

Australia's resilience during the global crisis, 2007-2009

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There is now an exhaustive literature detailing the causes and consequences of the global financial crisis. The point of this intervention is to look at the effects of the crisis on the Australian economy. Australia cannot be understood without regard to the international situation. The contribution therefore begins by briefly commenting on the nature of the global crisis. It then considers how the relative stability of Chinese demand, the buoyancy of the housing market and the circumstances of the financial sector have so far insulated Australia from the carnage witnessed in Europe, Japan and the US. The final sections comment on the current state of the Australian economy.

Over the last 15 years debt levels in most advanced economies have grown rapidly and financial speculation has been rampant. While these two developments led directly to the biggest financial crisis since the great depression, they were underpinned by low profitability in the advanced industrial economies. The rate of profit in the productive sectors of an economy provides the most meaningful gauge of the whole economy's health. The reason is simple—investment decisions are made on the basis of expected returns, while only the productive sector creates the new value that is realised as profits across the economy. Other things being equal, higher expected returns, i.e. a higher rate of profit, will lead to higher levels of investment.

The rate of profit declined from the mid 1960s to the early 1980s and subsequently did not fully recover in key Western economies.¹ Illustrative of the situation was the US economy.

- 1 For different explanations of this trend, see Chris Harman, *Zombie capitalism*, Bookmarks, London, 2009; Robert Brenner, *The economics of global turbulence*, Verso, New York, 2006 (1997); Simon Mohun, 'Distributive shares in the US economy, 1964–2001', *Cambridge journal of economics*, 30 (3), 2006; Andrew Kliman, 'The persistent fall in profitability underlying the current crisis: new temporalist

The major result of lower profitability was that capital moved into speculative areas. Mergers, acquisitions and leveraged buyouts became much more frequent. Financial services outgrew manufacturing to become the largest sector of the economy.² At the same time, the ruling class waged a relentless war on working class living standards in an attempt to lift the rate of profit. Real wages stagnated from the 1970s. The world's biggest industrial economy saw a trend decline in growth rates decade after decade.³

Ruling classes across the world have attempted to stave off dramatic economic contraction whenever it has threatened. The concentration and centralisation of capital has proceeded to such an extent that the threat of one or a few massive corporations going bust and dragging the rest of the economy into the abyss has been a repeated concern. The Federal Reserve Bank in the US consistently ensured cheap credit at perilous moments to promote borrowing, investing and spending to keep the economy ticking over. Government and corporate bailouts have become more frequent, from Chrysler in 1980 to the string of financial institutions today.

Yet the prerequisite for a return to high rates of profit was not loose monetary policy, but a general clear-out of inefficient firms and the devaluation of their capital. With labour being the only source of value in an economy, an increase in the capital-labour ratio generally means that the value created per unit of investment declines. So the ratio of outlays on capital as opposed to labour needed to be driven down and excess capacity eliminated. While some inroads were made in this direction in the 1980s and 1990s, economic expansion was primarily maintained by attacking the working class and piling up debt.

From the mid-1990s, financial speculation created the illusion that the whole economy had a new dynamism. The problems in the productive core of the world economy were smoothed over by artificially increasing consumption. As asset prices soared, many made great gains on paper. It was, however, a house of cards. Staving off economic downturn in this way only exacerbated the problems. The crisis was merely postponed. When it eventually came, it almost tore the system apart.

As the US housing bubble began to deflate in 2006, mortgage default rates rose significantly.⁴ The great gains were turned into great losses as nearly 8.8 million home owners owed more than the value of their homes on their mortgages.⁵ The bad loans which

evidence', 2nd (incomplete) draft, October 17, 2009, <http://akliman.squarespace.com/storage/Persistent%20Fall%20whole%20primo%2010.17.09.pdf>, accessed 12 December 2009.

2 Kevin Phillips, *Bad money*, Viking, New York, 2008, p. viii.

3 Brenner, *The economics of global turbulence*, Table 3.1, p. 240.

4 Federal Reserve Bank of New York, *Synopses of selected research on housing, mortgages, and foreclosures*, Homeownership and Mortgage Initiatives Research Subcommittee, 1 September, 2008, Figure 3: Mortgage delinquency rates rise with cooling of house prices, p. 66, <http://www.newyorkfed.org/regional/Synopses.pdf>, accessed 4 September 2009.

5 Edmund L. Andrews and Louis Uchitelle, 'Rescues for homeowners in debt weighed', *New York times*, 22 February 2008, <http://www.nytimes.com/2008/02/22/business/22homes.html>, accessed 4 September 2009.

triggered the crisis were relatively small compared to the losses elsewhere during the crisis. But the problem spread through the global financial sector because an entire system of betting on loans had developed among financial institutions. Institutions were financing their bets through debt while borrowing to purchase assets worth up to thirty times their actual capital base.⁶ The positions of the speculators were, in the jargon of finance, 'highly leveraged'. Losses were compounded as a series of major institutions bet the wrong way without having the financial position to pay out. Ripples from the mortgage defaults turned into thumping waves across the financial sector.

The problems in the financial sector had their origins in the real economy. Now, however, the financial sector created a negative feedback loop which choked industrial production. With bank lending frozen the real economy was starved of credit. The pattern was repeated across the developed world.

Collapsing US and European consumer spending and industrial output saw the 'multiplier effect' (where an initial boost in spending stimulates others to spend so that total expenditure rises by a larger amount) move into reverse. Global trade shrank even faster than production. Cross-border capital flows declined by 82 per cent in 2008.⁷ Key exporting economies and countries with seemingly little exposure to the actual financial crisis were hit hard as a result of the fallout.

The mechanisms that had previously allowed the economy to pull itself up were, through the course of late 2008 and early 2009, unable to stem the decline. Only extraordinary action was able to stabilise the system. The actions of governments in bailing out banks, flooding the system with money and undertaking unprecedented stimulus measures have not, however, resolved the underlying problem of profitability. New problems for the world system have emerged.

Australian resilience

Amidst the carnage in the global economy in 2008-09 there were some economies that held up better than others. Australia was one. Technically, there has not even been a recession in Australia. Three key factors, discussed below, contributed to this resilience: Chinese demand for Australian exports, a relatively robust housing market and the stability of Australian financial institutions.

6 Robin Blackburn, 'The subprime crisis', *New left review*, 50, p. 68, <http://www.newleftreview.org/?getpdf=NLR28403&pdflang=en>, accessed 30 June 2009.

7 Charles Roxburgh et al. *Global capital markets: entering a new era*, McKinsey Global Institute, September 2009, p. 11, http://www.mckinsey.com/mgi/reports/pdfs/gcm_sixth_annual_report/gcm_sixth_annual_report_full_report.pdf accessed 27 September 2009.

East Asian recovery

The first factor was the role of Asian—especially Chinese—demand in offsetting the impact of declining global trade on the Australian economy. There were precipitous export declines across the developed world in 2008-09. Germany and Japan saw their exports plummet 20 per cent and 46 percent respectively, in the year to March 2009.⁸ In the US, exports declined over 22 per cent in the year to June 2009.⁹ In volume terms world trade fell 7.1 per cent in the last quarter of 2008 and a further 11.2 per cent in the first quarter of 2009.¹⁰ In Australia, however, exports declined only 1.9 per cent in the September quarter 2008 and a further 1.1 per cent in the December quarter, before growing again.¹¹

Over the medium term, trade with East Asian economies has become more important to the fortunes of the Australian economy as it has integrated further into the world market. As total trade more than quadrupled over the 20 years before 2009, to reach 47 per cent of GDP, Asia became even more economically important to Australia.¹²

Australia's four biggest trading partners are now in Asia. Taken together, China, Japan, India and South Korea take 45 per cent of total Australian exports representing over 10 per cent of GDP.¹³ Coal, iron ore, gold, other minerals and petroleum make up the vast bulk of exports to these economies. The prices of these commodities soared over the six years to 2009 because of demand pressure. Export income became an even more important driver of investment.¹⁴ Billions of dollars accumulated in government coffers.

With the collapse in demand in the US and Europe as the crisis set in, Chinese exports fell over 25 per cent.¹⁵ In the first months of 2009, 20 million Chinese were put out of work. The Chinese government responded to domestic difficulties with a massive stimulus

- 8 Nelson Schwartz, 'Rapid declines in manufacturing spread global anxiety', *New York times*, 19 March 2009, <http://www.nytimes.com/2009/03/20/business/worldbusiness/20shrink.html>, accessed 4 September 2009.
- 9 US Census Bureau, *FT900: U.S. international trade in goods and services*, p. i, <http://www.census.gov/foreign-trade/Press-Release/2009pr/06/ft900.pdf>, accessed 4 September 2009.
- 10 Wim Suyker and Gerard van Welzenis, 'CPB memo', CPB Netherlands Bureau for Economic Policy Analysis, 'Table 1: world trade monitor, percentage changes', 26 August 2009, <http://www.cpb.nl/eng/research/sector2/data/trademonitor.pdf>, accessed 1 September 2009.
- 11 Australian Bureau of Statistics, *Australian national accounts: national income, expenditure and product*, catalogue 5206, September quarter 2009.
- 12 Department of Foreign Affairs and Trade, *Composition of trade Australia 2008-09*, November 2009, p. 1.
- 13 Australian Bureau of Statistics, *International trade in goods and services*, catalogue 5368, November 2009; Department of Foreign Affairs and Trade, *Composition of Trade*, pp. 1 and 7.
- 14 Reserve Bank of Australia, 'Indicators of business investment', *Bulletin*, December 2009, <http://www.rba.gov.au/publications/bulletin/2009/dec/3.html>, accessed 12 December 2009.
- 15 Yu Yongding, 'China's stimulus shows the problem of success', *Financial times*, 26 August 2009, <http://blogs.ft.com/economistsforum/2009/08/china's-stimulus-shows-the-problem-of-success>, accessed 29 December 2009.

program, pushing up investment to compensate for falling exports. Chinese banks were directed to lend and state-owned corporations in turn directed to borrow and spend. New loans totalled over \$AU1 trillion in the first half of 2009, more than three times the total in 2008. These measures accounted for roughly 75 per cent of growth in the economy,¹⁶ which quickly regained momentum.

In the 12 months to August 2009, while credit markets collapsed and industrial production plummeted in the US, Europe and Japan, China's industrial output expanded 12.3 per cent and fixed asset investment by 33 per cent.¹⁷ China was by far the most important of the Asian economies, but it wasn't the only one growing. South Korea grew at an annualised rate of 10 per cent in the second quarter of 2009. The Indian economy continued its expansion.

Diving commodity prices briefly threatened to blow the bottom out of Australia's resources sector. The exports of other advanced economies dropped over 10 per cent (30 per cent in Japan's case), but in the year to September, Australia's exports slipped only 0.2 per cent.¹⁸ In the five months to November 2009 exports to China *rose* by over 10 per cent on the corresponding period in 2008.¹⁹ Commodities prices stabilised and began rising again, with some posting the biggest gains in 40 years.

Clearly Chinese growth was important for Australia. However, the Chinese economy faces problems that should temper predictions of endless surging growth. Over the last decade the ruling Communist Party maintained dramatic growth rates by increasing the rate of investment faster than the rate of consumption. The share of consumption in GDP dropped from 46 to 35 per cent, while the share of investment increased 8 per cent, contributing 50 per cent to total GDP growth over the period.²⁰

There is an argument that these measures, in a closed, less developed economy, can sustain accumulation rates over an extended period and allow it to dodge cyclical downturns. Crises of overproduction can be avoided so long as the mass of surplus value is continually ploughed back into the production of capital goods which expand production of means of production. The limit to extending capital accumulation by staving off such crises will only be reached at the point of development parity with the advanced economies.²¹

16 Satyjit Das, 'Dragon's easy credit inflates bubble', *Age*, 29 December 2009, p. 11.

17 Martin Wolf, 'Wheel of fortune turns as China outdoes west', *Financial times*, 15 September 2009, <http://www.ftchinese.com/story/001028725/en/?print=y>, accessed 29 December 2009.

18 Australian Bureau of Statistics, *Australian national accounts: national income, expenditure and product*.

19 Australian Bureau of Statistics, *International trade in goods and services*.

20 Eswar Prasad, 'Rebalancing growth in Asia', *Finance and development*, International Monetary Fund, December 2009, pp.18-19, <http://www.imf.org/external/pubs/ft/fandd/2009/12/pdf/prasad.pdf>, accessed 14 January 2010.

21 The argument is Tony Cliff's. See Tony Cliff, *Selected writings, volume 3*, Bookmarks, London, 2003, pp. 101-110.

In China there is a contradiction in this growth model. China is not a closed economy to the extent that the former Soviet Union was, for example. It has an expanding private sector and exports are almost 40 per cent of GDP in price terms. China can be regarded as having two economies. One is heavily exposed to competition on the international market and earns huge revenues.²² The other is relatively insulated.

There is tension between these ‘two economies’. With growth coming primarily from investment, and investment heavily dependent on imports (not just of resources, but of capital equipment and high end technology), wasteful internal investment decisions create a greater reliance on the export sector for revenues.²³ Yet the export sector has problems of its own. Global integration has added Chinese industrial output to the world market. The world market is already suffering from overcapacity. By increasing investment to offset falling demand for exports, the Chinese Government is only worsening the problem.

If demand doesn’t recover significantly in the west, more stimuli will be needed, expanding capacity further while draining the accumulated reserves of surplus value. By adding to international overcapacity, the government actually undermines western industrial recovery. A concrete expression of the problem is the position of the Chinese currency. On the one hand the government keeps the value of the currency artificially low to maintain export competitiveness and to undermine the real wage of the working class. On the other, this undermines the position of western industry and therefore western consumption. If the Renminbi appreciated, exports and capital accumulation would decline. Chinese policy makers are caught in a bind.

Another way out of the reliance on exports might be to expand the domestic Chinese market by raising consumer demand. Yet the government faces more dilemmas here. This would require a total reversal of the very basis of Chinese growth to date—the decade long decrease in consumption as a share of GDP. Increasing the purchasing power of the working class would involve currency appreciation or directly raising wages, making export industries less competitive, resulting in job losses and thus reduced consumption. At any rate, as Chinese consumer spending is less than one sixth of that of the US, the domestic market is unlikely to be able to absorb the output of Chinese industry.

A second and possibly more immediate problem is that of asset price bubbles. Analysts at the Royal Bank of Scotland estimate that 50 per cent of new Chinese loans in the first half

22 Guangdong province alone, for example, accounts for nearly a third of China’s exports (Keith Bradsher, ‘China’s Unemployment Swells as Exports Falter’, *New York Times*, 5 February 2009, <http://www.nytimes.com/2009/02/06/business/worldbusiness/06yuan.html>, accessed 5 January 2010). This situation makes it difficult to assess concretely what the limits to accumulation are.

23 Yongding for example, notes that ‘[d]ue to the hasty and under-supervised implementation, waste in infrastructure construction is ubiquitous, and the prospective returns of this big push into infrastructure are less than promising’. See Yongding, ‘China’s stimulus’. While similar things are being said of all government stimulus programs, in China the problems existed prior to the stimulus measures.

of 2009 may have flowed into the stock and property markets.²⁴ This is a consequence of both corruption within the bureaucracy and the extent to which a large private sector somewhat immune to state economic directives has emerged over the last decades.

The problem is not specific to China. The United Nations Development Program recently called for capital controls, in view of 'big risks' stemming from asset price inflation across Asia.²⁵ This means that East Asian recovery, now lauded, could become the trigger for another wave of financial shocks.

China has not decoupled from the western economies, even if it has avoided crisis in the short term. In fact, Chinese reliance on current account surpluses means that the world rate of profit may have a more decisive impact on the prospects for rapid, continued expansion in the medium to long term than anything happening within China itself. With China's continuing reliance on the West, the rate of profit in the advanced economies is still the key determinant of Australian economic prospects in the medium term.

Buoyancy in the housing market

The impact of the resource sector in propping up Australian growth is overstated. Western Australia and Queensland, which account for 74 per cent of total mining sector output, grew 0.7 per cent and 0.3 per cent respectively in 2008-09 (in terms of growth per person both *declined* by over 2 per cent)—lower than the national average.²⁶ It was the Northern Territory, Tasmania, South Australia and the ACT that grew faster than the national average. After them came Victoria.

The second basis of Australian stability lies in the residential property sector. Across the developed world, the total value of residential property is estimated to have risen more than \$30 trillion in the five years to 2005—an increase equivalent to 100 per cent of those countries' combined GDPs'.²⁷ At the time, the Organisation for Economic Cooperation and Development (OECD) cautioned that 'the current house price boom... is strikingly out of

24 Jamil Anderlini, 'Rule of the iron rooster', *Financial times*, 24 August 2009, <http://www.ft.com/cms/s/0/ae083ef2-90de-11de-bc99-00144feabdc0.html>, accessed 29 August 2009.

25 James Lamont, 'UNDP calls for capital controls in Asia', *Financial times*, 13 December 2009, www.ft.com/cms/s/0/6216fbda-e7c5-11de-8a02-00144feab49a.html, accessed 15 December 2009.

26 Australian Bureau of Statistics, *Australian national accounts: state accounts*, catalogue 5220, 2008-09 (reissue). In fact, Queensland growth was driven primarily not by mining but by retail and wholesale trade, public administration and the agricultural sector, while growth in the West was driven equally by agriculture and mining.

27 *The Economist*, 'The global housing boom', 16 June 2005, http://www.economist.com/opinion/displaystory.cfm?story_id=4079027, accessed 26 June 2009.

step with the business cycle'.²⁸ *The Economist* concluded that 'the global housing boom is the biggest financial bubble in history'.²⁹

There were clear signs that the Australian market was caught up in this frenzy. Australia had the highest house prices compared to rent and the third highest prices compared to income in the OECD. Over-valuation was estimated at 51.8 per cent.³⁰ Like other developed countries, Australia saw a massive build up of household debt as asset prices sky rocketed. From having one of the lowest household debt-to-income ratios in the 1980s, Australia had, by 2008, become one of the most indebted countries. Household debt peaked in early 2008 at 159 per cent of disposable income (138 per cent being housing debt), up from 80 per cent (67 per cent) a decade earlier and 45 per cent (31 per cent) a decade before that.³¹ Yet, defying many predictions, the Australian property market has weathered the global storm. Residential property was the epicentre of the global financial crisis. Housing prices crashed in the US, Britain, Ireland, Spain and France. In Australia prices only dropped moderately in 2007-08 before rebounding strongly in 2009.

A number of factors contributed. The first was the federal government's stimulus program, which contained incentives of \$14,000 and \$21,000 for new home buyers and builders. While it was said to be a helping hand to those wishing to own a home of their own, in reality it mainly boosted house prices. The Government feared that fallign house prices would lead to more mortgage defaults and negative equity, which would have dragged down consumption. Combined with a precipitous drop in interest rates, the stimulus instead led to a significant increase in the growth of lending.³²

The second factor that kept house prices up was that demand outstripped supply in the housing market. A popular explanation has been that immigration and population growth are responsible. The figures do not seem to support this. The National Housing Supply Council reported how over the years 2001 to 2006, annual growth in household numbers averaged 105,000, while annual growth in the number of dwellings was 127,000—a net growth of 22,000 dwellings.³³ In the longer term, from 1985 to 2009, an average of one residential dwelling was built for every 1.75 new inhabitants. That rate of building is far greater than the current average of 2.56 persons per dwelling.³⁴ A decisive factor pushing

28 Organisation for Economic Co-operation and Development (OECD), 'December 2005: recent house price development: the role of fundamentals', in *OECD Economic Outlook No. 78*, 2005 [2], p. 125, <http://www.oecd.org/dataoecd/41/56/35756053.pdf>, accessed 4 September 2009.

29 *Economist*, 'The global housing boom'.

30 OECD, 'December 2005: Recent house price development', pp. 124-154 (in particular see Table III.2 p. 136).

31 Reserve Bank of Australia, 'Household finances—selected ratios—B21', *Statistical tables*, http://www.rba.gov.au/statistics/tables/index.html#assets_liabilities, accessed 12 November 2009.

32 Reserve Bank of Australia, *Financial stability review*, September 2009, p.31; Australian Bureau of Statistics, *Housing finance: Australia*, catalogue 5609.

33 National Housing Supply Council, *State of supply report 2008*, February 2009, pp. 12 & 34.

34 Ross Garnaut, *The great crash of 2008*, Melbourne University Press, Carlton, 2009, p. 17.

up demand appears to have been a trend to lower occupancy rates by the existing population. That is, while the total number of houses was rising, the number of people living in each house was falling. In the five years to 2003, the occupancy rate has dropped from 2.63 to 2.56 people per dwelling. That sounds modest, but one economist estimated that this increased demand by 40,000 dwellings a year.³⁵

Another factor may have been that the Government relaxed rules for foreign investment in residential property in March 2009. This may have added to speculation.

Whatever the reasons for the buoyancy of the housing market during the global crisis, it played a vital role in stabilising the Australian economy. Over the course of 2009 median prices rose a massive 17 per cent in Melbourne and 11.6 per cent in Sydney. This growth has underpinned continued consumer spending³⁶ and ensured bank balance sheets remain secure.

It is hard to say whether this situation can continue. There are contradictory pressures. The National Housing Supply Council estimates that by 2013 the housing shortfall will be 203,000.³⁷ Yet in the UK there has been a perennial housing shortage that did not prevent prices falling dramatically there.

There are high and unsustainable levels of debt supporting the housing market. The Reserve Bank has reported that personal debt levels are up 71 per cent compared with five years ago and, at over 100 per cent of GDP, have overtaken per person levels in the USA.³⁸ This cannot go on forever. If the economic situation deteriorates, supply may increase as people are forced to sell. The size of households could also begin to increase as more young people stay at or return to their parents' home, thereby diminishing demand.

The muted effect of financial contagion

The third factor that explains the robustness of the Australian economy was the absence of a collapse of any major Australian financial institution. Profits of the major banks were down 14 per cent in the six months to June 2009 compared with the same period in 2008, but together they still made \$8.6 billion.³⁹ Whereas 'non-performing loans' approached 6 per cent in the US, in Australia they represented only 0.62 per cent of loans in the housing

35 Brendan Crotty, 'What's driving housing prices and demand', presentation delivered to the Australian Business Economists seminar *Australian residential property—a bubble ready to burst?*, 13 August 2003, www.abe.org.au/papers/Crotty.ppt, accessed 10 December 2009.

36 Australian Bureau of Statistics, *Retail trade: Australia*, catalogue 8501, November 2009.

37 National Housing Supply Council, *State of supply report 2008*, p. 64.

38 Nick Gardner, 'Credit binge sets new debt level', *Sunday telegraph*, 27 December 2009, <http://www.dailytelegraph.com.au/news/sunday-telegraph/credit-binge-sets-new-debt-record/story-e6frewt0-1225813804691>, accessed 6 January 2010.

39 Reserve Bank of Australia, *Financial stability review*, p. 17.

market by June 2009.⁴⁰ Without a precipitous decline in property values, the percentage of impaired assets (an asset that has a market value less than the paper value listed on the bank's balance sheet) rose to only 1.5 per cent in June—far below the 6 per cent high of the early 1990s recession.

The toxic assets that polluted the rest of the world financial system were largely absent from Australia's financial system. From the mid 1990s, securitisation of mortgages—selling claims to mortgage payments as assets—increased dramatically from less than 5 per cent of total outstanding housing loans to nearly 25 per cent.⁴¹ These securities had not become part of the global 'time bomb'. This was in part because 'sub-prime' loans to high risk borrowers were much less common in Australia.

The situation was hailed as a triumph of good management and strong regulation.⁴² But the Australian financial sector was not quite as healthy as it appeared. Despite the arguments about the efficacy of financial regulation, in Australia the local mortgage market was moving in the same direction as its overseas counterparts. Ross Garnaut noted that

a transformation to US-style shadow banking was under way... Ian Rogers, editor of *The Sheet*, the Australian bank newsletter, says that 'the major difference between Australia and the US is that we were four years behind'. Nonetheless, the metamorphosis was advanced enough that when the crisis began in late 2007, the Australian shadow bank sector was faced with insolvency.⁴³

The Australian financial system had two immediate problems. One was that faced by the major banks. As the property boom proceeded, an increasingly large gap appeared between what the banks had saved (customers deposits) and what they were lending. Their ratio of deposits to total liabilities had dropped from 59 per cent to 43 per cent between 1994 and 2007. This gap was filled by foreign borrowings, which rose from \$30 billion in 1990 to \$357 billion in 2008. The key difficulty that the banks faced was the credit crunch. In the United States, falling asset values had torn holes in bank balance sheets and led to insolvency. In Australia, the problem was that banks had become reliant on foreign borrowing. The funds now dried up. Their survival threatened, Australian banks—like their US and European counterparts—went cap in hand to government. Several

40 Ibid., pp. 20-21. Non-performing business loans and for commercial property were rising faster to 2.9 per cent and 4.5 per cent respectively.

41 Michael Davies, 'Household debt in Australia' in *Household debt: implications for monetary policy and financial stability*, Bank for International Settlements Papers, 46, May 2009, p. 26, <http://www.bis.org/publ/bppdf/bispap46.htm>, accessed 12 November 2009.

42 Stephen Bartholomeusz, 'A crisis with capital', *Business spectator*, 24 September 2009, <http://www.businessspectator.com.au/bs.nsf/Article/A-crisis-with-capital-pd20090924-W78BA?OpenDocument>, accessed 24 September 2009.

43 The following two paragraphs draw on Garnaut, *The Great Crash*, pp. 63-64.

communicated to the Prime Minister that without government a guarantee on their foreign debt, they would face insolvency.

The other problem was experienced by non-bank lenders (corporations that don't receive deposits but do provide loans). These companies were far more tied up in the securitisation business. Along with medium sized banks, non-bank lenders had captured 30 per cent of the mortgage market by 2006, compared with 60 per cent for the big four banks—Commonwealth, ANZ, NAB and Westpac. But the widespread panic over mortgage backed securities led funding for these companies to dry up. No one wanted to invest in the very things that had seemed to cause the crisis. So again, it was the government to the rescue, initially throwing in \$8 billion to secure the sector and purchasing around 80 per cent of residential-mortgage backed securities issued over the next eight months.⁴⁴ The major banks' share of new mortgage lending increased to 81 per cent, while the share of non-mortgage lenders and medium sized banks collapsed.⁴⁵ A series of takeovers by the big banks occurred as small lenders went under.

The financial sector's reliance on foreign borrowing ensured that the global credit crisis flowed through to the rest of the Australian economy. With the Australian banks quietly enduring their own problems, new credit approvals to business declined by more than 25 per cent between March 2008 and June 2009.⁴⁶ From the heights of almost 30 per cent annualised business credit growth at the end of 2007 to an annualised contraction of over 5 per cent,⁴⁷ businesses were put under pressure. Yet companies were still able to finance most of their activities by cutting dividends and retaining earnings. For the remainder, where credit walked out capital markets stepped in (i.e. companies issued more shares) to raise funds. Listed companies raised three times the amount of equity in 2009 than the average of the three previous years.⁴⁸

So despite triumphalism about Australia's financial resilience, the sector did suffer. The tsunami that swamped the rest of the globe sucked necessary funds away from Australian shores rather than dumping toxic assets. It was not strong regulation that saved the sector (nor could it have) but government intervention in the face of international collapse. Nevertheless timing, as they say, is everything. The sector didn't implode and the guarantee stabilised it. Yet the sector's dependence on the rest of the world financial

44 Reuters, 'Govt RMBS plan in doubt as funds dwindle', *Business spectator*, 10 June 2009, <https://www.businessspectator.com.au/bs.nsf/Article/Australia-govt-RMBS-plan-in-doubt-as-funds-dwindle-SU973?OpenDocument>, accessed 10 June 2009.

45 Reserve Bank of Australia, *Financial stability review*, Graph 53, p. 31.

46 Reserve Bank of Australia, 'Bank lending to business—new credit approvals by size and by purpose—D7', *Statistical Tables*, <http://www.rba.gov.au/Statistics/Bulletin/index.html>, accessed 16 November 2009.

47 Reserve Bank of Australia, *Financial stability review*, p. 29.

48 John Broadbent, 'Reconnecting corporate Australia with frozen credit markets', address to Corporate Finance World Australia 2009, 10 November 2009, Sydney, p.3, <http://www.rba.gov.au/Speeches/2009/sp-so-101109.pdf>, accessed 21 November 2009.

system means that further shocks will flow through. It is also possible that national property markets will negatively affect balance sheets and consumer spending in the future.

Current state of the Australian economy

The rate of profit in Australia has followed a similar trajectory to the rate of profit in the other advanced economies for decades—dropping from the 1960s to a trough in the early 1980s before partially recovering by the end of the century.⁴⁹ Australia has, however, since 2002 consistently had a higher rate of investment than other developed economies. Over the last four years it was 30 to 40 per cent higher.⁵⁰ Business investment has grown by almost 50 per cent as a share of GDP since 2001, with 50 per cent of that growth in the mining industry.⁵¹ This reflects strength in the economy and indicates that there is an expectation of returns on investment.

But the rate of investment also masks a contradiction. The fundamental problem in the world economy over the last decades has been the inability of ruling classes to allow the mass of inefficient firms to go bankrupt. To do so would provoke an economic depression. Yet the devaluing of the mass of constant capital is a prerequisite for restoring health to the real economy, as only this will lay the basis for a substantial recovery in the world rate of profit. Throughout the crisis, company write-downs in Australia reached \$47 billion and aggregate business sector profits fell 6.5 per cent. This was significant, but the last recession was worse.⁵² Gross fixed capital formation fell 4 per cent over the year to September 2009, with private sector outlays on machinery and equipment down over 11 percent.⁵³ So far, the world crisis has not led to a significant process of restructuring in Australia. With industrial production registering a decline that was insignificant compared with the rest of the OECD, there has been no process of clearing out the inefficient firms. Such a process has been avoided because of appreciating asset prices and soaring commodity prices—but this may be exacerbating, rather than overcoming, future problems.

By the end of the 2008-09 financial year there was talk again of Australia's miracle economy. While the major OECD countries saw year on year (to June) contractions of an average of 2.9 per cent, Australia posted growth of 1 per cent. This picture overstates

49 Simon Mohun, 'The Australian Rate of Profit 1965-2001', *Journal of Australian political economy*, No. 52, 2003. For comparisons with other advanced economies see Brenner, *The economics of global turbulence*.

50 Reserve Bank of Australia, *Statement on monetary policy*, graph 87, p.75, August 2009, <http://www.rba.gov.au/publications/smp/2009/aug/pdf/0809.pdf>, accessed 27 December 2009.

51 Reserve Bank of Australia, 'Indicators of business investment', *Bulletin*, December 2009, <http://www.rba.gov.au/publications/bulletin/2009/dec/3.html>, accessed 10 January 2010.

52 Reserve Bank of Australia, *Financial stability review*, p. 49.

53 Australian Bureau of Statistics, *Australian national accounts: national income, expenditure and product*.

economic growth by ignoring population growth, which tends to increase the total cost of reproducing labour power while adding to value produced. At 2.1 per cent per year, Australia's population grew at the fastest rate since quarterly data collection began in June 1981.⁵⁴ This compares with the average growth of 1.2 per cent per year from 1991 to 2000 and 1.4 per cent per year from 2001 to 2007.⁵⁵ When looked at in terms of GDP per capita (growth per person), from the time of the international financial collapse Australia saw a year on year (to September) *decline* of 1.7 per cent.⁵⁶

Population growth in the US was estimated to be 0.9 per cent for the year to July 2009,⁵⁷ which roughly translated into an annual GDP per capita contraction of somewhere over 3 per cent (to the second quarter of 2009). Nominal figures put a gap of around 3.4 per cent between Australian and US growth rates. On a per capita basis, however, that shrinks to around 2 per cent. Further, Australian growth was higher firstly because imports were declining and secondly because government and households were increasing consumption.

Unemployment quickly increased after the onset of the financial crisis, but the rise was not as dramatic as elsewhere. By late 2009 unemployment was 5.8 per cent, which was 2.7 per cent below the average for the major OECD economies. Comparing Australia with the United States is instructive.

54 Australian Bureau of Statistics, *Australian demographic statistics*, catalogue 3010, March quarter 2009.

55 Garnaut, *The Great Crash*, p. 16.

56 Australian Bureau of Statistics, *Australian national accounts: national income, expenditure and product*.

57 US Census Bureau, 'Monthly population estimates for the United States: April 1, 2000 to October 1, 2009', <http://www.census.gov/popest/national/NA-EST2008-01.html>, accessed 16 November 2009.

United States and Australia (September 2008–September 2009)

	2008	2009	Change
Official unemployment	%	%	%
USA	6.2	9.8	58
Australia	4.3	5.7	33
Labour underutilisation			
USA	11.2	17.0	52
Australia	9.0	12.6	40
Average monthly hours			
USA	145.6	143.4	-1.5
Australia	143.8	140.5	-2.3

Sources: US Bureau of Labor Statistics, *Employment situation*, December 12 2009; Australian Bureau of Statistics, *Labour Force, Australia*, Cat. No. 6202.0, December 2009; Centre of Full Employment and Equity, *Quarterly underutilisation and underemployment indicators*, August 2009. Note that Australian underutilisation figures are August to August.

Clearly the US was shedding jobs much faster than the Australian economy, while there was a greater cut in average hours worked in Australia. This reflected the much faster decline in labour utilisation than growth of unemployment. When this is taken into account, the picture is quite different to that painted by the general unemployment figures. Overall, Australian bosses sacked workers at a fast rate until March 2009, at which point the unemployment rate stabilised. The underutilisation rate continued to rise and the number of hours worked continued to fall, due to leave taking, part time job creation and workers being forced to reduce their hours.⁵⁸

It is difficult to judge exactly how the economic situation has affected the working class as a whole. Because profits held up (relatively speaking) there has been no generalised ruling class offensive to drive down wages. In fact, average full-time wages have continued to grow, up 5.2 per cent from August 2008 to August 2009.⁵⁹ Those who retained their jobs came out of the crisis better off, one report finding that:

The proportion of people finding it ‘very difficult’ or ‘difficult’ to get by on their current household income has dropped from 20 per cent in 2008

58 Brigid van Wanrooy et al. *Australia at work: in a changing world*, Workplace Research Centre, Sydney, November 2009, p. 42.

59 Australian bureau of Statistics, *Average weekly earnings: Australia*, catalogue 6302.

to 16 per cent in 2009 ... [T]hose 'living comfortably' or 'doing really well' has increased from 41 to 45 per cent in the same period.⁶⁰

This has been due to a peculiar situation in Australia. In the midst of the greatest global crisis in generations net national disposable income fell by 4.8 per cent⁶¹ and household wealth declined by 36 per cent.⁶² Yet through a combination of stimulus cash handouts, falling interest rates and lower petrol prices, different calculations showed household disposable income rising by 5 to 9 per cent.⁶³

Those with existing mortgages who retained their jobs benefited most. With the Reserve Bank dropping interest rates down to 3 per cent by April 2009, the ratio of interest payments to disposable income dropped from 15.4 per cent to 10.3 per cent in the year to June 2009.⁶⁴ Low interest rates have not entirely offset the impact of high house prices. As an illustration, during 1989-90 interest rates were hovering around 17 per cent yet the interest payment to disposable income ratio was only 9 per cent.

For those who lost their jobs, worked fewer hours or were renting properties things were very different. Agency reports suggest that there was a significant rise in homelessness, to more than 100,000 over the last part of 2008 and through 2009, as unskilled workers became unemployed.⁶⁵ This was when, across the country, more than 800,000 homes were vacant.⁶⁶ Tenants saw rents increase faster than incomes with 65 per cent of low income private renters experiencing housing stress.⁶⁷

Many older workers, whose superannuation was depleted by the crash in equity markets, were forced back into the labour market: the number of retirees contracted by 65,000, while the number aged over 45 saying they would never retire rose from 379,000 to 575,000 over the year.⁶⁸ The level of aggregate hours worked, however, increased at the

60 Brigid van Wanrooy et al, *Australia at work*, p. i.

61 Australian Bureau of Statistics, *Australian national accounts: national income, expenditure and product*.

62 Peter Martin, '36 per cent tumble in household wealth', *Age*, June 27 2009, <http://www.theage.com.au/national/36-tumble-in-household-wealth-20090626-czx8.html>, accessed 27 June 2009.

63 IBISWorld macro-economic briefing, *Winners and losers of the Global Financial Crisis*, August 2009, p. 4; Steve Keen, 'Have we dodged the iceberg', *Steve Keen's debtwatch*, 40, 2 November 2009, <http://www.debtdeflation.com/blogs/2009/11/02/debtwatch-no-40-november-2009-have-we-dodged-the-iceberg/>, accessed 02 November 2009.

64 Reserve Bank of Australia, 'Household finances—selected ratios—B21'.

65 Matthew Denholm, 'Rudd losing the fight on homeless', *Australian*, 2-3 January 2010, p. 1.

66 National Housing Supply Council, *State of Supply Report 2008*, p. 69.

67 Toby Archer, 'Rental housing hits crisis point', *Tenant news*, 21, Summer 2008/09, http://www.tuv.org.au/pdf/tenant_news/tn_21_Summer_2009.pdf, accessed 9 January 2010.

68 Tim Colebatch, 'More people plan to work till they drop', *Age*, 18 December 2009, <http://www.theage.com.au/national/more-people-plan-to-work-till-they-drop-20091217-kzxc.html>, accessed 18 December 2009.

end of 2009. On the other hand, while older workers moved back into employment, young workers were pushed out. Youth unemployment rose from 17.9 per cent in November 2008 to 25.4 per cent in the middle of 2009 before declining slightly to 25 per cent at the end of the year.⁶⁹ The unemployment rate for women did not rise nearly as steeply as that for men. Underemployment for both sexes increased at a similar rate, although female underemployment was higher to start with.

Overall, for many workers times will be tougher during the ‘recovery’ phase than in the midst of the crisis. With government debt increasing by \$33 billion alone in the first half of 2009 there will be budget cuts, rather than cash handouts, in the future.

Conclusion

A mixture of domestic and international influences has contributed to the resilience of the Australian economy. Government intervention to stabilise financial markets secured the position of Australian banks. Continued growth in China and other parts of East Asia, and the appreciation of residential home asset prices also sustained economic stability. Some sections of the working class have come out of the crisis in a better position than they went in, while others have not been so fortunate. The ‘recovery’ phase, however, will probably see higher levels of financial stress and government austerity. Even if the economy revives as forecast, life will generally get harder for workers.

There is no guarantee that the recovery will continue. Nationally, the finance sector is dependent on global markets for funding; household debt is at dangerous levels; there still seems to be a housing price bubble and manufacturing continues its long decline, exacerbated by the high value of the Australian dollar. While Chinese electricity production has for three years (until recently) been an index for the Australian dollar, the rate of profit in Australia has tracked the general trend of the rate of profit in the other advanced economies for decades. If it has ‘decoupled’ recently, this is likely to be short lived.

Internationally, asset price bubbles appear to have reformed as a consequence of loose monetary policy; write-downs in the financial sector are not over;⁷⁰ many advanced economies face fiscal crises; overcapacity in the manufacturing sector is endemic and China faces many challenges. This will lead to instability in the world system and uncertainty in the developing economies. Australia’s current economic performance rests on unstable ground that could quickly give way.

The old certainties which underpinned optimism in the global economy—that markets are efficient, that bubbles would not, could not form, that house prices would not drop, that economic actors pursuing their own self interest in the market would lead to the greatest

69 Australian Bureau of Statistics, *Labour force, Australia*, catalogue 6202, November 2009.

70 International Monetary Fund, *Global Financial Stability Report*, IMF, Washington DC, October 2009, p. 9.

welfare for society as a whole—have been shattered. New certainties—that the Australian financial sector is a rock, that Chinese economy has decoupled or that it can power on into the distant future, that Australian house prices cannot fall and that debt levels are sustainable—are open to serious questioning.

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