

Mont Pelerin Society Speech

October 2010

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Australia is one of the few rich world nations to have survived the global financial crisis without a technical recession. Unemployment is now just over 5 per cent, central government public debt is forecast to peak at 6 per cent of GDP and the budget should return to surplus in three years. For Australia, the crisis was largely an external event. There was no domestic banking crisis caused by sub-prime loans and no need for government to bailout banks. Australia's perspective on the worst economic event since the Great Depression is that it was essentially a North Atlantic experience – to use the words of our central bank governor, Glenn Stevens.

The contrast between Australia and the North Atlantic economies reveals the unique circumstances that define Australia over the past generation. Australia is now in the 19th year of its longest unbroken economic expansion. The last recession was in the early 1990s. This history highlights the need to see Australia as a developed nation highly integrated into the Asia-Pacific and at distance from the European project.

The foundation of Australia's recent success lies in political leadership – notably the pro-market economic reform era that began in 1983 with the election of Bob Hawke's Labor Government. This reform age spanned the Prime Ministerships of Hawke, Paul Keating and John Howard, a period of more than 20 years. It now seems to be terminated.

The post-1983 reform age transcended economics. It constituted, in effect, a new national direction for Australia and was the latest in a long series of experiments that mark Australia's history.

Since Europeans arrived on this continent in 1788 there have been two conflicting interpretations of Australia. On one hand, Australia can be interpreted as an historical accident, a bunch of Europeans ship-wrecked on the wrong side of earth half a world from home, a nation isolated in racial and cultural terms, a bizarre and fearful museum left over from the European age of discovery. On the other hand, Australia can be seen as a beacon of hope, a new world society in the Southern hemisphere founded after both the industrial revolution and the American Revolution and embracing an ambitious mission – to build a better democracy and a better society than those of the old European world.

The recent reform age was the latest manifestation of this second instinct. It constituted a fusion of economic, cultural and strategic ideas. These ideas can be summarised as follows: a recognition that the age of Empire had passed and that Australia, once a proud member of the British Empire, had to accept responsibility for its own fate; an acceptance that in the globalised world Australia could survive and prosper only by running an open economy and becoming economically competitive; the conviction that as a nation occupying a continent Australia had to grow its population through a sustained immigration program and seek a new social model of unity in diversity; the strategic decision that Australia must seek a comprehensive engagement in Asia based upon mutual economic and political interests; and the view that the United States alliance was an enduring benefit assisting Australia in these great transitions.

Central to such conclusions was the political reality imposed by Australia's geography. Australian nationalism arises in the idea of "a nation for a continent" and Australia's future in the 21st century is that of a stand alone nation state. There is no regional economic model along lines of the European Union for Australia to join. It will not become a state of the United States. It will not find safety in numbers by trading away sovereignty to enter a regional federation. Its strategic fate is different from the original members of the old British Empire. Ireland solved its centuries old

dilemma by joining the European Union with panache. South Africa is destined to a leadership role within its own troubled continent. Canada, virtually co-terminus with the US, is fully integrated into the US economy and, in security terms, its interests completely overlap with the US.

Australia, by contrast, will succeed or fail as a free standing nation state that has one over-riding objective – to master first-best practice in the art of globalisation. This is the modern Australian project. Located in the Asia-Pacific where economic growth is dynamic and nationalism is on the rise, Australia faces exciting opportunities and immense challenges that fall under a single intellectual heading: how to become an economically successful, socially cohesive nation integrated into the Asian region. This is not a new event given that Japan became our major trading partner as long ago as the 1960s. But it assumes fresh dimensions with Australia enshrined as a resource supplier to China's industrialisation, a process certain to run for several decades. This highlights a fascinating juxtaposition – in the future Australia must manage China as its long-term major trading partner while the United States remains its most vital strategic partner. In short, Australia has a pivotal stake in successful relations between Washington and Beijing and any resort to military conflict between them is the nightmare scenario for Australia.

The post-1983 economic reform era was instigated by a sense of crisis. It originated in the belated recognition that Australia's 80 year old status quo was exhausted and broken – a consciousness created by the severity of the early 1980s recession. The status quo, in effect, had prevailed from the time of nationhood in 1901. Recognition that it was finished became a turning point in Australia's history.

The original early twentieth century Australian compact was created off the back of strong agricultural exports, a high tariff to protect manufacturing industry and jobs and a centralised judicial based wage determination system to re-distribute gains across the workforce on the basis of wage equity. In philosophical terms this was a fusion of two great ideas – belief in protection and faith in what Australians called the “fair-go”.

Economic protection was at the core of Australia's consciousness – it was tied to the notion of protecting a new world society from external contamination in every sense, notably from cheap coloured labour and from cheap imports. Just as powerful was the instinct for Australian egalitarianism entrenched in a society where there had never been a landed gentry and where democracy took root as fast and as deep as any place on earth. The nation lived by the creed of a Fortress Australia within a great empire, imbued with the British parliamentary tradition and faith in the white race, a champion of state power, protection of industry behind high tariffs, government sponsored nation-building, judicial-based wage determination and excessive public regulation. I have called this model the Australian Settlement – implying it was built to last.

The deceptive beauty of the Australian Settlement is that it chained both capital and labour to the model. Capital was protected and labour was the beneficiary of re-distribution. The model, outside Australian democracy, was the greatest achievement of our public policy over the first eight decades of the twentieth century. Yet the system was unsustainable. World Bank statistics show that from the late nineteenth century to 1980 Australia fell from first place to 14th in terms of GDP per head.

The 1983 election delivered power to Hawke and Keating, ambitious Labor politicians freed from the dead hand of the past. They arrived with fewer preconceptions, less attachment to party dogma and more open minds than any previous Labor Government. Aware of the failure of the 1970s Whitlam Labor Government, Hawke and Keating felt compelled to prove Labor's economic competence and, as intellectual pragmatists disposed to market forces, they were responsive to the ideas of the age. The result was the dismantling of the Australian Settlement, a triumph that transcended the cries of the doomsayers.

The milestones were the float of the Australian dollar in late 1983 and the de-regulation of the financial system followed over the coming decade by dismantling of the tariff wall and embrace of

free trade. Hawke and Keating privatised a series of government enterprises reversing Labor's historic support for public ownership and control. They cut income tax rates while broadening the tax base. They pushed means testing of welfare benefits accentuating the progressivity of Australia's welfare system. As Prime Minister Keating introduced National Competition Policy, sanctioned the central bank's shift to an inflation target policy and began reform of the industrial system by moving towards a system of enterprise bargaining.

In 1996, thirteen years after the launch of the reforms, a Liberal-National Party Government came to power led by John Howard with Peter Costello as Treasurer. With economic management as its priority, the new government gave reform a fresh momentum. Howard and Costello were pledged to a fiscal consolidation that saw Australia run a succession of surplus budget and, in 2006, the elimination of Australia's government debt turning the Commonwealth into a net creditor. The central bank was formally gifted its independence the upshot being an enduring low inflation cycle. Howard further de-regulated the labour market, privatised more government enterprises and won his re-election in 1998 on an ambitious tax reform agenda that introduced a broadly based indirect tax. Costello presided over an effective system of financial supervision that meant Australia's banks were not exposed when the global crisis arrived in 2008.

This was not a generation of perfect public policy. But it saw a fundamental re-orientation of the nation, impressive economic governance and a more analytical and transparent policy process. What were the factors that delivered such a sweeping reform era?

I would identify eight factors, each being important. First, there was a profound sense of national stagnation in the early 1980s with annual economic growth in the Fraser years (1975-83) being 2 per cent, proof of sub-standard outcomes. This mood surrendered to alarm in 1986 when Keating issued his famous warning that Australia's external accounts threatened to make the nation "a banana republic". Without doubt, economic crisis propelled the reform compulsion. The feeling among much of Australia's economic elite was that a new direction was essential and urgent.

Second, there was a set of ideas waiting for Hawke and Keating to embrace flowing from the international and local economic debate. These ideas, critically, had currency in the main economic institutions, the Treasury, the Reserve Bank of Australia, the Prime Minister's Department and the Finance Department and internationally within the OECD. The main principles were the need to embrace freer markets, de-regulation, free trade, lower taxation and a more transparent government intervention that spurned rent-seekers. Acceptance of these ideas within the government's advisory apparatus was decisive. This was promoted by an evolving shift in Australia's political culture fermented by a loose group of fellow-travellers that involved politicians, government advisers, academics, journalists and businessmen agitating for a new direction. Think tanks, such as the Centre for Independent Studies, were promoting the ideas of Adam Smith, Friedrich Hayek and Milton Friedman. Within Australia's media a number of influential economic journalists began to re-frame the debate calling for urgent action. In short, the intellectual case was made and was gaining traction.

Third, Hawke-Keating reforms were part of a governing Labor Party strategy designed to win elections. For this reason consultation, agreement and even consensus was accorded a high priority in policy making. Hawke and Keating were leaders but also persuaders. They presented the reforms not as aberrations but as essential steps in Labor's transition as a party. They argued the policy merits in cabinet, the parliamentary party, in Labor's internal machinery and with the trade union movement. Hawke and Keating had no interest in sacrificing power on the altar of policy reform purism. Their aim was to make reform into a winning formula at the ballot box and they succeeded. Labor's victory at five successive elections (1983, 1984, 1987, 1990 and 1993) entrenched its reforms in the country and pre-empted internal party revolt from the Left. Fundamental to their success is that Hawke and Keating enjoyed a formal compact with the trade union movement. The unions signed off on many reforms, sealed only after a bargaining process and trade-offs.

Fourth, reform in the 1980s was assisted because the Opposition Coalition usually attacked Labor from the Right, that is, for not going further and faster. This was the stance adopted by John Howard as Liberal Party deputy and then leader. For example, the Coalition supported financial de-regulation, lower tariffs, tax reform and tighter fiscal policy. It criticised Hawke and Keating for not tackling labour market reform, for privatising too slowly and for not being sufficiently aggressive on microeconomic reform. In short, the Coalition's attack was not that Labor's reforms were ruining the country but that Labor was too timid. This gave Hawke and Keating political flexibility to continue the reforms and to occupy the political middle ground.

Fifth, the reform age was conducted in the tradition of Australian political pragmatism not as an ideological re-making of the nation. Hawke and Keating were pragmatists not ideologues. They embraced reform not because of any ideological attachment to economic freedom but because they recognised that pro-market reforms were in the public interest. At no point did they endorse Smith, Friedman or Hayek as their guiding stars. Their aim, however, was to re-invent Labor policy and invest Labor with a new political consciousness as the party of economic reform.

Proof that reform in Australia must be achieved through pragmatism not ideology came at the 1993 election. The Opposition Coalition under the leadership of an economist, Dr John Hewson went to this election with the most comprehensive program ever devised in Australian history, called Fightback! and running to several hundred pages. Described by Hewson as a character test for the Australian people it involved zero tariffs, smaller government, a zero to 2 per cent inflation target, education vouchers, new price signals in health care and significant labour market de-regulation. This was "big bang" reform, contained in a single ideological manifesto for implementation on a broad front as had been done in New Zealand. But Keating defeated Hewson depicting his agenda as falling outside the accepted norms of Australian polity. This forced the Coalition back to the strategy of reform via pragmatism and this was the technique followed by Howard during his 11 year prime ministership (1996-2007).

Sixth, just as Hawke and Keating had to inject an economic reform mindset into Labor's culture, Howard faced a similar task with the conservative parties. The previous Coalition Government of Malcolm Fraser had followed the Australian tradition of protection, regulation and wage arbitration. The necessary re-casting of the conservative side occurred during its long wilderness period (1983-96). This meant that when Howard won office in 1996 he was the first Liberal Party Prime Minister who could be classified as an exponent of economic liberalism. Once again, this was a belief qualified by political pragmatism.

Howard was never a theorist; he rarely invoked Smith or Hayek as models. He never espoused as an objective a reduction in the size of the state. He shunned intellectual abstractions and focused on reforms that were practical, often substantial and would deliver benefits for households and businesses. Howard's core economic belief was that a more flexible Australia would promote personal initiative, entrepreneurship, erode class divisions, create more jobs and encourage a more aspirational culture. He was criticised for being too cautious by many free market intellectuals. This included occasional assaults from the Centre for Independent Studies for the generous cash support he provided for families to assist with the burden of child rearing. In his later years Howard enjoyed strong revenues from the China boom and now lives with the accusation that he spent too much of the proceeds and squandered the opportunity to achieve a decisive reduction in the tax burden and 'purchase' more economic reforms.

Seventh, throughout the reform era Hawke, Keating and Howard sought to salvage the spirit of Australian fairness in the march towards a more pro-market economy. Their aim was to achieve efficiency and equity together. This was assisted by means testing welfare benefits, putting more jobs into jobless households and by the way government programs were structured. The Australian experience is that de-regulation leads to greater inequity among private incomes yet the Australian state is probably the most highly re-distributive within the OECD with the top 40 per cent supporting the bottom 60 per cent via the tax/transfer system.

The single strongest attack on reform policy was the repeated claim the ethic of Australian fairness was being destroyed. There is no more powerful appeal in our politics. It is a necessary test to apply for a compulsory voting democracy. Yet fairness has also been recruited as the rationale for every reactionary, special deal and rent seeking rort in Australia's history. The sins in its name are legendary.

In short, both Labor and Liberal leaders tried to retain public support for pro-market reforms by distribution of the benefits. The termination of the reform age, however, came partly from its breaking on the wheel of equity.

My eighth point is the most obvious: reform in Australia was best achieved by dual leadership. On Labor's side it was Hawke and Keating; on the Liberal side it was Howard and Costello. These names conjure famous rivalries. It is too easily overlooked that both pairings worked successfully together for many years as Prime Minister and Treasurer to re-cast the nation's policy framework.

Australia has just completed its 2010 national election that sees a minority Labor Government under Prime Minister, Julia Gillard with the Coalition under Tony Abbott, a Howard protégé, narrowly defeated and in opposition. The campaign was typified by policy timidity and short-term horizons. Indeed, the recent election testifies to the shift in Australia's political culture away from market-based reforms.

The evidence suggests the post-1983 reform era is completed and that Australia has moved into another historical cycle that still defies definition. The causes of the reform era's demise are complex and contested. However, I would identify three enduring elements.

First, the post-2003 terms of trade boom originating in an historic leap in commodity prices has exerted a profound and debilitating decline in the quality of Australian public policy. This revenue surge with its hefty boost to national income has contributed to pervasive policy complacency. It is often said that reform is driven by crisis not prosperity and Australia's post-2003 story confirms this theory.

Howard and Costello struggled after 2003 initially unaware of the sheer scale of the commodity price surge. Too much of the revenue was spent; not enough was invested in productivity-enhancing reform. There was insufficient attention given to competition policy, reform of federalism and infrastructure policy.

Under the Rudd Government Australia survived the global financial crisis without a technical recession, assisted in part by its integration with China. This is a crowning achievement yet it has a downside. Psychologically divorced from the economic crisis in the North Atlantic zone, Australia seems to be drifting. One of Australia's most prominent economists, Professor Ross Garnaut, argues persuasively that the 19 year unbroken economic growth cycle has inculcated a lethargy into our political system. The Labor Government has enshrined the fiscal stimulus as the main reason Australia survived the crisis, a half truth that obscures another more useful narrative – that Australia survived because of its commitment to economic reform manifested in a budget surplus, absence of government debt, sound financial management and banks with minimal bad loans.

Second, reform momentum has been unwound because of a series of spectacular reform failures that generated a fatal political backlash. The main examples are Howard's final term experiment in industrial relations reform that carried the title WorkChoices and Rudd's botched 2009 effort to legislate an emissions trading scheme that priced carbon.

WorkChoices permitted the reduction by employers of some employee work entitlements – an opportunity seized by the trade union movement for a huge and successful scare campaign that became a potent factor in Howard's 2007 election defeat. It was a case of reform leading directly to political rejection. The upshot has been a partial re-regulation of the labour market under the Labor Government, the discrediting of labour market reform and a Coalition wary of economic reform ventures more generally. This retreat on labour market policy is first time since 1983 that market-

based reforms have been reversed in Australia. It testifies to the enduring institutional strength and loyalty in the Labor Party-trade union bond. The union victory is such that it remains virtually impossible in Australia to discuss further reform of the labour market.

There are many lessons from Rudd's abject defeat on carbon pricing, a defeat that was a factor in his removal as Prime Minister by the parliamentary party in June 2010. One lesson was Rudd's decision not to proceed with his ETS without Coalition support, that is, without the political cover of bipartisanship. Rudd had declared action on climate change to be the moral imperative of the age; he insisted on a market based mechanism; and he presented his ETS as a seminal economic reform. But when challenged by an Abbott-led Coalition that rejected his scheme as a new tax, Rudd faltered. Intimidated by Abbott, he refused to back his scheme, declined to take the issue to the people and was seen to lack the policy courage for the moral cause he had proclaimed. The upshot is that Australia, having got to the brink of carbon pricing, succumbed to a crisis of faith in the cause and political division about the path forward.

The climate change debate in Australia is high profile and unresolved. It has soaked up enormous parliamentary energy and political capital, provoked internal crises in both parties, distracted from other reform causes and has become a road block in Australia's overall progress towards more market-based solutions.

The third factor inhibiting reform is the decisive cultural change in Australian politics. This is exemplified by the institutionalisation of short-term factors in decision-making, the sheer power of the negative campaign at election time, the new premium placed on caution in policy design and the rise of the 'focus group' technique in virtually all aspects of politics and campaigning. It is now difficult to advocate a reform that generates 'winners' and 'losers' because the negative story will prevail. Australia's dilemma typifies that of contemporary democracy reflecting the contradiction between, on one hand, the tyranny of the 24 media cycle and, on the other hand, the need for long-run policies based in demography, tax, climate change, productivity, population and infrastructure. The nature of the contemporary political contest undermines the flexible policy responses so essential for nations to succeed in the high-tech globalised age. This is the origin of the 21st century crisis of democratic governance.

In the new century party faiths and ideological conviction are in decline as tribal political loyalties erode. The consequence is that incumbency is more important than ever. As political parties become weaker they are more dependent than ever on executive government to conceal such weakness and make them strong. The purpose of political parties today is to win office, not to nurture their constituencies as vanguards of a particular global ideology. In office, even the weak strut the stage as giants. In opposition, their weakness is exposed before the world. Politics is now driven by a ruthless pragmatism – the quest to mobilise the instruments of executive power to reward a coalition of interests that can sustain a party in office. As Tony Blair says, the political contest has become more ferocious while the ideological divide has narrowed. The cause of good policy is increasingly lost in this vortex.

In Australia such problems are now compounded by a divided parliament and the first minority government since 1940. This is not an encouraging omen for bold policy.

In its advice to the new Labor Government, the Treasury warns that with Australia's economy approaching capacity constraints induced by the resources boom, there is a premium on supply side reforms to maintain productivity growth and a flexible economy. Since 2002 productivity growth has slowed, a weakness concealed because Australia's high terms of trade off the back of China's growth have boosted national income.

Herein lies the great trap: that Australia will be deceived into taking the easy path courtesy of China's boom. The nation will need intelligent and bold leadership to manage the challenge of prosperity and to ensure the so-called golden age does not evaporate.

