Reform, Structural Change and Growth in the Australian Economy: Current Obstacles

SAJID ANWAR

Adelaide Graduate School of Business, University of Adelaide, 233 North Terrace, Adelaide, South Australia 5005, Australia

Sajid.Anwar@adelaide.edu.au

BOB CATLEY

Central Coast School of Business, University of Newcastle,
PO Box 127, Chittaway Road, Ourimbah,
New South Wales 2258, Australia

Bob.Catley@newcastle.edu.au

The Australian economy has gone through a number of significant reforms and structural changes during the past few decades. The overall impact of these reforms on the economy has been positive as indicated by the strong growth. Due to rising demand in the domestic market and significant currency depreciation, the economy was also able to withstand the Asian financial crisis of 1997-98. This paper examines some of the main factors that have contributed to economic growth and growth in productivity in Australia. The paper also considers issues such as the rising current account deficit and household borrowing which can slow down the rate of economic growth in Australia. The paper argues that the most recent economic growth has been largely reliant on rising domestic demand. The household

Published by the BRITISH AUSTRALIAN STUDIES ASSOCIATION
saving ratio during 2002 and 2003 has been negative indicating that the economic growth at least in the short-term would have to be fuelled by export growth. Recent free trade agreements with regional economies and the US and continued economic growth in China provide an excellent opportunity for Australia to take advantage of positive development in its external environment.

Keywords: Australian Economy, Economic Reforms, Economic Growth

Introduction

During the last decade the Australian economy has been among the best performed of developed countries. A sharp increase in the value of the Australian dollar led to a steep decline in Australian exports in 2003. Exports have registered a slow increase since late 2003 as the Australian dollar lost some ground from its peak of 80 cents US. But Australian exports have not performed particularly well even during the previous few years of a lower currency. Appreciation of the Australian dollar is partly linked to inflows of investment and partly to increases in Australian interest rates during the second half of 2003. It is interesting to note that the increases in Australian interest rates took place while there was no change in the US interest rates. The continuing weakness in the US dollar is likely to help the Australian currency to maintain its recent gains against other major currencies such as the pound sterling, the yen and the euro. The Reserve Bank of Australia (RBA) engineered the interest rate increases in order to discourage, among other things, the rising household debt which accounts for a significant proportion of dwelling purchases. Together with a very favourable taxation regime for investment property this has fuelled a substantial rise in property prices, 1998-2004.

External factors, such as the spread of SARS and the War in Iraq, also contributed to a decline in the Australian exports in 2003-04.
However, an increase in domestic demand appears to have offset the adverse effect of a decline in exports (OECD, 2003). Accordingly, the Australian economic growth rate has remained steady and firm, and the economy is expected to continue to register a solid growth rate of around 4 per cent in coming years, with 0.6 per cent in June quarter 2004 and 4.1 per cent for that year. The continued strong economic growth in Australia can be linked to the process of economic reform and liberalisation that began twenty years ago. The following figure shows the growth rate of the GDP, inflation rate and the unemployment rate from the 1950s to the 1990s. These figures include periods of recession.

**Figure 1: Australian Economic Performance**

![Graph showing economic performance from 1950s to 1990s](image)

Source: Gruen and Stevens (2000)

The Australian economy has experienced four major recessions during the past 5 decades: 1960-61, 1974, 1982-83 and 1990-91. 1975 to 1983 was the period of stagflation. The economic performance during the rest of the period was not entirely smooth. As indicated by Gruen and Stevens (2000), the economy slowed down considerably during 1957, 1965, 1972, 1976-77, 1986 and
1996. There was also a brief slow down in late 2000 following the introduction of the Goods and Services Tax (GST) and the end of the Olympic Games generated construction boom. Gruen and Stevens have further argued that: (a) an increase in the growth rate of per capita GDP during the early and mid 1990s can be attributed to a reduction in immigration, which reduced the population growth rate; and (b) a decrease in GDP volatility during the 1990s can be attributed to an increase in the share of the services sector. It is also worth mentioning that the 2000-2001 drought had a significant adverse effect on Australian GDP growth. Adam, Horridge Madden and Wittwer (2002) estimate the overall impact on the GDP growth to have been -1.6 per cent. Although some areas have now been declared drought free, a large part of the country is still affected by drought.

In overall terms, the comparative record in the OECD group of developed countries shows a gradual improvement in the Australian economy compared with the earlier twenty years, 1964-84, when it generally moved downwards in per capita income rating. 3

1984-90 was a period of strong growth accompanied by inflationary pressures and a continuing deterioration of the balance of payments and rising, mostly private, international debt. This was a period during which the policy makers introduced a program of economic liberalisation designed to change the structure of the Australian economy making it more responsive to both domestic and international market signals. This was intended to produce a more flexible economy more resilient to international shocks, which had produced sharp downturns in 1974 and 1982, and more capable of sustained strong growth. Partly as a result the unemployment rate has been somewhat higher than earlier periods as policy makers have pursued growth and flexibility as priorities rather than high rates of labour employment which tended to make earlier policy settings less flexible. 1990-92 was a period of recession when unemployment and inflation reached levels matching those of the 1982-83 period, whereas 1992-2005 was a period of almost uninterrupted and strong
growth. Economic growth has resulted in larger than expected budget surpluses that can be used to finance the cost of tax reforms and infrastructure upgrade.

The performance of the Australian economy in recent years and OECD forecasts are shown in Figure 2 as follows.

**Figure 2: Recent and Projected Economic Performance (percentage change)**

<table>
<thead>
<tr>
<th>Exports</th>
<th>GDP</th>
<th>CPI</th>
<th>Unemployment Rate</th>
<th>Current Account Balance</th>
</tr>
</thead>
</table>

![Economic Performance Chart](chart.png)

Source: OECD (2005)

Figure 2 above shows the growth rates of exports, GDP, CPI and the current account deficit as a percentage of GDP. Recent decline in the value of the Australian dollar and overall performance of the economy in 2005 appear to suggest that exports and GDP would continue to grow at a reasonable rate with low inflation and unemployment rates. Although during the past few decades the Australian economy has, aside from the 1990-91 recession, registered strong growth, areas of serious concern remain. Specifically, a persistent current account deficit and the rising level of household debt are the main problem areas at present. The main objective of this paper is to highlight the factors that have
contributed to recent sound economic growth in Australia and identify major obstacle to its continuation.

The paper focuses on the performance of the Australian economy during the past two decades and then examines the issues that need to be considered in the immediate future. The paper concludes that structural reforms undertaken by successive governments helped the country to achieve high levels of economic growth. The economic growth during the past decade has been mainly domestic demand driven. Rising level of household debt and expected increases in interest rate are likely to slow down the domestic demand growth. The growth of the Australian economy in the next decade would then have to be mainly fuelled by export growth. But, despite the introduction of microeconomic reform, Australian firms have found it difficult to improve their competitive position.

Australia has tried to overcome this problem by pursuit of domestic economic reform and increased multilateral commitment to free trade. But unsuccessful attempts to join the Association of South-East Asian Nations (ASEAN) and the shifting of the focus of the Asia-pacific Economic Co-operation (APEC) Group to political issues in the aftermath of September 2001 attacks on the US, has forced Australia to rely more on bilateral free trade agreements. These have now been introduced with New Zealand, in the 1980s, and Thailand and Singapore in recent years. Agreement reached with the US has been recently ratified with amendment by the parliament. In addition, a free trade deal with China is likely to be concluded within a year. These free-trade agreements (FTAs) may contribute to the alleviation of the current account deficit problem by opening the largest international market and the fastest growing one to Australian exporters. Continued economic growth in China (and the recent acceleration of growth in India) can provide an impetus for Australian exports. In fact, China has become Australia's major Asian trading partner. However, unresolved international disputes such as the Taiwan problem, the slow pace of political reforms and
external events, such the recent steep increase in the price of crude oil, can slow down the Chinese economy.

One of the engines of Australian economic growth in the 1960s had been provided by sales of primary product, notably minerals and energy, to an industrialising and rapidly growing Japan. In the 1980s this beneficial trading relationship was extended to much of the rest of east Asia. In a seminal report, Garnut (1989) argued that trade with Asia could fuel Australian economic growth for some decades to come. Since its election in 1996, the Howard government has sometimes been criticised for moving too close to the US and ignoring Asia. In fact, growth of trade with Asia did slow following the Asian financial crisis of 1997, when Australian trade diversified to other markets unaffected by that phenomenon. Since the Asian recovery, trade has continued to grow and has, for example, been marked by the largest Australian single trade deal in 2002, involving the delivery of $A25 billion worth of liquefied natural gas to China. The agreement reached with East Timor on development of natural resources in the Timor gap area is also likely to provide a significant boost to the domestic economy. Australia has also recently negotiated an energy deal with Mexico worth A$50 billion. This deal aims to open up a new market for the supply of liquefied natural gas on the west coast of the US.

The rest of this paper is structured as follows. The next section contains a discussion of the factors that have contributed to sustained economic growth in Australia. Some unresolved issues and areas of concern are outlined in the following section, before concluding remarks.

Recent Economic Growth in Australia

During the past few decades, the Australian economy has gone through a number of structural reforms as a result of deregulation policies by authorities. These policies were a response to the late 1970s onset of ‘stagflation’—low growth and high inflation—which
beset Australia and other developed economies at that time (Catley, 2002a). After considerable debate and political conflict, the Labour government after 1983 adopted a broad policy of liberalisation to deal with this problem (Catley, 1996).

These policies were often characterised in Australia as ‘economic rationalism’ or ‘neo-liberalism’. As in many other developed countries, which had suffered the ‘crisis of stagflation’ in the late 1970s, these policies were intended to apply market solutions to problems of economic management that had been dealt with by state regulation during the previous decades (Catley, 2002b). Critics believed they were a backward step towards pre-Keynesian techniques of economic management. In the main this reform process did, however, contribute to the revival of economic growth in Australia combined with low levels of inflation.

This section contains a discussion of some of these reforms.

**Financial Deregulation**

The Australian financial sector was and is dominated by banks. Until the early 1980s, banks operated in a protected environment subject to significant controls implemented by the Reserve Bank of Australia.

Despite an early attempt by the British Treasury in 1840 to impose limitations on Australian Banks, the Australian Financial System enjoyed almost 50 years of growth in a fairly deregulated and competitive financial environment. When 13 of the 22 banks prevented depositors accessing funds in 1893, this set the stage for the introduction of stronger government controls after federation created the Commonwealth of Australia in 1901. The Commonwealth Bank was established in 1912 and steadily began to attain the functions of the central bank in Australia. The Commonwealth Bank’s role expanded to include the manipulation of the exchange rates, buying and selling of foreign currency and holding exchange
settlement accounts of other banks. The establishment of a Royal Commission in 1937 and the subsequent outbreak of World War II led the Australian government to enforce further measures that restricted the banks' ability to trade freely. These restrictions were introduced in August 1939 and included comprehensive exchange control. This meant that every purchase and sale of foreign exchange required the permission of the Commonwealth Bank. In November 1941, banks were required to invest a certain proportion of their asset in “special accounts” at the Commonwealth Bank. The profits of commercial banks were restricted to a pre-war average and the interest rate regulation was introduced in February 1942. This regulatory regime had been strengthened by the coalition government in 1959, when, through an act of parliament the Commonwealth Bank's original body corporate was preserved as the Reserve Bank of Australia (RBA), which started functioning as the central bank from January 1960 (see Felmingham and Coleman, 1995).

In the early 1980s, the Committee of Inquiry into the Australian Financial System advocated substantial deregulation of the financial system. The 1981 Campbell Report is widely credited with having steered the Australian financial system in the direction of deregulation. The recommendations of the Campbell report were subsequently supported by the Martin Review Committee. As a result, a number of constraints on the banking sector were removed which led to significant competition in the financial sector.

The process of financial liberalisation began with the floating of the Australian dollar and admission of foreign banks in 1983-84, following a run against the currency. The Labour government, elected in 1983, floated the currency and announced foreign banks would be licensed to operate in Australia. During the following twenty years the currency has been quite volatile moving between US$1.20 (in 1984) and US$0.48 (in 2001). This has meant that Australian prices have increasingly reflected international market conditions. While foreign banks have not entered into branch, high street banking, other institutions have encroached on other areas of
traditional bank dominance — including mortgage lending — and other regional banks like the St George, Bendigo Bank and the Bank of Adelaide, have increased their activities at the expense of the four majors: Commonwealth Bank, ANZ, NAB and Westpac. In addition, several of the state owned banks have been privatised, including the State Bank of South Australia and the Bank of Victoria. The result has been the creation of a new financial sector in which capital more closely follows returns and associated risk, and is less influenced by political decisions and fixed interest rate mortgage lending as was the case in the past.

Historically Australia has had varied experience with respect to restrictions placed on its banks. It is, however, worth mentioning that despite deregulation, significant prudential controls remain in place. The 1997 Wallis Report on the financial system in Australia made a number of substantial recommendations, which led to fine tuning of the Australian financial system. It should also be noted that improvement in communication technology has resulted in a situation where traditional banks are now facing stiff competition from other financial intermediaries such as the insurance companies, building societies and credit unions.

The deregulation of the Australian financial system was part of a worldwide trend of reducing the controls imposed on financial markets during the 1980s. Despite the best efforts of the RBA, funds flowing out of Australia increased in the early 1980s. RBA had over time established an intricate and complicated dictum in order to shield the Australian financial system. As these controls were being circumvented and the leakages overseas increased, the idea of introducing even more regulatory measures became less appealing to policy makers. It was also becoming increasingly difficult for RBA to effectively enforce existing regulatory measures. Deregulation was also necessitated by the need to reduce the institutional distortions that existed in the domestic public and private sector at that time.
Under the new deregulated financial system projects that could earn higher returns were able to bid successfully for funds, which subsequently meant that capital was reallocated from low yielding to high yielding projects, which presumably led to a more efficient allocation of resources. This also led to a significant increase in lending by the late 1980s as Australian financial institutions were more readily able to access foreign sources of funds. Bank credit surged in the 1980s from an annual growth rate of 12.9 per cent between 1978 and 1983, to a rate of 18.8 per cent between 1984 and 1988 (see Flemingham and Coleman, 1995). Another consequence of allocative efficiency was the implementation of the user pays system and the elimination of what was effectively a cross subsidisation of financial services.\(^8\)

Deregulation afforded banks not only the opportunity to modernise and to embrace new technology but the ability to expand beyond existing business. The corollary of this was that consumers were offered more choices and products in an increasingly competitive market. Consumers seized the opportunity to borrow from overseas and to diversify their investment portfolios internationally. Australia’s economic growth has been, in part, fuelled by overseas borrowing. It is interesting to note that in the period immediately following financial deregulation, Australia was proportionately one of highest borrowers of overseas funds and the Australian financial institutions accounted for a large segment of this. At the end of June 1994, borrowing by private and government financial enterprises was 45 per cent of gross external debt; three-quarters of this borrowing was due to private financial enterprises (Flemingham and Coleman, 1995). The ability to borrow from overseas combined with the late 1980s’ property boom and the euphoric atmosphere at the time proved to be a recipe for disaster.

Companies that borrowed heavily from overseas to finance the property boom faced bankruptcy, when the property market bubble burst with the high interest rates of 1989-90 and took their assets downward with it. The Victorian Pyramid Building Society collapsed
after lending depositors’ funds to commercial property developers with disastrous consequences. The state of Victoria’s largest group of building societies – the Farrow group – collapsed and the government’s venerable State Bank was forced into sale to the Commonwealth Bank because the magnitude of the loan losses of its subsidiary, Tricontinental. South Australia’s State Bank made losses of even greater enormity (on a per capita basis) and had to be rescued by an injection of more than 3 billion dollars of public funds, leaving that state in a parlous financial situation until it could sell off sufficient public assets to reduce its debt to manageable proportions.

All three of these failing groups had pursued rapid asset-led growth, with much lending to highly leveraged ‘entrepreneurs’ and commercial property developers. In an environment of fierce competition and shrinking profit margins lenders are sometimes willing to take risks that they may not have in an otherwise sedate atmosphere (Flemingham and Coleman, 1995). Financial sector reforms have, nonetheless, been largely successful. The Asian financial crisis of 1997-98 had a very limited effect on Australia but recent corporate failures such as the collapse of the HIH suggests that there is room for further improvement.

**Tariff cuts and reduction on controls on foreign investment**

A move towards free trade also facilitates a relocation of the factors of production – labour, land, capital and entrepreneurship - to activities of higher return, which can also reduce inflationary pressures by reducing basic cost structures. Disruption of trade due to World Wars I and II led Australia to decrease its dependence on international trade. This task was accomplished by promoting domestic import competing industries through tariffs and subsidies. Trade protection as a means of infant industry development resulted in a number of inefficient industries. Further growth required these industries to compete internationally. Well before the end of the Cold War, the Australian authorities began to recognise the need for a reduction in tariffs. At first tariff cuts were introduced ad hoc in
1973, and then on a piecemeal basis in the 1980s. In 1991, the Australian Labour government committed to a program of tariff reduction in its statement *Towards a More Competitive Australia*. This was followed by a multilateral commitment to tariff reduction during the annual APEC meetings. This was accepted with some reluctance by labour unions and agricultural producers, previously major beneficiaries of protection. The present centre right Liberal coalition government in 1997 and then again in 2003 replaced the tariff reduction program with a less ambitious regime.

Nonetheless, the impact of tariff reform has been considerable. The Productivity Commission — the long-term successor to the Tariff Board — believes this was the main contributor to Australia’s recent productivity surge (see Barnes and Kennard, 2002). Nonetheless, financial and tariff liberalisation has left Australia more open to fluctuations in the value of its currency. In 1997-98 it avoided involvement in the regional turmoil of the Asian currency crisis by allowing its currency to depreciate and diversifying its export markets. This can be seen in the following figures (3 and 4) showing the slowing and then renewal of export growth to the EU.

**Figure 3: Exports to EU in Million Dollars (1991-July 2004)**

![Graph showing Exports to EU](image)

The export growth to ASEAN has recently declined mainly due to the appreciation of the Australian dollar. However, there has been a steady increase in exports to China.

Figure 4: Exports to ASEAN and China in Million Dollars (1991-July 2004)


Although the previous Labour governments maintained a Foreign Investment Review Board with powers to review any intended large and/or sensitive foreign investment proposals, this became progressively less restrictionist. However, during recent years, the Australian Coalition government has also blocked a few takeover/merger bids. Australia has completed free trade agreements with Singapore and Thailand and free trade deals with the US and China is in the pipeline. In overall terms, the impact of tariff reduction and relaxation of foreign investment controls on Australian economy has been positive.⁹
Cuts to size of the public sector

The Australian economy before 1984 had been characterised by a large state owned sector with numerous state-owned enterprises (SOEs) at both Commonwealth and state levels of public sector management. This had originated in the six colonial economies where authorities had often used colonial borrowings to finance infrastructure on an immature economy. These had been later augmented after 1901 by extensive use of state ownership at a Commonwealth level in new sectors as they developed, like central banking, airlines and telecommunications, in a situation of widely perceived market failures.

For example, the state-owned Qantas airlines was used to ensure air transport developed on trunk routes in a small national market, and the privately owned Ansett airlines was used to construct a regulated duopoly in which there was an appearance of competition. This two-airline agreement was abandoned for greater competition in 1989 and the regulated duopoly collapsed entirely with the bankruptcy of Ansett in 2001. Since the sale of the Commonwealth Bank, Qantas and part of Telstra, the process of privatisation has accelerated to include much of the telecommunications sector, airports, gas, water and electricity.

From 1985 onwards the Commonwealth government also committed to the reduction in the size of overall public sector expenditure. This is difficult to measure since, although the OECD provides a comparative figure on an annualised basis, this is often in dispute. In the late 1980s the Hawke Labour government committed to the so-called trilogy of reduced taxation as a per cent of GDP, reduced public expenditure as a per cent of GDP, and reduced public sector deficits. This commitment was, nonetheless, abandoned in the recession of 1990-91. During the five-year period of the Keating Labour government, 1991-96, the Commonwealth budget deficit averaged around $15 billion annually and was designed to provide economic stimulation. The incoming Coalition government com-
mitted to running surpluses to repay Commonwealth debt, as it did for four years. This commitment was, in turn, abandoned in the face of the need to campaign for the 2001 election when new forward commitments amounting to around $20 billion on estimates were undertaken. Nonetheless, policies of the new government in late 1990s produced strong economic growth, which resulted in renewed budget surpluses in 2002-2003 and a projected surplus in 2003-2004. Treasury estimates during the 2004 election campaign have projected a total budget surplus of $25 billion over four years, underlining the strength of the economy. Australia now has a public sector debt level among the lowest in the OECD.

These successful efforts to control the size of the public sector, however, only produced limited success in the area of taxation reform. In 1983 Australian income and company taxation rates were very high but evasion was considerable. In 1985 the Labour Treasurer, Paul Keating, attempted to reform the taxation system by introducing a GST and reducing many others.10 This was vetoed by the then powerful trade unions on equity grounds. Keating then took another tack and reduced income and company tax rates but enforced greater compliance and introduced other taxes, including a Capital Gains Tax. But tax rates remained high relative to other OECD and particularly regional economies. In 1991 the Liberals in Opposition proposed a general tax reform again based on introducing a GST, but this was rejected at the 1993 election.

In 1997 the present Liberal Prime Minister, John Howard, announced he would introduce a GST based tax reform after the next election, which he duly won in 1998. After complex negotiations in the parliament a widespread but not universal GST was introduced in 2001. The revenue collected - $41 billion in 2004-05 – was entirely transferred to the states but no substantial income tax cuts were made. As a result Australia retains one of the highest income tax rate regimes in the world, with 48.5 per cent cutting in at $62,500, together with its known impact on incentives and efficiency. It also has inefficient state based SOEs, including hospitals and transport
systems, whose budget derives from state authorities who do not collect the revenue and with consequent limited incentive to drive reform.\textsuperscript{11}

\textbf{Reduction in state determined wage fixing system and lowering of proportion of work force in labour unions}

The colonial states began regulating wage rates in the nineteenth century. After federation in 1901, the Commonwealth took over some of this activity and, following the 1907 ‘Harvester judgement’, the majority of wage rates were regulated by a ‘basic wage’ that contained both social and economic calculations, and margins for skill. This was maintained until the 1980s but was incompatible with a deregulated and internationalised open economy in which returns to labour were required to reflect, like other factors of production, their productivity.

During the 1980s, the Labour government, politically dependent on the good will of the labour unions, used its Accord with organised labour to produce a reduction in real wage rates in exchange for an expansion of some aspects of the welfare system (the ‘social wage’). This offset the likelihood of rising wage costs in a growing economy with sectoral and occupational labour shortages. During the early 1990s, the recessed economy then placed a brake on real wage rate increases. These were then resisted, as growth renewed and the labour market tightened, by further applications of the Accord formula until the mid-1990s.

When the present Coalition government gained office in 1996, however, the Accord device was not available for political reasons. But by then the labour market was rapidly changing. The proportion of workers covered by state regulated wage rates was progressively and rapidly falling, in large measure due to the reforms of the Labour government. This was reflected in the decline in the proportion of workers in labour unions, which dropped from nearly sixty per cent in the late 1970s to around twenty per cent in 2004. This proportion
of unionised labour was increasingly concentrated in the public sector, particularly public servants, teachers, nurses, and transport workers. There they were, as they had long been, rent seekers whose wage levels did not necessarily reflect their productivity.

In the private sector, therefore, wage rates have been increasingly determined by labour productivity. The rapid decline in private sector union membership has been accompanied by the pursuit of higher wage rates through higher productivity, in turn most often requiring higher levels of training and skill. This has indeed occurred and, for example, the number of university students doubled in the 1980s and doubled again to 800,000 in the period to 2004. Nonetheless, the concentration of union membership in the public sector has continued to provide problems for productivity growth by maintaining inefficient practices. These are most notable in the public hospitals, urban transport system systems and the education system from primary to tertiary level. One added difficulty is that while the Commonwealth collects the $41 billion Goods and Service Tax (GST) revenue, it is handed to the states to run programs. This reduces the incentive for states to enforce efficiencies against recalcitrant rent-seeking unions and several SOEs lag in productivity improvements.

Expansion in resources devoted to education and labour training

The Australian tertiary education system had developed to service a primary product exporting economy with heavily protected and regulated secondary and tertiary sectors. It lagged developments in other high wage and developed countries. In the late 1980s the Commonwealth government undertook the most ambitious expansion of the system of tertiary education since the 1960s. Essentially this entailed the consolidation of all tertiary education institutions into what became 38 universities in a uniform national system of funding and accreditation. This was to expand the proportion of the relevant age group attending university from
around five per cent to thirty per cent quite rapidly. These skilled workers would provide the backbone for the services, professional and managerial sector of the labour force for a modern internationalised economy.

Later, the Commonwealth created the Australian National Training Authority, partly to coordinate the provision of skills training to the rest of the workforce. A number of other reforms were also introduced to ensure that skills offered were closer to the needs of economic institutions. For example, business organisations were well represented at all levels of the planning for the TAFE (Training and Further Education) system. In both these systems, the provision of business related skills, particularly as they were evolving in the restructured and more market driven Australian economy, were greatly expanded.

The Australian education system also emerged as a major export earner, with government claiming export revenue in excess of five billion dollars by 2004. Chiefly this was generated by international students studying in Australia and the provision of Australian educational programs offshore. In the tertiary education sector, business studies soon emerged as among the largest sectors in the new university system. By the early 21st century about one-third of all activities in the university system were related to business studies which also accounted for about half of all international students in Australia.

It may be suggested that this had two direct consequences. On the one hand, the increased links between the Australian tertiary education system – and therefore the Australian economy – and the emerging tertiary-educated management strata in other countries facilitated and intensified the internationalisation of the Australian economy. Some supporting data for this may be found in the growth of international economic links between Australia and those countries providing students for the Australian system, most of them in the Asia Pacific region. On the other hand, the domestic products
of the expanded tertiary educational system were acquiring the professional skills required to manage the newly created, market oriented Australian economy. As business skills replaced administrative skills, as requirements for managing a market replaced those for running state owned enterprises, so Business (and Communications and IT) faculties replaced Arts faculties as the focus of non-technical activities in the Australian university systems.

The performance of the public school system has been less impressive. The states have responsibility for schools and have been unwilling to enforce competitive practises on a heavily unionised work force. The results have included the preservation of very poorly performing public schools and a drift of pupils to a growing private school sector.

Reduction in subsidies, abolition of commodity marketing boards and microeconomic reform

During the 1930’s Depression the Australian state had become more actively involved in the marketing of Australian agricultural commodities. Several marketing boards were established to control the sale and distribution of primary commodities including, most notably, wheat and wool. These systems worked by allocating production quotas and the relevant Board buying the commodity at a fixed price. It then was intended to stockpile the product in a poor year of low prices and sell the stockpile off in good years of high prices.

The outcome of this system was extremely distorting. As world production of agricultural commodities grew rapidly under the impact of the Green Revolution, and as there was considerable growth in state subsidies – notably in the European Union under the Common Agricultural Policy, but also in the US and Japan – so world market prices tended to decline. This had two outcomes for Australian producers.
On the one hand Australian producers, selling to agricultural Boards, were not in direct contact with the market and consequently had no market signal requiring them to either get out of producing their allocated commodity or begin production of a commodity with rising demand. The abolition of the Marketing Board system was a necessary pre-condition for holders of agricultural land to be given incentive, for example, to cease production of barley and begin the planting of wine producing vines. This occurred with some success in the 1980s and 1990s, although some sectors, like sugar in particular, remained unreformed and a stumbling bloc in the FTA negotiations with the US. Following this agreement the Commonwealth offered considerable incentive for sugar producers to leave the industry.

On the other hand, the marketing boards increasingly found themselves stockpiling products bought at higher than world market prices and awaiting the recovery in prices that never came. By the early 1990s, indeed, the Wool Board had stockpiled over $4 billion of wool with poor prospects of selling. The dissolution of the Board system only contributed to the rural depopulation as the subsided agricultural sectors were exposed to the world market with varying results.

Implicit in this commitment to liberalisation in pursuit of growth, was acceptance of the likelihood that some industry sectors would indeed decline. While the market would be the best method for identifying these, there would also be some requirement that the state did not maintain or even enhance that system of subsidies, which already existed. Resources would need to leave inefficient activities if they were to be redeployed to more efficient uses. In the same way, regions whose activities no longer matched the needs of the market would experience a decline that the state could only be expected to ameliorate for social reasons and not reverse for economic ones.
In pursuit of this reallocation of the factors of production, subsidies of various kinds were progressively withdrawn from industries. The inefficiencies thereby exposed were widespread and diverse, having accumulated over the period of a century. They included state enforced monopolistic market conditions that enabled extensive featherbedding in industries like rail transport and telecommunications; state subsidisation and successful rent seeking, as in the Universities and aspects of the health system, including the hospitals and restricted supply of general medical practitioners; oligopolistic licensing arrangements as in the electronic media; direct regulation by fiat, as in airline transport; tariff protection and subsidisation as in the Textiles, Clothing and Footwear sector; in regulated markets in semi-public utilities like state-based electricity or gas transmission; or in local content provisions and state provided financial systems in film and video production.

The withdrawal of these subsidies often involved difficult political decisions but would clearly produce a lowering of imposts on producers or taxpayers. In 1991, an attempt to reduce the crew on Melbourne trams from two to one produced a sector wide strike and the welding of trams to their rails to prevent usage.

Reform was also pursued in the economic infrastructure in particular to reduce the cost structure for the economy as a whole. In sectors such as airlines, rail and road transport; health and education service delivery, micro-economic reform was pursued to enhance their efficiency.

In these cases a broad practise for reform could not be articulated since the nature of the inefficiencies varied from case to case; but central principles could. In the airlines lack of competition, over-staffing and poor management had produced an underused and expensive duopoly. The railway system was too extensive and heavily subsidised by mostly state governments. The medical profession kept its fees high by restricting the supply of doctors and running a very effective labour union (the Australian Medical
Association) in conjunction with a system of private insurance companies. The flexibility of the Universities was greatly reduced by a rigid system of tenured academics (until this was diminished in 1989).

In general, the Commonwealth sought to limit funding increases, and trade that off for the agreed introduction of efficiencies, however they might be won, in each sector. Together with the progressive diminution of SOEs by privatisation, this ensured a more market responsive infrastructure system with increased efficiency had come into existence by 2004.

**Reform of the welfare system**

In 1984 the Australian welfare system was relatively small compared to European Union countries and more comparable in size to that of the US. This was the result, largely, of the social democratic Labour Party being in power for only three years between 1950 and the late 1970’s stagflation crisis – the classical period of welfare state expansion. During those three years, 1972-75, the welfare system and the state in general did expand, but off a relatively low base. During the succeeding period its expansion was constrained by a centre right Coalition government in 1975-83.

After 1983, anxious to avoid a general growth of the welfare system, Australian authorities adopted a policy towards greater ‘targeting’ of recipients of welfare programs by use particularly of asset and incomes testing. They also simultaneously sought to impose a degree of discipline on welfare usage by introducing various forms of ‘user pays’ practices. This both avoided free goods and yet provided the possibility of universal access.¹³

We may take several examples of this practice. The child-care system for working (and other) mothers enabled children to be minded during working hours and the cost shared by the beneficiaries – the state that expanded the work force and its tax
base, and the parent who augmented family income. The Medicare universal health system provided cheaper health care by imposing a universal levy but also (mostly) a modest fee for service. Access to Universities was improved, by increasing their funding and so student places by charging the students an after-graduation fee under the Higher Education Contribution Scheme.

The aged care pension system was also reformed and the universal, state provided aged pension subjected to rigorous income and assets tests. Instead, most workers were given tax and other breaks to enable them to personally save for their retirement in private funds. As a result, by the twenty first century only a third of retirees were receiving a full state aged pension and a third none at all. In addition, large sums of capital were made available to the investment market in Australia (and offshore) through the managers of the resulting pension funds.\textsuperscript{14} Compulsory superannuation coverage is a policy that is aimed to address the issue of aging population. Prior to the introduction of the scheme the population was financially supported via the aged pension. In the absence of an increase in the level of immigration intake, the working population proportion is likely to shrink.

\textit{Immigration towards a more skills-based system}

Finally, the system that controlled immigration to Australia was re-designed. During the period of regulated and inward looking industrialisation, from 1945 to 1984, immigration had been designed to expand the domestic labour force and the market for domestic production. Skills were a lesser consideration since international competition was broadly ruled out except in the primary sector where efficiencies were being maintained, although even these declined. As liberalisation proceeded it became apparent that the immigration program could provide an influx of skilled labour to match market expectations for labour and product. This was deliberately pursued in the 1980s but then the immigration program in general was wound back the early 1990s’ recession in response to political opposition.
As economic growth expanded after 1992, so the immigration program was again expanded and, particularly after the Coalition government returned to office in 1996, authorities tried to restructure the intake to correspond more closely to the skills needs of the economy. While the political ramifications of trying to exclude political asylum seekers who entered the country illegally gained much publicity, it occurred within a strategy of emphasising the skills base of migrants as against their family connections, humanitarian considerations or periods of residence.

The new system involved identifying skills shortages and awarding preference for applicants who held them, preferring business aspirants and looking to employer nominations. In the main this does seem to have been successful in increasing the average skills level of the migrant intake. The level of migration was also expanded and about 150,000 long-term arrivals occurred in 2003. The 2003 Economic Survey of Australia released by the OECD strongly endorsed Australia's economic performance and the Coalition government's immigration reform policies. It noted the Australian economy was 'one of the best performers in the OECD', and had the capacity to survive internal and external shocks. The "special topic" in that Survey was, 'The Economic Impact of Migration in Australia'. It found that Australia's immigration policy delivered economic benefits and assisted economic growth in part because of its emphasis on skills and its successful approach to integration (OECD, 2003).

As a result of this raft of changes, the open, responsive Australian economy is more stable now than before when it was more extensively regulated. Microeconomic reform, deregulation of the financial sector, a reduction in tariffs, privatisation of airlines, Telstra, and other SOEs, and labour market reforms have been the major contributors towards this economic flexibility and stability. But there remain unresolved issues.
Unresolved Issues

The current account deficit and the rising household debt are the biggest obstacle to Australian economic growth. These problems require immediate attention. The hopes of an export-led economic growth remain elusive at this stage despite a reduction in trade deficit in August 2004. Despite a significant reduction in the degree of protection, many Australian exporters find it difficult to compete at the international level often due to a high domestic cost structure. It has been argued that this problem is linked to lack of past global exposure arising out of the government’s long pursued protective strategies, the lack of economic diversification and remaining internal inefficiencies.

While the May 2004 budget projected, rather optimistically, that export growth would replace domestic consumption growth as the world economy recovered, little evidence of this was to be found later in the year. In August 2004 the Australian Bureau of Statistics declared that, for the June quarter 2004:

In seasonally adjusted current price terms, the balance on goods and services was a deficit of $5,974m. The deficit on goods was $5,484m, a decrease of $932m on the deficit of $6,416m in the March quarter 2004. Higher goods exports, up $3,258m (12 per cent), were partly offset by higher goods imports, up $2,326m (7 per cent). The increase in goods credits was driven by non-rural goods, up $2,362m (13 per cent), and rural goods, up $992m (16 per cent). The increase in goods debits was driven by intermediate and other merchandise goods, up $1,127m (9 per cent), capital goods, up $718m (9 per cent), and consumption goods, up $618m (6 per cent).

In seasonally adjusted volume terms, the deficit on goods and services was $11,341m, an increase of $264m on the $11,077m deficit recorded in the March quarter 2004. The
goods deficit rose $89m to $9,632m. Goods debits rose $1,047m (3 per cent) while goods credits rose $958m (3 per cent). The net services balance was a deficit of $1,709m, a $174m increase on the March quarter 2004 deficit of $1,535m.

The increase of $264m in the deficit on goods and services in volume terms could be expected to make a contribution to growth of -0.1 percentage points in the June quarter 2004 volume measures of GDP, assuming no significant revision to the GDP chain volume estimate for the March quarter 2004 [ABS (2004), ‘Balance of payments and International Investment Position’, 5302.0, Canberra, 30 August 2004].

The results for the period, which mostly encompassed the Howard government, are summarised in Figure 5 below.

**Figure 5: Current Account Deficit in Billion Dollars**  
*(June 1991-June 2004)*

![Bar Graph](image)


The current account problem has also been highlighted by, among others, Garnaut (2004). He warns, ‘In the May 2001 budget papers, Treasury forecast export volume growth of 5 per cent, said to be a
"little below trend". The next year's budget reported the outcome at minus 2 per cent. The same forecast for 2002-03 was 6 per cent. The reported outcome was zero. The forecast outcome for 2003-04 was again 6 per cent. The outcome was reported the next year as 2 per cent. So what do we make of the latest budget forecast of 8 per cent growth in export volumes? (Garnaut, 2004). The following figure shows that imports are growing continuously but not, perhaps, at an alarming rate (Figure 6).

**Figure 6: Australian Imports in Million Dollars**  

![Graph showing Australian imports from 1991 to 2004.](image)


Other issues remain but their resolution is more likely. Due to rent seeking pressure from the labour unions, public sector wages have often increased without a significant corresponding increase in productivity. The present national Coalition government has attempted to decrease the power of the unions, but its success was limited to the ports. The state public sector workers are presently beyond its control and under the jurisdiction of the Labor party, which runs all six states and the two territories. This political configuration will, of course, not last forever.
Some researchers have also highlighted the role of poor management practices developed in a regulated economy, although these are being addressed by the rapid expansion of business skills training, referred to earlier, and also by recruitment of foreign managers through migration or temporary residence, as is occurring. The inefficiencies can also be linked to the small size of the domestic market, which does not allow firms to appropriately exploit the economies of scale. Liberalisation and freer trade is of course intended to offset this. While high unemployment was only a major obstacle to economic growth during the early 1990s, recent evidence suggests that more children are now living in households, which still have no earned income (Dawkins, Gregg and Sкуletta, 2002). Also, sharp decline in the household saving ratio, starting in the 1980s but accelerating from 2002, is a major concern (Figure 7). It has been argued that the most recent growth in the Australian economy is “debt ridden”. A slowing down in the property market that started in 2003-2004 and the expected further increases in interest rate are likely to reverse this trend. A reduction in the tax burden of the middle income Australians (specially the wage earners) needs serious consideration.

**Figure 7: Household Saving Ratio (June 1991-June 2004)**

The trade deficit problem will likely not be solved unless there is a substantial increase in the export of high value added products. Free trade agreements (FTAs) with Singapore, China and the US may help in this regard. These FTAs and APEC are also expected to open up new markets that could favourably utilise Australia’s competitive advantage in natural resources. The small domestic market and the lack of technologically sophisticated market leaders does not provide for economies of scale nor scope. Most of the Australian exporters, particularly in the secondary industry sector, are small. In addition, these firms are generally perceived to be opportunistic and consider exports only when domestic markets are weak. Failure of the most recent round of trade negotiations under the auspices of the WTO and global security fears have contributed towards a push for bilateral free trade deals. Due to its location and regional technological edge, nonetheless, Australia may be in a unique position to take advantage of continuing economic growth in China and emerging strong growth India.

Microeconomic reforms are intended to improve efficiency thereby improving the competitiveness of the Australian firms. These reforms are intended to improve efficiency through increased domestic competition, which is also enforced by several pro-competition agencies. But such increased competition does not always help domestic firms to compete at international level. In many cases only large firms able to exploit economies of scale are able to compete with established firms. This means that in order to help its firms to compete internationally a country may have to allow small domestic firms to merge. In other words, government planning and support is required to encourage and facilitate domestic firms to better prepare for an increasingly competitive international environment.
Conclusions

In overall terms, during the past two decades, the Australian economy has registered a strong economic growth. This growth can be attributed to domestic economic policies as well as positive changes in Australia’s external economic and political environment. Australia has, after deregulation, experienced some transitional difficulties in an attempt to develop from being a highly regulated domestic economic environment to a more flexible and efficient one. The spread of SARS during 2003, a significant surge in the value of the Australian dollar during 2002-2003 and the war in Iraq have contributed to what may be a short term worsening of the current account deficit. The current account deficit has been exceptionally large during 2002 and 2003.

The current account deficit and the rising level of consumer debt, stand as the most important obstacles to Australian economic growth in years to come. While the high level of consumer debt is being viewed as unsustainable and hence undesirable, it nevertheless has been closely linked with the continued strong economic growth in Australia. The housing boom, driven by rebates from the government and low interest rates as the Commonwealth retired debt, and the increase in exports, due to significant currency depreciation during 1997-2002, helped the economy to grow while other major economies were struggling. With the deliberate slowing down of economic activity in the property market, the government would have to find some new impetus for continued economic growth in Australia.

Steps in this direction have already been taken in the form of a free trade agreement including with the US. Recent studies have indicated that economic integration with the US and Canada has resulted in insignificant gains to Mexico. Australia tried, unsuccessfully, to become a member of ASEAN and then to deepen the embrace of APEC. The Asian financial crisis of 1997-98 reduced the attractiveness of ASEAN, and the September 2001 attacks in the US
appear to have significantly reduced the effectiveness of APEC. Australia has completed free trade agreements with New Zealand, Thailand and Singapore. The free trade agreement with the US has passed the hurdle of legislative approval, and formal talks with China on a free trade agreement are likely to start soon. After some hesitation, the Chinese authorities appear ready to conclude a free trade deal within a year.

Industrial relations and tax reforms are steps in the right direction. Increase in private sector business investment in recent years is likely to make a significant contribute to continued economic growth. The impact of a steep increase in the price of oil seems to have been largely cancelled out by the decline in the price of imported manufactured goods. Continued economic growth has in recent years delivered larger than expected budget surpluses that could be used to finance the cost of tax reforms and infrastructure upgrade.

The external environment is likely to further improve with the early signs of recovery in the Japanese economy and invitations to meetings of the ASEAN in the aftermath of a change of leadership in Malaysia. Terrorism threats in the region could, of course, offset some of the positive changes in Australia’s external environment.

During the past decade, Australian economic growth has been largely driven by growth in the domestic market. Growth in the next decade is more likely to be driven by growth in trade, particularly with China and possibly India. The Chinese economy has been growing at a phenomenal rate of around eight per cent, but domestic factors, the unresolved issue of Taiwan and recent steep increase in the price of crude oil can hamper future economic growth. India now appears to be in the early stages of a strong growth trajectory. The formation of a minority government and unresolved border dispute with Pakistan and China can hinder Indian economic growth.

While Australia’s external environment appears to be most promising, this can change quickly. Therefore it cannot rely alone on
export growth to regional markets. Externally it should continue past practice of flexibly pursuing export opportunities as they arise. At the same time continuing steps must be taken to improve overall productivity, retain economic flexibility and maintain public sector savings and increase the level of household saving in Australia.

NOTES

1. The authors are extremely grateful to two anonymous referees for value comments and suggestions that led to a significant improvement in the quality of this paper. All remaining errors and imperfections are the sole responsibility of the authors.

2. The Australian dollar had appreciated from approximately 50 US cents to 80 US cents. At present, the Australian dollar is hovering around 74 US cents.


4. Pitchford (1991) argues that large current account deficit may not be bad for a small economy like Australia. He also argues against government intervention except for exceptional circumstances.

5. This report was commissioned not as a direct response to a serious macroeconomic crisis but more as a critical assessment of the effectiveness of the evolution of the Australian Financial System. The report questioned whether interventionist government policies successfully achieved their economic aims and whether allowing the financial markets to become less regulated and more responsive to market forces would be a more effective way of achieving these goals. The Report suggested a decrease in government control and argued that over-regulation would produce inefficiencies that would subsequently be disadvantageous to Australia (see Perkins, 1982).


8. Deregulation affected the financial sector in a number of ways. For example, prior to deregulation banks were only permitted to charge for the debt facility, which the use of credit cards offered, but not for the transaction facility. Consequently, the costs associated with the provision of the transaction facility were borne by the users of the debt facility in the form of higher interest rate charges. Following the deregulation, the banks were able to reduce the cost to consumers using the debt facility and transfer the charges to the users of the transaction facility. Since a charge was introduced to a service that was previously free and there was no longer a need for the subsidisation of this service by the debt facility users, the interest rate for this service was reduced. Another example of the user pay and allocation efficiency consequence of deregulation was the experience in the rural areas of Australia. Under regulation, banks were expected to service rural regions for a fraction of the cost. This meant again that banks were subsidising these branches from the more profitable urban areas. With the advent of deregulation and subsequent new entrants to the more competitive market, it became increasingly difficult to continue this practise. Deregulation has also resulted in closing of branches in many of the rural regions.

9. Bloch and McDonald (2001) have shown that an increase in import competition has resulted in an increase in productivity of the Australian workers. Mahadevan (2002) has argued that trade liberalisation has contributed to an improved technological progress in Australia.

10. For a recent discussion of the impact of the GST on inflation in Australian capital cities, see Valadkhani and Layton (2004).
11. Schmidt (2003) while examining the impact of tax reduction on savings and investment in Australia concludes that the potential benefits of tax changes are limited.

12. For a detailed discussion of the rationale for funding of higher education in Australia, see Harrison (1997).

13. Quiggin (1998) and Catley (2001) when comparing with New Zealand argue that the Australian reforms were less radical and have resulted in much better outcome.

14. Withers (2002) argues that immigration has played a significant role in reducing the growth of social expenditures in Australia.

References


