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## Comment 1 on ‘Booming sector economics’ by Freebairn

Robert G. Gregory<sup>†</sup>

It is always good to end a review by suggesting where the future research frontier lies. With this in mind, it is important to emphasise the extraordinary nature of the current mining boom and slump. Only once in 150 years has Australian per capita income lifted as much as 15–20%, relative to that of the United States, and remained above US income levels for almost a decade. This extraordinary macro outcome was predominantly driven by trading gains, the result of resource export price increases relative to import prices. With export prices subsequently falling, Australia is moving towards a substantial decline in income relative to other advanced economies.

This remarkable history provides both a unique macro quasi-experiment to enable us to understand better the impact of large trading gain shifts and an opportunity for special Australian research contributions to the world booming sector literature, in much the same way that occurred after the 1970s less substantial resource boom.

In part 6 of the review, John Freebairn begins to focus on trading gains, but the journal-based academic literature inevitably lags behind our recent history. That history indicates quite clearly that resource economists should move away from their traditional emphasis on intersectoral resource competition and into the new territory of macroeconomy responses to large trading gain changes and a reassessment of the nature of our national accounts data.

The textbook static theory of trading gains is well known (Kohli 2004; Coleman 2008), but the magnitude and dynamics of macroeconomic responses to substantial trading gain shifts is not. Let me illustrate this by comparing the income paths of the two major Australian ‘recessions’ of the last quarter-century. The income paths are measured by Real Gross Disposable Income (RGDI) per capita, which is Real Gross Domestic Product (RGDP) per capita adjusted to incorporate trading gain changes.

In the major Australian income recession of the early 1990s, RGDI per capita fell 5% over two years and then recovered strongly. Almost all the RGDI fall was generated by RGDP falls with little trading gain contribution. From 2011, there is a longer-lasting income recession. RGDI per capita has fallen 4% over four years. This is a pure trading gain recession as RGDP per capita has continued to increase. All indications are that this recession will

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continue to deepen and Australia will experience the most serious and drawn-out income recession since the 1930s.

But there is a major issue here. Recessions are usually measured by unemployment increases. In the 1990s recession, unemployment increased to 10%. In the current recession, unemployment has increased to 6%. The current recession, despite large per capita income losses, does not seem to be that bad from an unemployment perspective! This situation arises because the first RGDI recession was generated by RGDP losses, whereas the second recession is generated by trading gain losses.

In the national accounts, a dollar lost from RGDP is interchangeable with a dollar lost from a trading gain, implying income lost from RGDP recessions can be directly compared to income lost from trading gain recessions. But something is missing here. Suppose, since 2011, the loss of income as measured by the time path of RGDI is unchanged, but the income loss was generated by RGDP falls rather than the trading gain losses. Then, current RGDP would be about 8 percentage points lower than it is today, and the unemployment rate would be well above 10%, even though there is no change in RGDI outcomes. Everyone would accept this hypothetical recession is more serious than the current recession even though the RGDI outcomes are the same. This example makes clear that a dollar trading gain loss is not commonly thought to be the same as a dollar output loss, despite the national accounts. The tensions among the national accounts, the simple trading gain model and our different response to an income recession, depending on the source of income loss, lead naturally to the new research frontier of integrating trading gains into macro analysis in a more meaningful way. The road to the research frontier – and the need to move booming sector economics away from the overemphasis on intersectoral resource competition – can be seen more clearly in the less formal and more macro-focused discussions in Gregory (2012), Garnaut (2013), Pincus (2014) and Edwards (2014) than in the formal academic literature.

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