

Economist urges free trade caution



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Economist Edward Luttwak joins Lateline Business to discuss the future of Australia's consumption-reliant economy given the rise of China.

Transcript

BRIGID GLANVILLE, PRESENTER: Australia's economy may be the envy of the developed world, but critics point out that we have a lot of eggs in one basket: raw materials.

And just like the rest of the developed world, we're reliant for a large part on the rest of our economic growth on consumption - everything from retail sales to food, goods and services.

What then could this mean for the future of the Australian economy, especially in a region China expects to dominate?

To discuss this further, we're joined by Edward Luttwak, and he joins us from our Melbourne studio.

Thanks very much for being here.

EDWARD LUTTWAK, ECONOMIST AND HISTORIAN: Good evening.

BRIGID GLANVILLE: Firstly, look, earlier this week we spoke to a chief economist from Standard & Poor's who said that Americans should go out and spend and actually go into debt even if they need to do that to boost the economy.

Is that what got the US into trouble in the first place?

EDWARD LUTTWAK: Well, as you know, there is this huge disagreement. On one side there is the classic Keynesian theory that you spend your way out of an economic crisis.

This is textbook theory. On the other hand there is the opinion of the American Tea Party with all their funny hats, but also of the Cameron government in England, also the French government of Sarkozy and the Germans, that now is wrong and we cannot do it; we have to do it the other way, namely cutting government spending and stop this process where

governments issue bonds and soak up the capital and mainly make too many decisions so that private companies don't decide because they don't know where they are.

That's the other theory, and the other theory is gonna win, because come November, the Tea Party will win. Whether most of them Republicans or Democrats - they're all going to go for cutting government spending. They're gonna do exactly what the Europeans are doing.

BRIGID GLANVILLE: Do you think this will happen, given back in 1999, you said that you warned other countries about not adopting American-style capitalism, and we're still in this situation we are today?

EDWARD LUTTWAK: Well, listen, America-style capitalism has worked splendidly well. It has to adjust to up a couple of phenomena.

One of them is China. China, without any evil intent whatsoever, it has the potential and the actuality of de-industrialising – de-industrialising everybody else.

Now when you de-industrialise, all kinds of things change. Let's say in Australia you may have, I don't know, an air structures manufacturer, somebody who cuts metal for pieces of aeroplanes.

Well, if he goes out of business because you don't safeguard and protect him in whichever way it has to be done, then you won't have any aeronautical engineerings, there's no point teaching aeronautical engineering in Australia.

If all the work is being done in China, why bother teaching Australians? There's no industry. Then there is no aerospace research and development, therefore there's no breakthrough in that area, therefore there is (inaudible).

And you end up flattened with a parasitic population, like Saudi Arabia, standing around doing much, while in fact the foreign currency is earned by raw material exports. And in due course of course, these companies, these mining companies which issue shares on the stockmarket will be bought out.

So, Australia will be kind of worked back into being a purely colonial phenomenon.

Now all of this has to be avoided, otherwise, you know, the country will - not just economics, not just money.

BRIGID GLANVILLE: So you believe that Australia is too reliant on China?

EDWARD LUTTWAK: Not a question of being reliant on China. China is, as I said, all the Chinese want to do, they want to employ the unemployed. And that means industrial expansion.

There's not gonna be agricultural or something like that. And the way they do it is by being hard-working, competitive. And when that doesn't work, they do it by having subsidies, subsidisation, like in the solar panels. When that doesn't work, they do it by undervaluing the currency.

So if they do all these things and the Australians remain transfixed by free trade theory, free trade theory out of some textbook, the claims that yes, it's true, if everybody does free trade is the best thing.

But if you remain wedded to that, then the country will be de-industrialised and the fact that there are raw materials in Australia, even that will not be of any use, because you can't have - I mean, we have seen what happens when in the Midlands in England deindustrialisation takes place. What happen, you get the population marooned with nothing to do and all that stuff.

BRIGID GLANVILLE: So what should Australia be doing? Should they be basing themselves, modelling them on something like Germany has done?

EDWARD LUTTWAK: Well, I don't Australia should model itself on - the Germans have their method, which is the Middlestadt method with the bank's support, etc.

The French method is that anything important is really nationalised and state-owned, you know. You go and try and purchase Airbus or whatever or try to buy - sell locomotives to the French railways, which are now made in France - forget it. Each country has its own method. Australia has to have its own.

The one thing Australians cannot afford to do is to remain enthralled prisoners of a old theory that doesn't work. After all, the Chinese used to be prisoners of Maoism.

They've disenthralled themselves of Maoism and Australians are still enthralled by 19th Century free trade theory, which simply doesn't work when the Chinese are around.

And that's not because they're evil; it's simply because it is their approach naturally to want to employ Mr Lee and Mr Ping, and the way you employ 'em is by industrial expansion. And, as I say, they do it by competition; if that doesn't work, they do it by subsidisation. And that's what's been happening.

BRIGID GLANVILLE: Edward Luttwak, we'd have to leave it there, but thanks very much for joining Lateline Business.

EDWARD LUTTWAK: Thankyou. Thankyou.