

**EQUITY AND AUSTRALIAN DEVELOPMENT: LESSONS
FROM THE FIRST CENTURY**

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1. Equity and National Development

In the early years of its Federation, a century ago, Australian society was discussed more amongst the world's people who read and write and talk about ideas than it is today. It was discussed above all for its high material standards of living, its near-universal democratic franchise, its high wage levels, and its utilisation of an unusually wide range of government business enterprises and interventions in the economy. Australians themselves defined what was special about their country first of all in terms of high standards of living and rights and dignity of ordinary citizens. The white Australian majority almost invariably excluded from the national definition people of Aboriginal, Asian and Pacific Island descent (these being the limits of contact for all but tiny numbers). Women were included in some male definitions of the national community (the right to vote, a couple of decades before Britain or the United States), but not others (participating in employment at the high Australian wage). An egalitarian edge to the democratic character of the polity was strengthened further in the 1920s by the adoption of compulsory voting.

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White Australians' confidence in and enjoyment of these characteristics of their country were qualified by occasional realisation or fear that they were vulnerable to large outside forces that were beyond the control of a country with a tiny population (three and three quarter million at Federation, or about as many people as in Queensland now) occupying a large land mass on the edge of the teeming populations of Asia. Australians mostly thought of themselves as a British people, challenged from time to time by the imperial ambitions in the Southwest Pacific of the enemies of Britain in continental Europe, by the rising power of Japan, and in unspecified ways by the people who did not share Australian standards of living or culture or democratic organisation in China, Southeast Asia and India. Disrespect for Britain with its traditions of non-democratic privilege, and recurrent anxiety that Britain would trade Australia's hopes for its own imperial interests, were tempered by acceptance that Britain was for the foreseeable future the insurance against the great external dangers. Australia needed more people and a bigger economy to hold its material and political assets, and this, together with a sense that growing communities could enjoy higher standards of many kinds of public consumption that were highly valued, made national development a comfortable adjunct of White Australia's egalitarian democratic self-definition.

At the time of Federation, the Australian self-definition in terms of a high and democratically distributed material standards of living and commitment to national development was greatly affected by the recent experience of a great financial crisis. The Depression of the 1890s was the Australian version of the crisis that came upon the rapidly growing economies of Southeast Asia in the late twentieth century. The Depression was seen as having come to Australia from world markets for goods and capital, challenging and for many people temporarily defeating the high material standard of living. By the early twentieth century, these forces from the global economy were amongst the elements against which Australians saw their possessions as needing protection. This recent experience helped to shape the young Australian

Federation's development of the instruments through which it would pursue its goals of national development with a high and (amongst adult white males) egalitarian distribution of income. It tipped the balance in favour of a national policy of trade protection and rigid regulation of minimum wages by occupation for adult white males. It sharpened the pressures towards definition of a White Australia in terms that went beyond the general racial prejudice that was a strong influence on immigration policy in other countries of recent white settlement in North America and across the Tasman in New Zealand. (South Africa made a different racially prejudiced choice, in favour of the comforts that could be obtained from an abundance of non-white unskilled labour).

Australian egalitarianism, and acceptance of use of the power of the state to pursue economic objectives, was eventually influential in many aspects of national life. The egalitarian and regulatory instinct affected relative levels of wages across States, the allocation of public goods and services of many kinds, and rates of economic development amongst regions. An industry or a region that was damaged by one of the primary egalitarian policies (for example, tariff protection or national wage regulation) could appeal to a national sense of fairness for compensation. Hence tariff protection to compensate once-competitive manufacturing industry for protection of other industries; "protection all round " to compensate rural industries for manufacturing protection; and fiscal compensation to the smaller States to compensate for the costs of protection to manufacturing industry in the large cities.

The attempt to use the power of the State to insulate the domestic standard of living, and to promote the ambition for national development, in the face of external dangers, was taken progressively further through the first third of the twentieth century. It came under some domestic challenge in the late nineteen twenties, as disappointment grew at the limited progress in national development. There was a larger trickle of southern European labour in the late 1920s (with a political response that it was not-quite-white); some questioning

of the tradition (emerging from the Harvester Judgement of 1907) that family welfare was promoted best by high adult male wages and not by family payments; a review of the costs of protection in the celebrated "Brigden Report" (which concluded that some protection was helpful to national development at the high Australian wage but that it had been taken too far); and the Bruce Government's fateful attempt to abolish the Commonwealth Arbitration Court. These challenges were swamped by the extreme problems of the Great Depression, seen then and after as having international origins. The questioning from an internationalist or analytical economic perspective ceased, and the average level of tariff protection was taken to its greatest height by the Scullin Government in 1931. Efforts were made to maintain the real wage levels that had been entrenched by regulation from the time of the Harvester Judgement in 1907. Violent community and responsive electoral reactions stopped the experiments with higher levels of non-British, European immigration, although there were occasional acts of humanity in relation to refugees.

The Great Depression therefore ended one line of questioning of the established Australian approach to maintaining high egalitarian standards of living and national development. However, the extreme social distress of the time, and the security crisis that followed, led to pragmatic moderation of policy in many areas, within the broad approaches first adopted in the early twentieth century.

The moderation overlapped with the final intensification of Australian regulatory isolationism. The Scullin Government's "Premier's Plan" applied conventional economic wisdom in a way that gave more than lip-service to the Australian sense of distributive justice. Nominal wage cuts and more importantly the Lyons' Government's devaluation of the Australian against the British pound were important among the reasons why Australia's path out of Depression was more rapid than that of other deeply affected democracies.

Devaluation provided a context for some small reductions in protection (Chart 1). Family payments introduced during the late 1930s began the loosening of the connection between wages and the welfare of families.

Beyond policy decision, the crushing economic and social pressures of the Great Depression weakened the occupational segregation by gender that had supported wage discrimination under the Harvester Judgement. Women's employment (at about 40% of the male wage) extended into previously male domains, and in total was maintained in a shrinking economy, while male employment declined dramatically. The female dimension of the labour market story of the Great Depression is so far from Australians' conventional understanding of their labour history that it is seldom told. The same Harvester Judgement pattern of wage regulation that made the Great Depression particularly severe in Australia, caused unemployment to be overwhelmingly a male phenomenon. For women, it began the walk towards labour market equity that was only partially reversed before the Second World War created opportunities for its extension (Chart 3).

The softening of the early regulatory isolationism was extended in the immediate post-war period by the elaboration of the early "welfare state", and by a long period of wage moderation in the context of the new welfare state, supported politically by and rendering feasible the Government's unequivocal commitment to full employment. This was an early and less formal version of the 1980s "Accord", when labour's acceptance of wage moderation in the national interest helped to reconcile centralised wage determination with strong employment growth and reasonably strong growth in economic output. In turn, full employment joined the over-riding imperative of population growth in supporting acceptance of large-scale European immigration from outside the British Isles.

By the mid-1960s all elements of what might be described as the original Australian regulatory isolationism were under intellectual and political challenge.

The final third of the twentieth century, the years from 1966, began with halting steps towards reform of the old Australian system. The various strands of policy reform coalesced into coherent movement towards greater international orientation and acceptance of a larger role for markets in economic activity after 1983.

The history of the period after 1983 was and is seen by some as a comprehensive retreat from the values and policies through which Australians in the early Federation had primarily defined their nationality. There was certainly a retreat from the policies of the early Federation. White Australia had given way by the 1980s to large-scale, racially non-discriminatory immigration. Prime Minister Hawke's Economic Statement of March 1991 announced the reduction of tariff protection to below the low levels in place at the beginning of the century. Considerable flexibility in wage determination was introduced under the Labor Governments and extended by the Howard Coalition after 1996. In wages policy, however, neither the shift nor the extension extended to "safety net" minimum wages, which after a period of moderation within the Accord rose more rapidly in real terms in the last 5 years of the century than over any comparably long period from the original adoption of the Harvester Judgement approach, excepting only the years of the Whitlam Labor Government in the mid-1970s.

There was no retreat in the period of internationally-oriented reform from the early Australian commitments to equitable distribution. The Australian compulsory-voting democracy required market-oriented reform to be taken forward within wider policies that acknowledged traditional Australian concern for equitable distribution. The considerable expansion of access to

upper high school and tertiary education in the 1980s and early 1990s, the re-introduction in slightly modified form of the Whitlam Government's Medicare and a series of income taxation changes that generated benefits to wage-earners were important to the Labor Government's capacity to win the acquiescence of the trade union movement and wider community in wage restraint and internationally-oriented reform of industry policy. There were large additional social security payments to low-income families with children in the late 1980s, and further increases in these and other social security payments under the Coalition government late in the century.

On the old goal of population growth as an element of national development, the signs in the 1990s and since have been more equivocal. Levels of migration since the 1990-91 recession have been lower than in the 1980s, and there has been more open challenge to cultural and racial tolerance and diversity. The Premier of New South Wales, Bob Carr, emerged as the first major Australian political figure to favour stagnant or declining population, in his case on environmental grounds. These issues have not yet played themselves out in the political market place, although the announcement of higher migration targets from 2002 suggested re-commitment to longstanding Australian approaches.

2. A Good End to a Fairly Good Century: National Development

How well did Australia perform on its hopes for national development through the three periods with distinctly different approaches to regulatory policy in the twentieth century?

Population grew strongly through the century, more than in any of the countries that are now rich (see Chart 4 for comparison with the United States). In the later decades of the century, Australia, with the United States and Canada, was one of a small number of developed countries that still had significant population growth in an era when fertility was well below replacement levels.

In the first third of the century, when the system of regulatory isolationism was being installed and taken to its greatest extent, output per person grew more slowly in Australia (and the United Kingdom) than in any other of the countries that are now rich. Australia was a poor to middling performer through the second trimester of more moderate application of the policies of the young Federation. Australia's performance relative to other developed countries was strong through the third trimester of internationally-oriented reform, rising to top place in the decade after the 1990-91 recession (see Charts 5 and 6 for comparisons with the United States). Despite higher Australian GDP growth in the last decade of the century, employment growth was stronger in the United States (Chart 7).

Relatively low growth in output per person through the first two trimesters removed the superiority of the standard of living in which Australians had taken pride early in the twentieth century. This slide down the world league table was one of the spurs to radical policy change. Australia's average output began to rise relative to all rich countries in the third trimester when comparison is based on domestic purchasing power, but only against some by other measures.

The most common measure of average output for comparison across countries is GDP per capita as revealed in the national accounts, converted into a common currency at exchange rates in the year under consideration. This measure is relevant to assessment of relative international purchasing power, and to some extent locational decisions by people whose financial or human capital gives them choice on country of residence. By this measure, Australia continued to lose ground relative to the United States even in the 1990s.

The explanation of the divergence between the two measures is the large depreciation of the Australian real exchange rate relative to the United States

over the last decade. Australian currency was weak relative to the United States dollar through the twentieth century (Chart 8). For the most part, the weak currency was matched by higher Australian inflation, so that there was a much smaller fall in the real exchange rate. A large part of the century's fall in the real exchange rate was concentrated in the last decade.

What is the cause of the long-term nominal and the less pronounced real depreciation of the Australian dollar? Does it matter, and is it likely to continue?

For the most part, the nominal depreciation has been associated with high inflation. The ultimate cause of the long-term inflationary bias in Australia has been the combination of downward inflexibility in wages and to a lesser extent other prices in combination with volatile terms of trade in an economy more reliant than other developed countries on exports of primary commodities. In the 1990s, broad support for Central Bank independence around low inflation targets, greater price and structural flexibility in the economy and more diverse exports weakened the long-term tendency towards relatively high inflation and therefore nominal exchange rate depreciation. High inflation damages real economic performance if it goes beyond moderate limits, and the monetary caution that is necessary to stay within those limits is costly to output through the period of contraction.

The real depreciation of recent years may be partly explained in terms of an unsustainable strengthening of the United States dollar. While the strong dollar lasts, Americans, like Japanese in the late 1980s, have exceptionally high international purchasing power. One consequence is an enhanced capacity to buy Australian business assets, which has generated unease in the Australian business community and to some extent in the wider society. Even if there is a substantial 'bubble' in the current value of the United States dollar (and no-one can know for sure except as history), it is likely that an element of twentieth

century and probably of post-1990 real depreciation would remain after the bubble bursts. Over the first two trimesters of the twentieth century, the decline in relative output per person and wages in Australia contributed to the real depreciation. Over the century as a whole, the long-term decline in terms of trade (export relative to import prices) was a significant cause. Over the past one and a half decades, real depreciation has reflected as well the removal of the tendency for protection and exchange controls artificially to raise domestic relative to international prices. Each of these factors had run its course by the beginning of the twenty first century, making it more likely that the long-term real depreciation would also be coming to an end.

The comparisons of economic performance with the United States in this paper are a tough test, since the U.S. was a relatively strong performer through the century, and had one of its strongest decades in the 1990s. Comparisons with other countries that are now developed demonstrate more strongly Australia's relative underperformance on output per head in the first (although less so against Britain) and second trimesters, and its relatively strong performance in the third trimester and especially in the 1990s.

Factors other than the suitability of policy for growth affected relative economic performance. The high intensity of external trade with slowly growing Britain through the first and to a lesser extent the second trimester was a drag on Australian performance through these periods, and the increasing and high intensity of trade with rapidly growing East Asia in the third trimester favoured Australian growth (Chart 9). But an element of the strong orientation of trade towards the United Kingdom in the first two thirds of the century reflected discriminatory policy. The preferential trade area with the British Empire intensified in the 1930s, and discriminated against other Asian economic partners, most notably Japan. Its dampening effects on trade beyond the British Empire must be marked against the policies of the time. The greater orientation towards East Asia later in the century partly reflected the removal

of tariff and exchange control discrimination, as well as public trade diplomacy to open markets in East Asia, and private investment in building productive trading relationships in Australia's neighbourhood.

It might be argued that the strong concentration of Australian exports in farm and mining products, subject to declining prices relative to other goods and services throughout the twentieth century, was a smaller disadvantage after the late twentieth century diversification of exports (Chart 10). This argument would ignore the extent to which the rapid growth of manufactured and services exports from the mid-1980s was caused by the greater international orientation of policy, including the reduction of the real exchange rate following the dismantling of exchange controls and protection.

One significant influence on the comparisons of economic performance over the first trimester was the decimation of Australian youth and the build-up of foreign debt in the First World War. In explaining relatively weak British economic performance after the Second World War, much is made of the effect of destruction in Britain during the Second World War on post-war British economic performance. The proportionate Australian loss through death and injury (overwhelmingly prime-age males in the awkward language of labour economics) in the First World War, was much greater than that of the British in the Second World War.

3. A Fairly Good End to A Fairly Good Century: Equity

The Australian concern for "equity", and pragmatic acceptance of a large role for the State in its pursuit, was the focus of much international interest in the country at the beginnings of the Federation. The important place of equitable distribution in national goals had origins in the scarcity of labour, high average incomes and the early democracy that went with them, as well as in distinctive features of the early Australian economic structure. It has survived the twentieth century. No important policy change is feasible if it violates broadly

supported conceptions of equity, whichever of the major political parties exercises executive power. The concern for equity may be less central to national objectives in Australia than in a number of European democracies. But it remains much more important in Australia than in the principal comparator in this paper, the United States.

There have been changes over time in the categories of people amongst which the Australian polity has sought equitable distribution. Closer inspection reveals an unusual focus on "horizontal" (similar treatment of people in similar positions in the society), rather than on "vertical" equity (pursued by measures that raise the circumstances of people with lower incomes and wealth relative to those with higher incomes and wealth). The priority of horizontal equity has been modified over a century of democratic practice in Australia, but continues to be uncritically accepted in many areas.

Thus the original focus of the Harvester Judgement wages system was on equitable treatment of employed, adult, white males. The Arbitration system went on to develop an elaborate and rigid set of relativities across skills and industries: if a Grade 2 sawmiller received X% of the wage of a Grade 1 train driver in one decade, X could only be different in much later decades if the Court accepted after long argument that changes in the relative skill and other content of the jobs provided good reason for it.

Over the twentieth century, mainly in the later decades, the focus on horizontal equity across the employed was extended at least nominally, and over time increasingly in reality, to all Australians. This required extension of the centralised wages system to women, and to Aborigines and other non-Europeans. By the late 1970s all employed Australians had been brought within the Arbitration system's conception of horizontal equity. The breaking down of the gender and racial segregation in the labour market which had been a necessary support for wage discrimination began earlier (at least for gender,

under economic pressures in the Great Depression as discussed above) but is taking longer to complete.

The pursuit of horizontal equity amongst the employed reduced focus on other measures to raise the economic welfare of families. It also delayed development in Australia of the welfare state behind the high-income democracies of Europe. Through the first half of the twentieth century, an employed adult male received a wage that was supposed to meet the costs of supporting a wife and (variously in different formulations) two or three children, and an employed woman with children was supposed to make do with what was necessary to support a single woman. The family income supplement and its successors from the late 1980s greatly expanded recognition of the different circumstances of families with children. The later developments were the most important reason why the real living standards of the poorest 20 per cent of families rose in Australia, when they were falling in other developed countries through the global structural changes of the late 1980s and 1990s.

A second implication of the focus on horizontal equity through most of the twentieth century was to downplay the effect of unemployment. There were exceptions, in the policies for recovery from the Great Depression embodied in the Premiers' Plan and the early years of the Lyons Government, the full employment policies of the post-war Chifley and Menzies Governments, and the period of the Accord under the Hawke Government (the early progress on which was broken by mismanagement of monetary policy leading to the 1990-91 recession). The exceptions required and received in varying degrees cooperation of organised employed workers in wage restraint, in the context (again in varying degrees) of other policies directed at vertical equity.

One consequence of the extension of "wage equity" to young people, women and Aborigines was to increase the importance of unemployment amongst these groups. In the first half of the twentieth century, unemployment

was substantially higher amongst adult, white men than other Australians. Through the final two decades of the century, unemployment was much higher amongst young people and Aborigines than other Australians, and higher for adult women than for adult men. Given the extension of wage regulation beyond white adult males, increase in the burden of unemployment on other Australians would have been greater if it had not been for the weakening of gender and racial segregation in the labour market.

The concern for horizontal more than vertical equity is part of the explanation for the exceptional unimportance of taxation of wealth (as distinct from income) in Australia, relative to other developed countries, including the United States and Japan in the Asia Pacific region. The abolition of gift and probate taxes in the 1970s and 1980s passed with little comment about its effects on equitable distribution, just at the time when the reduction in average family size and increases in average life-time accumulation of wealth were beginning to make differential inheritances a much more important source of future inequality in income as well as wealth. Until 1985, Australia was one of a small number of developed countries (with the United States amongst the large majority) that had no capital gains tax. The severity of the Australian capital gains tax was reduced (and the opportunities for avoidance of income tax by many people on high incomes simultaneously enhanced) in 2000 with little Parliamentary and community comment.

The policies of "protection-all-round" owed a great deal to the Australian concern for horizontal equity. Tariff protection for manufacturing industries and fiscal subsidies of various kinds had a large and inequitable effect on the vertical distribution of income, but were broadly accepted as being fair to the extent that they seemed to be applied equitably across producers of various goods.

The priority of horizontal equity can also be seen at work in the distribution of taxes raised by the Commonwealth Government and distributed amongst the States to correct the imbalance between the respective revenue-raising capacities and expenditure responsibilities of the two sovereign levels of Government within the Australian Federation (Garnaut and Fitzgerald, 2001, 2002). Recent research by the National Centre for Social and Economic Modelling (NATSEM) for the Review of Commonwealth-State Funding has shown that the equalisation payments do not lower the gini coefficient of the overall Australian distribution of income after Government expenditure is taken into account, or raise the average incomes after fiscal interventions of the poorest two deciles of the population

This is another example of exceptionally strong Australian commitment to equity, but to its horizontal rather than its vertical dimension. In the case of Commonwealth grants to the States, the element of horizontal fiscal equalisation increased greatly through the twentieth century, and reached its greatest extent and was on an upward trajectory at the end of the period.

Interestingly, Harding's work for the Review of Commonwealth-State Funding (Harding et al, 2002) reveals that the Commonwealth's fiscal intervention affecting directly the vertical distribution of income amongst Australians through the income taxation and social security systems, has larger effects in redistributing purchasing power amongst the citizens of the States than Horizontal Fiscal Equalisation in the distribution of grants to State Governments.

How has Australia performed over the twentieth century, in relation to the polity's concern for equity and the *de facto* priority of horizontal equity?

It is inherently difficult to separate the effects on the distribution of income of underlying change in economic, demographic and social structures, from the

effects of policy interventions. Australia's early twentieth century comparative advantage in natural resource-based industries was less conducive to equitable distribution of incomes through market processes, independently of Government intervention, than the more diverse distribution of comparative advantage that emerged with population growth and the global decline in the relative economic importance of natural resources. The latter decline, however, created severe adjustment problems for the old rural communities and provincial towns in which broadacre farming provided the main economic base, especially with the corruption of world trade in farm products that intensified from the mid-1980s. The greater technological sophistication of economic activity in the late twentieth century, and the entry of large developing countries into the world economy as suppliers of labour-intensive manufactured goods, increased the market value of highly educated relative to unskilled labour in all of the developed countries. The improvements in transport and communications extended nationally and internationally the markets for individual enterprises, and raised the economically efficient scale of production in many (although not all) goods and services. This increased the rents of superior performance or good fortune: for Chief Executive Officers; the stars of sport, cinema, media, theatre, literature and invention; and the people with the skills to contribute to development of global businesses. The social change that led to higher proportions of children being brought up by single parents has been a source of increased poverty.

That said, a few generalisations can be made about the contribution of policy to trends in income distribution in Australia over the past century.

The old Australian labour market segregation was greatly damaging to vertical equity until late in the century. The rigid wage regulation, through its effect on unemployment, continues to be damaging. The removal of formal wage discrimination changed the age, colour and gender of unemployment, with

the increase in employment amongst women being ameliorated somewhat by the end of occupational segregation.

The performance on employment and unemployment is the persistent weakness in Australian policy performance related to equity through the twentieth century, remaining poor through the stronger economic conditions of the 1990s. The comparison with the United States is highly unfavourable, and became even more so with further divergence in approaches to social security and minimum wages from the 1970s. In 1970 the ratio of total employment to numbers of residents above 15-16 years was 57.4 per cent in the United States and 59.7 per cent in Australia. By 2000, the ratio in the United States had risen strongly by 64.5 per cent, to well above the Australian ratio of 59.9 per cent (Chart 12). The social dimension of contemporary unemployment is understood better when attention is given to the growing importance of “jobless families” and to the high proportion of children now being born into “jobless families” (McLure, 2000; Dawkins, 2001). The correction of this weakness would make a major contribution to equitable distribution. Because it would be associated with much more complete utilisation of economic resources, it would contribute to economic growth as well.

The gradual strengthening of social security arrangements based on the circumstances of individuals and families has made a major contribution to vertical equity, with the personal income tax playing a significant supporting role. The strengthening continued to increase late in the century with the adjustments at the time of the introduction of the Howard Government's “new tax system” in 2000. The large extension of the social security system in the 1980s had taken the form of tightly means-tested benefits, which exacerbated disincentives to labour force participation. The correction of associated problems was commenced but not taken far with the introduction of the new tax system.

Interstate and inter-regional inequality has been less important in Australia than in other geographically large and many small countries. This owes a great deal to the geographic mobility of the Australian population, itself supported by high levels of immigration. Despite the mobility of the population, the slowest-growing States in population and economic activity (first of all Tasmania) have grown substantially more rapidly, absolutely and relative to the national totals, than the slower-growing States in the United States and Canada. Interestingly, the rate of growth of non-metropolitan regions was much stronger late in the twentieth century, absolutely, and relative to the capital cities, than in earlier periods of regulated isolationism (Chart 12).

4. Contemporary Challenges, Old and New

What are the challenges facing Australia, in seeking to maintain through the twenty first century the relatively strong economic performance of the late twentieth century? What are the additional challenges associated with achieving this result while pursuing policies that advance old Australian commitments to distributional equity?

It is necessary to examine the relevance of old goals as a basis for assessing the prospects of making progress towards them. The experience of Australia's first century suggests that, in the absence of a large and unlikely change in political culture, the two questions are really one, since growth-promoting policies that violate community perceptions of distributional equity are not feasible in this compulsory-voting democratic polity.

On the relevance of old goals, variations on the themes that originally drove Australian commitment to national development remain important.

Commitment to the goal of national development is now qualified by concern for the link between population growth and environmental degradation, especially in Australia's politically influential largest city. The environmental concern about population growth needs to be tempered by recognition that suggests that the

nature of the link can be changed by wise policy, and that it is more likely to be changed in an economically successful community. To the extent that Sydney is different, the national debate will be affected by Sydney's success or failure in dealing with the problems of congestion. The balance of the debate will be affected as well by the policies that affect old and immigrant Australians' locational choices.

The technological change that has reduced the costs of transport and communications and driven the phenomenon described as "globalisation" has, on balance, increased the economic penalty of small scale, at least in economies that are separated from the world's main centres of economic activity. There has been no diminution in the importance in consumption of non-traded goods and services in which small scale is a disadvantage. The foreign policy and defence realities that shaped positive Australian attitudes to growth in population and economic activity in the early years of the Federation and again in the period after the Second World War push in the same direction now as in the twentieth century. Today the old fears of invasion have little basis, but challenges to Australian sovereignty could arise in different ways from failures of political stability and development in Australia's immediate neighbourhood. Now, as a century ago, some Australian's pin their hopes for protection of their country's sovereignty on alliance with the world's greatest military power. Now, more than a century ago, it would be wise to recognise the limits to protection through alliance, and the contribution that independent Australian strength can make to the reliability of preferred alliances.

Most Australians, now as a century ago, live in communities that value the expansion of amenities and opportunities associated with increasing population. Communities in which population growth ceases, as in Tasmania at the end of the twentieth century and in many smaller communities over longer periods, express unhappiness about it.

There is a contemporary debate on the goal of national development that has not yet been worked through politically. Only a comprehensive failure of leadership and management affecting provision of services in the great city of Sydney would cause the differences to be resolved in ways that did not support national population growth at least at something like the current level of about one and a quarter per cent per annum. This rate is lower than the average for the twentieth century, (Chart 12), but would still be the highest of the developed countries.

There is no sign of diminished commitment in Australia to the goal of rising levels of output per person and the associated increase in living standards.

On the old goal of distributional equity, the twentieth century experience suggests that analysis and political debate and conflict can vary the extent of community attachment to particular instruments of policy, and the range of Australians for which the polity seek equitable outcomes. Over the century, there was an increasing tendency to emphasise vertical equity amongst all Australians, rather than on horizontal equity amongst sub-groups of the community. The extension of politically influential concern for equity amongst employed white males to other Australians was the most important example of this tendency. There is a possibility that there will be further broadening of the reach of Australian concern for equity, for example with higher priority being given to the interests of the unemployed. What is unlikely is a general downgrading of concern for distributional equity. There is a danger that the changing demographic structure, working through electoral politics, will come to privilege income support and services for the aged, in the way that policy at other times privileged other sub-groups of the Australian community.

Successful reform of policies and institutions to raise economic performance in Australia have invariably been accompanied by other policies that appeal to concern for distributional justice. Effective measures to promote distributional

equity make large demands on the country's fiscal resources. Economic growth is therefore a necessary underpinning of progress towards distributional equity. For these reasons, it remains likely that Australia will have all of productivity-raising economic reform, progress towards greater distributional equity and strong economic growth, or none of them. The centrality of expansion of employment and reduction of unemployment to the vertical equity that has been rising in priority may make progress in reducing unemployment a condition for continued economic reform and economic growth.

Global technological, demographic and economic developments have important implications for Australia's prospects for national development and distributional equity, in both positive and negative directions. The technological change that has driven "globalisation", has raised the stakes of success in national economic development. The gap between good and poor outcomes is greater in the modern international economy. Poor national performance now carries a greater risk of cumulative decline, with small, internationally isolated and less successful economies risking the loss of skilled and young people and capital in other forms.

Technological change has also widened the dispersion in the distribution of personal incomes from the market. It has made it more difficult to limit inter-personal income inequalities. In this sense, technological change has also raised the stakes of economic success for individuals.

Demographic change and in particular the decline in fertility has increased the difficulty of maintaining high rates of economic growth in Australia as in other high-income countries. At the same time, low fertility and low rates of growth of work-age population in themselves have eased the problems of providing employment for young people, amongst which unemployment has been highest in recent decades. The ageing associated with low fertility in all high-income countries has introduced fiscal problems and reduced capacity for innovation

and structural change. It has been one more factor tending to increase the stakes around success in national economic development, since the problems of ageing can be moderated by some forms of immigration. A large gap has emerged between economic performance of countries of immigration and other developed economies, that is likely to widen through the twenty first century. Australia's experience in the second half of the twentieth century gives it a large advantage at present, but this may be challenged as other countries seek the economic advantages of immigration. Recent policy change to facilitate greater immigration of skilled people in Germany is likely to be emulated elsewhere.

The interaction of strong economic growth in many including the most populous developing countries (most dramatically China, but also India) with demographic change will, if it is sustained, gradually diminish the extreme disadvantages of unskilled labour in the global economy that have emerged in recent decades. Global population growth is decelerating more rapidly than anticipated even a few years ago. The entry of the major developing countries into the global economy and the economic success with which that has been associated has been a short-term challenge but over time will become more benign in relation to the distribution of income in developed countries.

Rapid economic growth in East Asia contributed much to Australian economic development during the period of internationally-oriented reform in the late twentieth century. It has been common in Australia to see the East Asian financial crisis of 1997-8 as a watershed, with slower East Asian growth after generating fewer opportunities for Australia. A closer look reveals no general loss of Asian growth momentum at the time of and following the crisis. The stagnation of Japan is neither new nor unanticipated (Garnaut, 1989), under the influence of one of the world's largest declines in fertility. The continued rapid expansion of the Chinese economy through the financial crisis and now

through the United States "tech-wreck" and global recession of 2001 has reinforced confidence in its sustainability. The resilience of market-oriented reform in India through these shocks in the Asia Pacific economies reflects the strength of the new growth trends that emerged through the 1990s. Southeast Asia did move to a lower growth trajectory with the financial crisis, but since that set-back has still been sustaining growth at rates above the average for developing countries, and above such good performers amongst developed countries as the United States. The centre of gravity of global economic activity has continued to move towards Australia since the East Asian crisis, albeit at a more measured pace. Australia's location alongside the dynamism of the Asian economies will continue to be an asset in Australian national development, at least through the first several decades of the twenty first century.

Most challenging for continued national development with equity in Australia will be the inter-related factors that make it more difficult to attract and to hold young people with economically valuable skills. Here the challenge comes from two sides, and responses on one side can complicate defence on the other.

On one side is the dependence of support for internationally-oriented reform, and for reasonably high levels of migration in the interests of national development, on equity in domestic distribution. National development therefore depends on high employment and income security of Australians who are poorly endowed with economically valuable skills. On the other side is the challenge to attract and retain people with economically valuable skills, at a time when technological and economic change has been tending to widen the dispersion in the distribution of market outcomes. One important detail of this challenge is that Australian marginal tax rates on professional and managerial incomes are high compared with most of the countries with which Australia is competing in the market for skilled labour. Concern for national development alone would argue for acceptance of much wider after-tax income differentials.

Unless achieved within a broader framework for achieving equitable distribution including high employment, this outcome could weaken support for internationally-oriented policies, and defeat national development from another direction.

5. Prioritising Equity in an Internationally-Oriented Economy

National development and equitable distribution remain the primary goals of Australian economic policy, despite the large changes in the way in which “equity” is perceived, and some equivocation on population growth.

Australia’s starting point in seeking progress towards these goals in the early twenty first century is in many ways favourable, after almost two decades of internationally-oriented reform.

Australia, with its standard of living well above that of the rest world, had wider margins for error when it set out on its national journey a century ago.

Australia fully utilised its margin for error through the twentieth century, but reacted to deterioration in its relative position amongst high-income countries in time to keep alive old ambitions for national development with equitable distribution. In this, it was unlike other countries of recent European settlement in the southern hemisphere, including Argentina, South Africa and (to a less remarkable extent) New Zealand, which had also seemed to be well-placed early in the twentieth century.

The great challenge in the period ahead will be to make Australia an attractive place to live, build careers and develop businesses for large numbers of talented and well-educated young people, while meeting old Australian concerns for equity

Progress on the agenda for reform to promote national development would on the whole be favourable to equitable distribution. Strong economic growth,

above all from increased productivity, can provide the fiscal capacity that is necessary for expansion of the social security, health and education that are most important to raising the welfare of Australians who receive low incomes in the market place. The concentration on economically valuable skills in the immigration programmes improves the prospects of relatively disadvantaged Australians.

There are, however, elements of a reform programme to raise total output and incomes that would challenge both perceptions and realities of distributional equity. Fiscal resources applied to the pursuit of equitable distribution compete directly with the resources required to keep marginal tax rates low enough to hold and to attract people with the education and skills which are necessary for national development. The fiscal resources required to meet the aspirations of increasingly politically influential older people conflict with the requirements of educating and retaining the young. They conflict as well with the demands of social security and tax reform to reduce marginal effective tax rates and provide income security for poorer Australians as a basis for moving to high levels of employment and low unemployment. High Commonwealth funding for fiscally weaker states competes for fiscal resources with improvement of public infrastructure in the great cities, in which congestion has generated resistance to growth, and in expanding provincial cities everywhere.

Here, too, there are important lessons from the twentieth century experience. At a time of high stakes in national economic development success, and low margins for error, community aspirations for equitable distribution in Australia can be advanced only through having clear priorities amongst measures that are desired in the name of equity.

Efficient distribution policies require a consistent focus on vertical equity. Intervention that churns the relative standing of people in the middle of the

distribution often has similar economic costs to changes that focus on raising living standards of the poorest people.

We learned from the relationship between wage rigidity and unemployment in the twentieth century that fiscal payments for families are more effective in alleviating poverty than high legal minimum wages.

We learned as well that social security payments targeted tightly on people on low incomes create problems through the effects of high effective marginal tax rates on the proportion of the population in jobs. We have to be much more clever in designing social security arrangements in ways that maintain incentives to employment to the greatest extent possible. A form of negative income tax, with lump sum payments to members of the labour force, would reconcile most effectively income security of low-income people with economic incentives to full employment. It happens that such a system could also address problems of child care (for its own sake and as an incentive to fertility) and inter-regional equity. The negative income tax is fiscally demanding, and its introduction would need to be phased in over six to ten years of relatively strong growth. In the meantime, the Five Economists' tax credit can generate much of the gains, at low fiscal cost, while being consistent with later movements towards a negative income tax (see Dawkins, et al, 1999; Garnaut, 2001, especially Chapter 13).

The greatly improved economic performance of Australia through the period of internationally-oriented reform provides the basis for an optimistic view of Australia's twenty first century prospects.

It is prudent, however, to conclude by drawing attention to two potential developments, either of which could weaken this favourable outlook.

One dangerous development in an area over which Australia has been able to exercise some influence in the past, is the recent weakening of the international trading system. Australia, as a small and geographically isolated economy, still with farm products playing significant roles in exports and domestic income distribution, would be damaged exceptionally by retreat from the late twentieth century tendency towards open, non-discriminatory world trade. The global multilateral trading system has been strengthened in recent times by the entry of China and Taiwan into the World Trade Organisation (WTO) and the launch of a new round of multilateral negotiations at the WTO Ministerial meeting in Doha. Despite this good progress in the multilateral system, there is currently much excited consideration of a large number of small-group free trade areas that, were they to become realities, would seriously damage the multilateral system that is so valuable for Australia. If it is not obvious from analysis, the danger to Australia should be apparent from the experience with preferential trade during the 1930s. Australia's participation on discussions of discriminatory free trade, and its contemplation of partially free trade with some trading partners, is inconsistent with the spirit, and also the effectiveness of WTO rules. Australia is not the main cause of the current dangers to itself in the international trading system, but is contributing to the risks.

The second caution relates to the ambivalence about racial diversity that has become more prominent in Australian public discussion in recent years. If it grew to the extent that it seriously influenced immigration policy, it would undermine the great asset for national development that Australia currently shares with the United States and Canada: the capacity to continue to retain structural flexibility and growth in an era of low fertility in the high-income countries.

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Chart 1

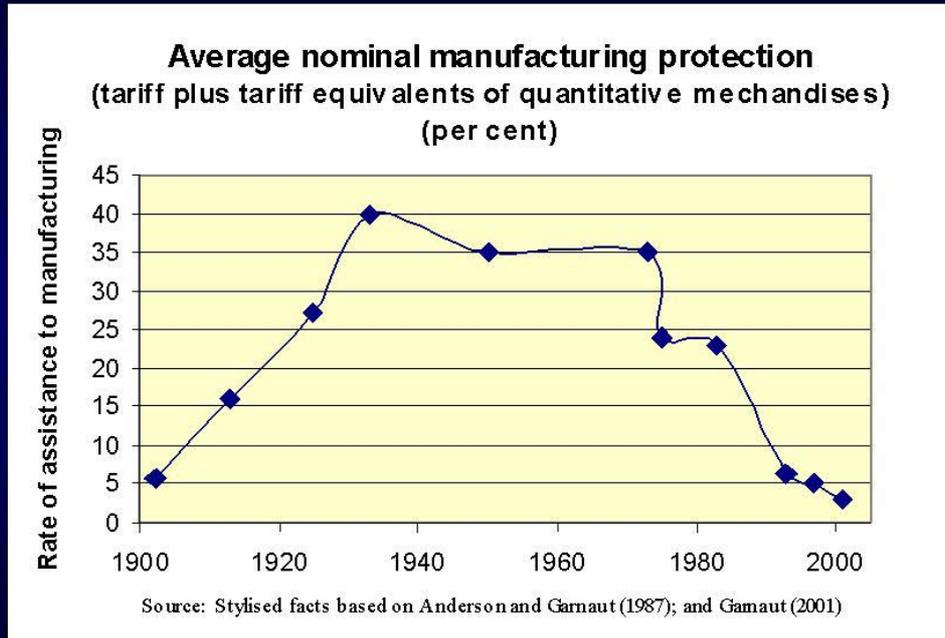


Chart 2

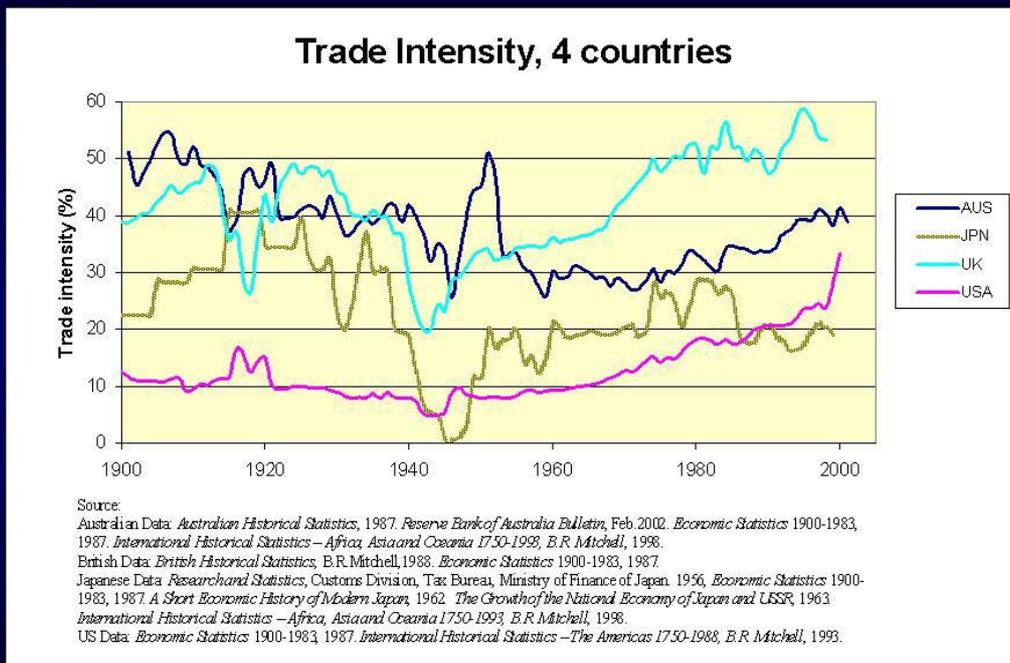


Chart 3

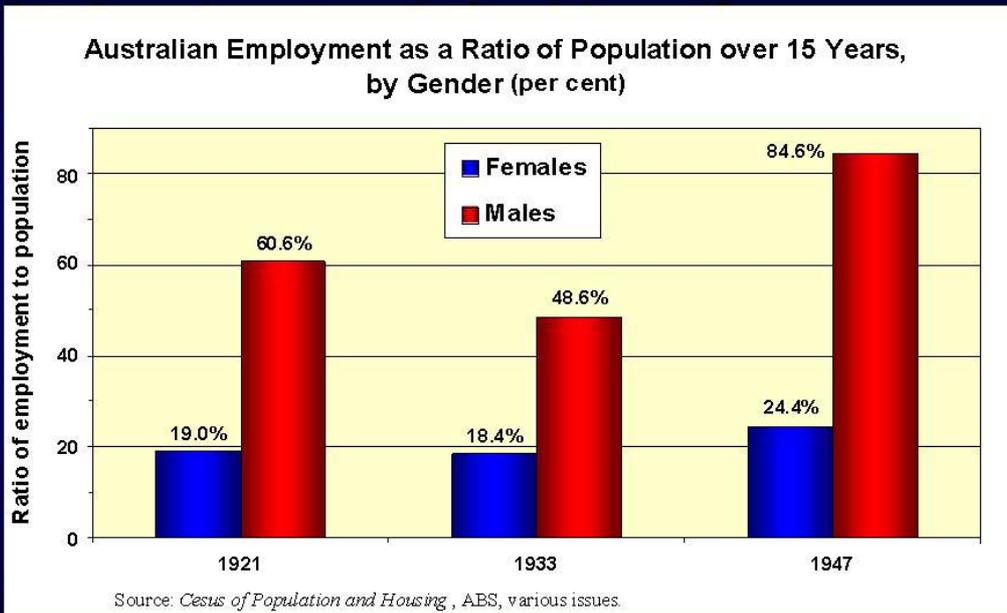


Chart 4

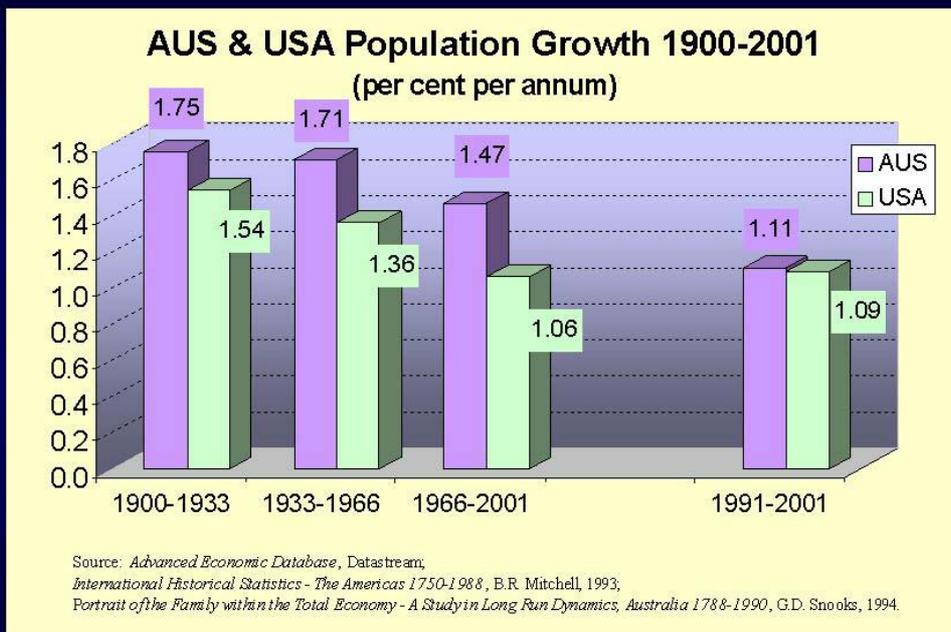


Chart 5

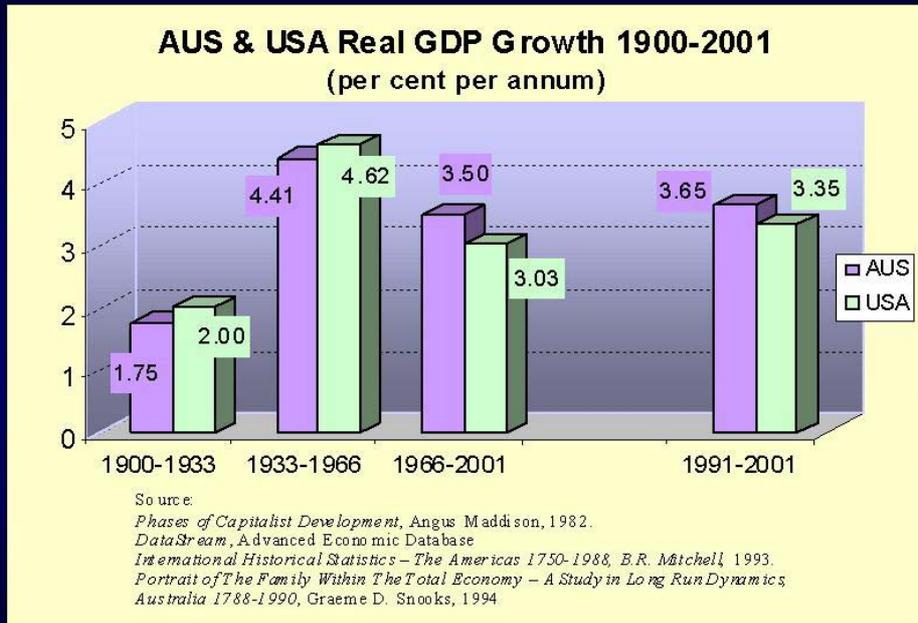


Chart 6

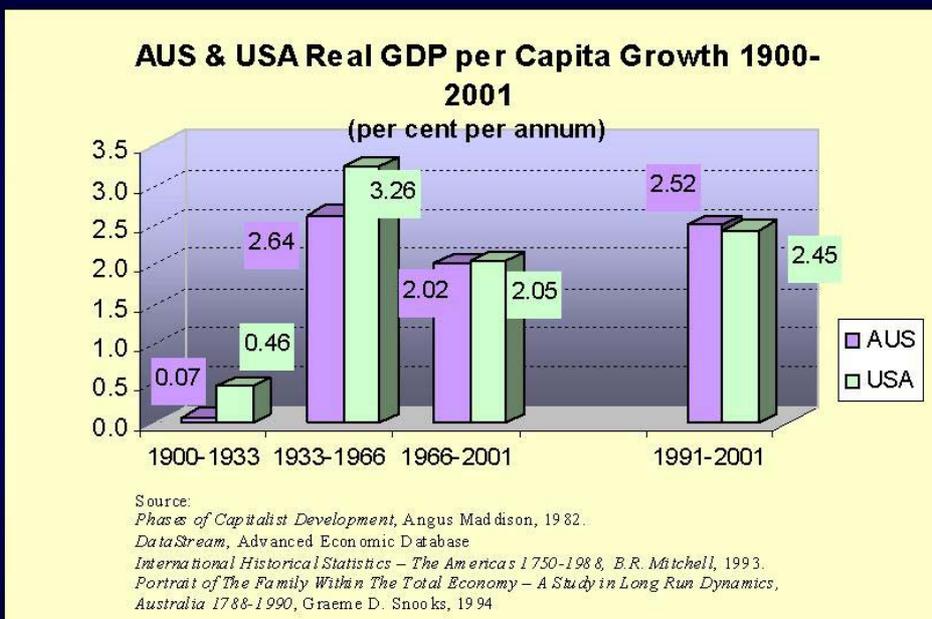


Chart 7

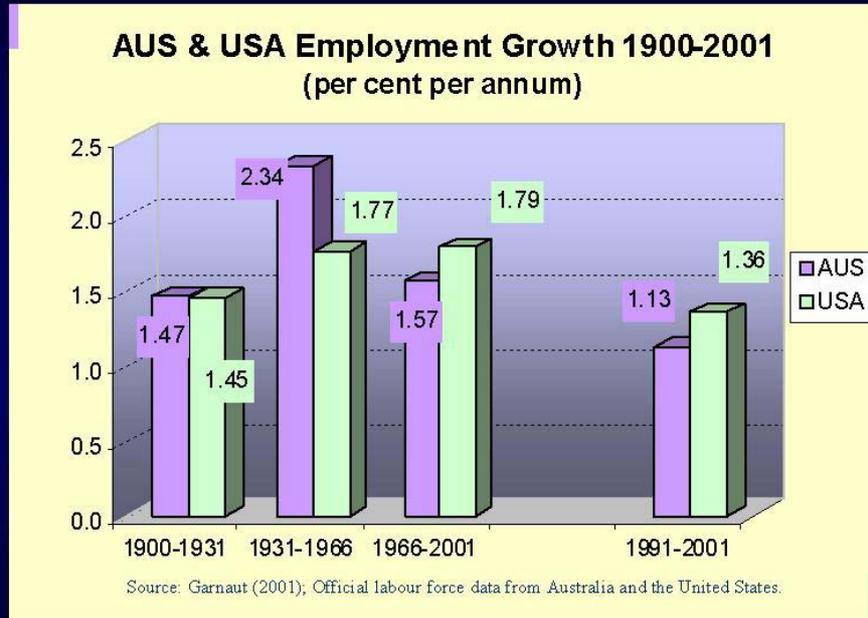


Chart 8

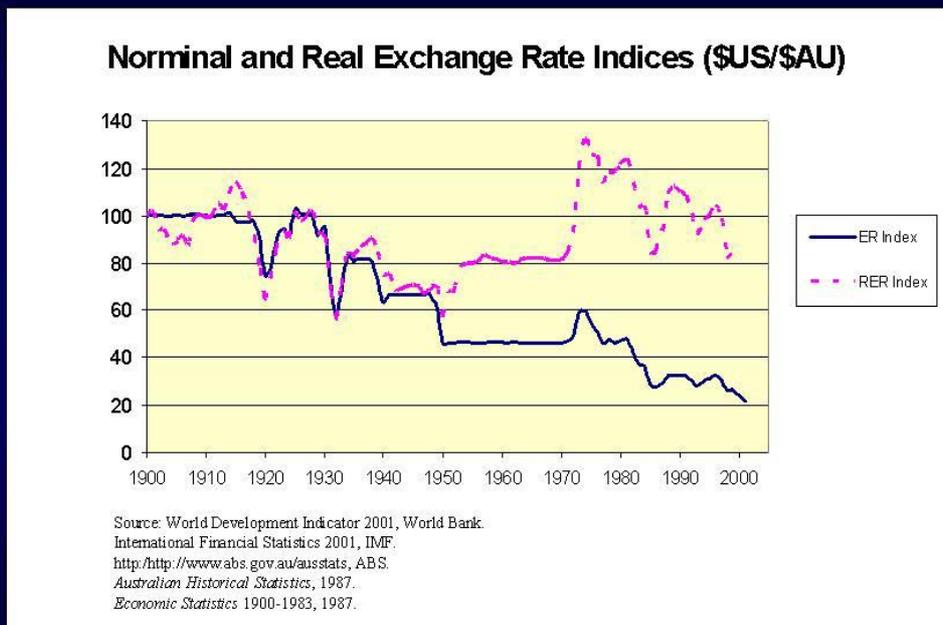


Chart 9

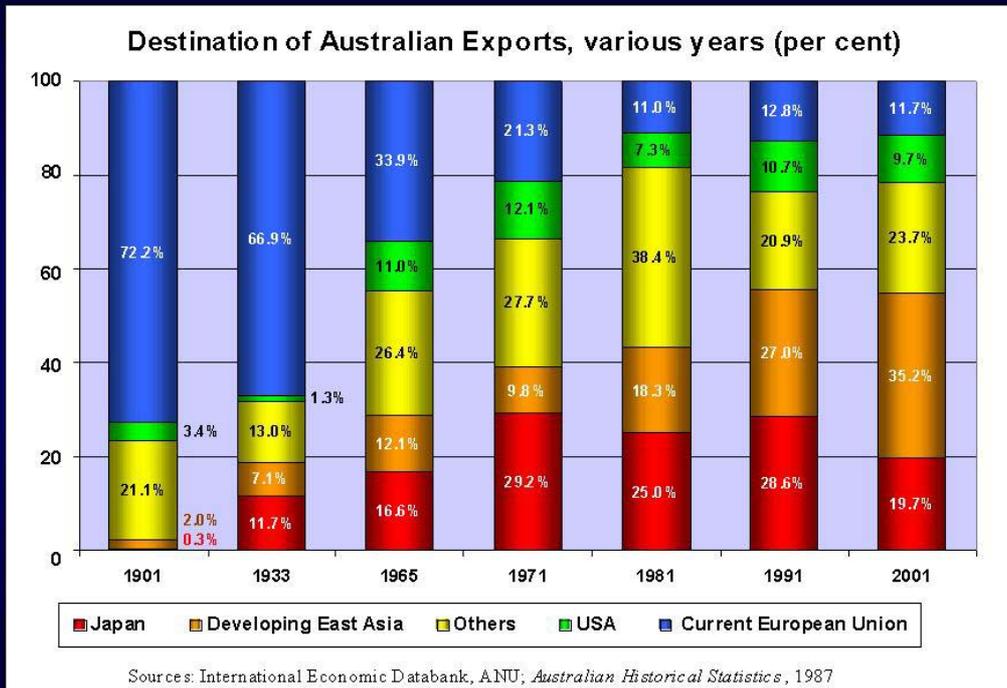


Chart 10

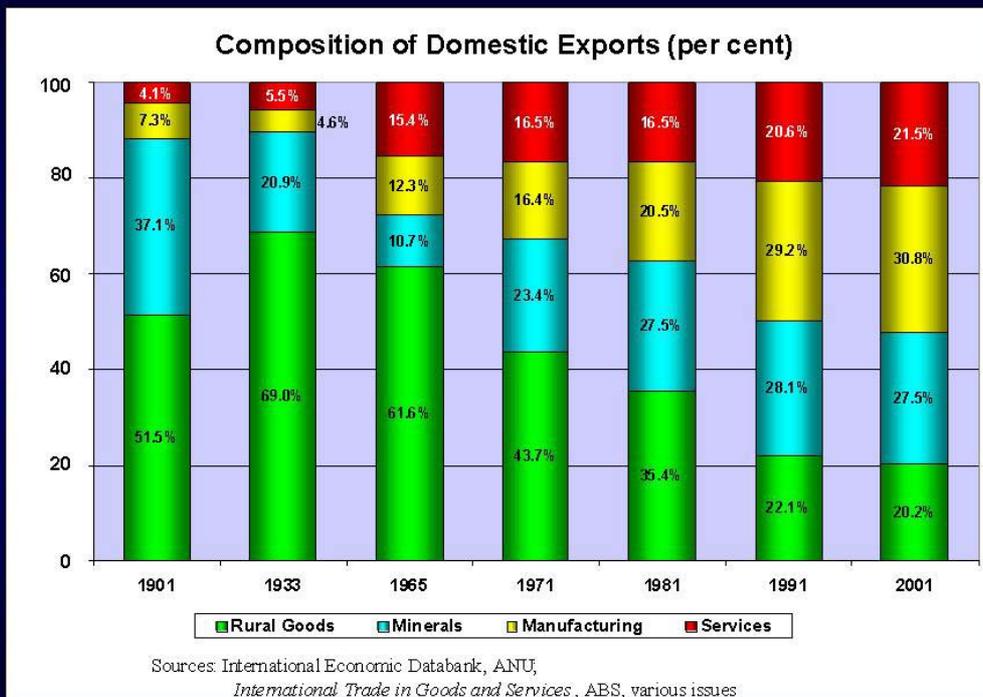


Chart 11

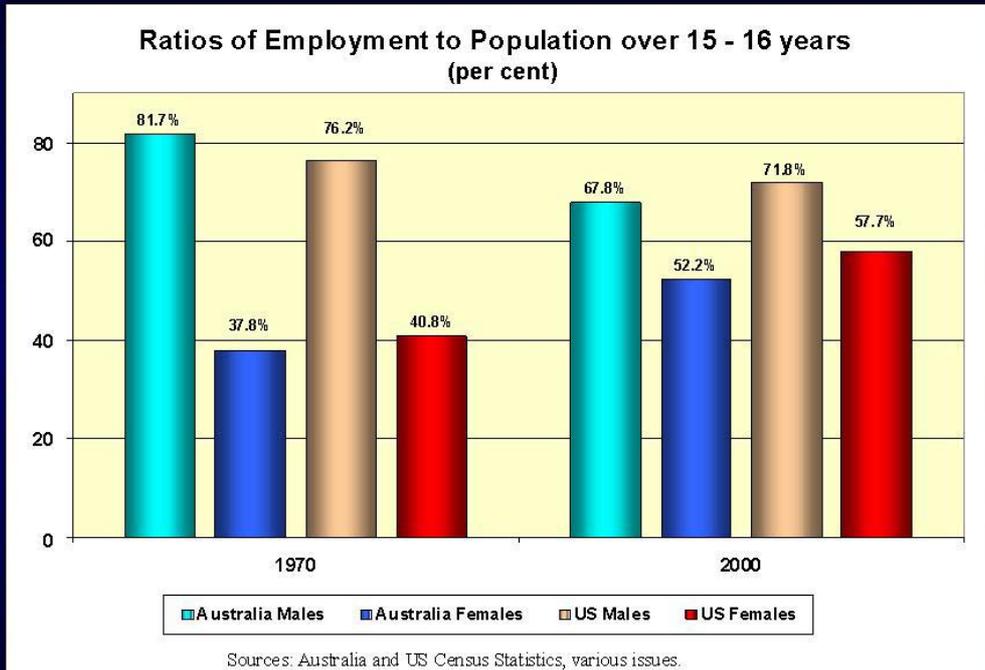


Chart 12

