



Worth Noting

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Worth Noting is the journal of research and conferences company L21. It is focused on issues of relevance and interest to senior executives.

Imagining Australia: Ideas for our Future (Allen & Unwin, 2004) is written by four young Australian recent Harvard graduates.¹ Designed to be a book that presents a series of ideas and arguments to base future Australian policy from the economy to foreign affairs to Australian identity, *Imagining Australia* was official launched in Sydney last week.

Receiving strong reviews from political identities such as Mark Latham, Bob Carr, Julia Gillard and Nick Greiner, journalists such as Paul Kelly from *The Australian* newspaper and Phillip Adams, High court Judges such as Justice Kirby and former Chief Justice Mason, policy leaders such as Allan Fels and Allan Gyngell and personalities such as Peter Garrett, Cathy Freeman and Steve Vizard, *Imagining Australia* has made a notable splash as a thought provoking and challenging book about issues facing Australia. In the last few weeks, the book has been featured on TV programmes such as the *Today Show*, on radio programmes on the ABC, SBS and 2GB, and in print media such as *The Australian* and *Sydney Morning Herald* newspapers. Although released in the shadow of an impending Federal election, the book is designed to be a look at issues unencumbered by ideological baggage or rhetoric.

It has been brought to out attention that a couple of the authors of *Imagining Australia* are current subscribers to the L21 *Worth Noting* periodical and for this edition, we thought it might be interesting to offer a survey of some aspects of the book.

¹ MacGregor Duncan, Andrew Leigh, David Madden & Peter Tynan.

We clearly do not have enough time to go through all aspects touched on by *Imagining Australia* and will limit our review to Chapter 4 of the book. This chapter is entitled 'Sustaining Growth and Prosperity'.

Imagining Australia: 'Sustaining Growth & Prosperity'

The chapter begins by making the frequently noted observation that on a per-person basis, there are only a handful of countries in the world that are wealthier than Australia (U.S., Canada, Japan and some Western European countries).

This fact is obvious and needs no further argument here. However, the authors then go on to argue that:

“...until the 1980s, the history of the Australian economy was a disappointing tale of relative decline and missed opportunity.” (p. 137)

Why? The authors go on to argue that:

“In 1870, the Australian people were the richest in the world ... But by the 1960s, we had slipped below the average. Although Australian was still prosperous throughout this period, we were declining in relative terms ... In the early 1970s, the structural weakness of our economy became painfully apparent. Following the 1973 oil shock, inflation hit 13 percent, and unemployment became a serious problem for the first time since the Depression. By the early 1980s, it was clear that Australia needed a new economic approach.” (pp.137-8)

We do not dispute this characterization up to here. The above observations are well supported by objective data. Even though many nostalgically look to the 1950s as the high point of our national economy, we have indeed been in decline since the turn of the century. Our research suggests that Australia was at her relative peak in the last two decades of the 1800s.

What does *Imagine Australia* say happened in the 1980s and why did the Australian economy take a turn for the better?

According to the authors, old notions of economic management were replaced by the philosophy of economic liberalism. In terms of actual policy changes, several key things happened:

- The dollar was floated in 1983 and the financial sector was opened to international competition.
- Trade barriers were gradually dismantled, with sector specific plans for the textile, steel and car industries.

- There were attempts made to widen our production base beyond mainly agricultural and mineral commodities – most notably summarised by Keating’s ‘Banana Republic’ speech.
- Backed by an economic liberalisation philosophy, important microeconomic reforms took place: deregulation of the telco and airline sectors, establishment of the ACCC clamping down on anti-competitive practices, inserting more flexibility in labour and industrial laws, and so on.

The authors then argue that largely due to these economic changes, the path was paved for the prosperity of the 1990s where real GDP per person grew at an annual average of 2.4 percent. At this rate, the standard of living in terms of real GDP of the average person doubles every 30 years.

We do not wish to question in detail the broad arguments made up to this point. Perhaps the only comment we would add at this point is that in the 1990s, Australia was riding a wave that was largely not of our own making – the U.S. led global boom, the rise of real productivity improvement from technology advances, the boom in Asian economies etc. We do accept that the reforms in the Australian economy in the 1980s put our economy in a much better position to take advantage of these opportunities. That said the position presented by the authors up to now is quite an orthodox and uncontroversial one.

What gets interesting and gives us food for thought are the arguments made in *Imagine Australia* as to the lessons learnt and the course we should steer following the boom of the 1990s.

‘Sustaining Growth and Prosperity’: Lessons learnt

The authors argue that the main lessons learnt from the experience of the 1980s and 1990s are as follows:

a) *The success of economic rationalism*

This really means the success of liberal economies. The historical context prior to the policies of the 1980s and 90s are important.

“Following Federation, a rigorous debate ensued between the Victorian protectionists and the NSW free traders. By the end of WWI, the protectionists had prevailed. Tariff walls were raised around manufacturing, and Australian industry remained sheltered from the outside world for the next 60 years. When commodity prices slumped during the Depression, Australia was hit harder than most other nations ... Geographic isolation and industry protection proved a devastating combination.” (pp. 141-2)

The authors make the point that no small nation has ever become rich from isolating itself from the rest of the world. Economic history between developed economies clearly supports this point.

b) Leaders must be successfully selling the message of economic rationalism

The authors point to a debate in Australia regarding the merits of 'economic rationalism' You don't have to go to a university to hear this debate going on. It is current in any social circle that talks about broader economic policy.

Critics of 'economic rationalism' have come from all sides: obviously from the far left of politics to the right including figures such as Malcolm Fraser and Pauline Hanson.

Arguments are sometimes also made that ordinary people consider 'economic rationalists' as a ruthless and uncompassionate bunch of people. To rework an old cliché, 'economic rationalists' are those people with maybe a mind but without a heart. For example, the authors point to a survey by Michael Pusey published in 2003, a critic of 'economic rationalism', of about four hundred Australians. Pusey concludes that "public opinion in middle Australia is holding out against economic reform."

What is interesting about this survey by Pusey is that asked about their own position, about one third of Australians believe that they have been losers from "fifteen years of economic change" and nearly two thirds believe that "ordinary people have lost out." What is notable is that when surveyed about Australian economic policies from 1945-85 (when in relative terms we lagged behind the rest of the developed world), supporters outnumbered opponents of policies in this period by five to one. There appears therefore to be a persistent myth about Australia's 'golden age' in the 1950s.

The lesson here is that despite the advances made in making the Australian economy more resilient from the mid-1980s onwards, there is a perception that 'economic rationalism' makes the rich richer, not Australians richer as a whole. Indeed, in what editor-at-large at *The Australian* newspaper Paul Kelly calls the "great deceivers", academic and intellectual commentators outside specifically businesses circles frequently reiterate a return to increased regulations, higher tariffs and barriers for foreign investment – in other words, a return to the mythical 1950s when all was seen to be good. Incidentally, the rejection of economic rationalist has close ties with the perceived rise in globalization and the discomfort many feel about economies becoming more global.

This is despite global trends where even traditionally large government countries like Sweden have moved to deregulate their economists.

The authors point to a failure by politicians and leaders to explain what 'economic rationalism' means, why it promotes growth, and how growth is necessary to underpin greater public goods and compassionate initiatives in any modern economy. Citing the examples of Paul Keating and John Hewson in recent times as exceptions, the authors argue that Australian leaders from all sides of politics have had a poor record of detailing economic reforms and economic visions for the country to people.

This seems from our research to be correct. There is plenty of examples where leaders speak about objectives (ie., 'no child in poverty'), but few examples where attempts were made to explain processes and reforms and why they matter.

In this context, the authors make the point that should politicians and policy makers fail to explain to Australians why and how 'economic rationalisation' took place, and why liberalization is not merely a philosophy for the rich to get richer, the process of continual liberalisation of our economy will be stalled.

'Sustaining Growth and Prosperity': Further policies and reform

a) *Multilateral free trade*

For the authors, free trade must continue. Despite the protestations of protectionists several decades ago, data indicates that as a result of more open trade policies, consumers are at least \$6.6 billion better off per year than they would have been if trade barriers at 1983 levels still operated.

Moreover, in a relative sense, the biggest beneficiaries of more open trade had been poorer Australians. The average Australian family spends about \$1000 less per year than they would have otherwise if barriers had not been removed.

The authors argue that the future ahead should be through multilateral free trade agreements. Where we differ with the authors is that the authors argue bilateral trade agreements (ie., the U.S.-Aust FTA) bucks the operation of effective multilateral free trade deals. Our research shows this not to be the case (WN, Volume IV, Issue III.) Briefly, the operation of multilateral FTA's is an imperfect and sometimes inefficient ones and bilateral FTA's can be tailored to extract greater benefits for countries.

b) *Foreign Investment*

The authors argue that foreign investment should be encouraged because foreign capital jumps in where national savings is insufficient to provide capital or where risk takers cannot be found for potentially fruitful ideas – contrast with the Dick Smith approach.

We could not agree more (see WN, Volume II, Issue III). For example, Australia's R&D spending and investment in innovation is abysmal when compared to global leaders. Only in a few industries such as biotechnology do we have proud records. Without foreign investment, where our saving levels of 18% are significantly lower than the OECD average, monies to invest in innovation from within Australia is not enough.

c) Fiscal policy reform and flexibility

Just as the establishment of an independent Reserve Bank to set monetary policy (interest rates) was crucial to promoting stability, the authors argue for an independent fiscal policy authority with limited control of fiscal policy. The government would still decide the big-picture fiscal issues such as where monies should be spent and how progressive a tax system we should have. But the independent authority would be given the power to adjust, say, tax rates up by one or two percentage points to smooth the economic cycle.

This has the advantage that small changes can be immediate (as small changes will be discretionary and there is no need for new legislation) and such changes would not be a result of political motives of the government in power.

This is not as radical a proposal as it might seem. Establishing an independent monetary authority was a much more radical move since under this proposal, the government still dictates the general rates of taxation and spending. The independent authority does the technical tinkering only.

d) Bankruptcy law reform

The authors cite the example of Ansett and United Airlines. Both filed for bankruptcy. United is still flying; Ansett is not. Why?

The authors give the following prelude:

“Like eucalyptus seeds which germinate following a bushfire, bankruptcy is part of the creative destruction process of capitalism. Companies are formed when a market opportunity opens, and wither when the opportunity closes. ... The result is a continuing cycle of innovation and improvement. But amidst creative destruction, we should ensure that companies are not prematurely forced to close.” (pp. 158-9)

Back to the airlines, Australian insolvency laws operate as follows. When an Australian company becomes insolvent, they have two choices: liquidate or attempt a reorganization of the company's operations and finances to pay creditors.

When a company enters into voluntary administration, the directors and management relinquish control of the business to a professional insolvency administrator who is usually an accountant or a lawyer. A moratorium on creditor collections is authorized while the administrator investigates the company's ability to pay the debts. Within one month, the administrator must tell creditors whether the company should continue trading, enter into an arrangement to reschedule debts or be liquidated.

For SMEs in Australia, this seems to be an effective regime. But for large companies like Ansett, voluntary administration may not be timely or flexible enough to help companies recover. One month is not a long time to decide the best course for a large company with complicated problems. In this context, at the end of the month, administrators at Ansett decided to liquidate and Australia's second largest airline sunk; and with it 3000 jobs.

The options for U.S. company United were different. Board-led reorganisation is the central feature of Chapter 11 of the U.S. Bankruptcy Code. When a company becomes insolvent, the directors petition for temporary relief from creditors and directors themselves formulate a plan for reorganisation. Significantly, they are allowed 180 days (not the 28 days in Australia) to work out a payback schedule with creditors. If most creditors accept the plan, the court will approve the plan and the company declared free of bankruptcy.

The main advantage of the U.S. provisions is that in the Australian scenario, bankruptcy is a plan of last resort. Control is ceded to outside, independent administrators who have professional skills, but maybe not business minds. In the U.S., because directors retain control following a bankruptcy declaration and there is more time allowed in which to work out a plan of reorganisation, companies are far more willing to declare bankruptcy at an earlier stage where the horse may not yet have bolted. The options available are far more attractive for a proactive approach in the U.S. Businesses may retain or change management, appoint an administrator or appoint a turnaround specialist. Turnaround specialists go beyond strict insolvency frameworks to effect turnarounds of businesses – something much more prevalent in the U.S. and almost non-existent in Australia.

While we do not believe this process always leads to the resurrection of companies and can allow companies to over-promise on payback schedules to creditors (see WN, Volume IV, Issue VII regarding United), we believe such a process allows companies in trouble a greater chance of recognizing their problems early and rebuild to suit new market environments. As the authors argue, this is part of the process of the fall and rise of companies. There is no doubt that a more flexible insolvency regime would have allowed Ansett to continue to fly for some time and perhaps even HIH to honour many of their policies.

Imagining Australia: 'Innovation'

The authors end the chapter with emphasizing the importance of promoting innovation, R&D and a culture of entrepreneurship and risk taking in our business culture.

Suggestions include channeling the \$7.3 billion in government handouts and tax breaks toward businesses and industries that specifically promote job creation and innovation. This might seem obvious but there is in fact very little thought given to businesses and industries that receive these benefits. Decisions are more generally made in order to stem immediate job losses, or are based on populist (i.e., major sporting events) or political reasons.

Little thought is also given to the role governments play in creating 'clusters' of successful businesses that promote the rise of globally successful industries. Silicon Valley is an example of a successful cluster in technology. The Australian wine industry is another.

Various editions of *Worth Noting* (e.g. WN, Volume II, Issues III-IV) have emphasized the importance of innovation and the comparative weakness of our innovation spending, culture and environment in Australian business. The emphasis on practical initiatives to promote innovation that governments can lead is something we would support strongly (bearing in mind that we believe governments can aid and promote innovation but industry are still the drivers of it.)

Conclusion

In this edition, we have only touched on one chapter of *Imagining Australia*. *Imagining Australia* is a highly readable and thought provoking book on several higher level issues. There are other interesting chapters, albeit in our opinion more controversial and sometimes contestable ones, on topics such as Australian identity, social policy and foreign policy which we have left alone.