046.pdf> [↑](#footnote-ref-5)
6. Refer page 22 of RBA Chart Pack January 2021 for Australian business lending rates. See <https://www.rba.gov.au/chart-pack/pdf/chart-pack.pdf?v=2021-01-29-16-16-42> [↑](#footnote-ref-6)
7. Refer page 8 of RBA Chart Pack January 2021 for business investment decline over recent years, and page 11 for decline in net capital stock back to early 1990 levels. See <https://www.rba.gov.au/chart-pack/pdf/chart-pack.pdf?v=2021-01-29-16-16-42> [↑](#footnote-ref-7)