PRIME MINISTER

CHECK AGAINST DELIVERY

LAUNCH OF "THE GREAT CRASH OF 2008" BY ROSS GARNAUT
PARLIAMENT HOUSE CANBERRA, 22 OCTOBER 2009

I acknowledge the First Australians on whose land we meet, and whose cultures we celebrate as among the oldest continuing cultures in human history.

I'm delighted to launch Professor Garnaut's book today.

Not just because it's an important early assessment of the causes of the global financial crisis.

But also because Ross has been spilling red ink on my own work for a quarter century - since the days in the Embassy in Beijing when he was Ambassador to the People's Republic of China, and I was First Secretary – and tasked with the critical responsibility of doing the embassy photocopying.

So today I've finally got the chance to mark his homework – or at least respectfully to reflect upon it.

It's chance also to even up the score from some of my less than spectacular days when the Australian Embassy would play cricket against other assorted embassy teams – most especially the Poms.

Ross, correctly, has reflected on the fact that while I exhibited great enthusiasm for the game, I rarely troubled the scorers.

The Peking Cricket Club wasn't exactly like the Gabba – instead of bowling from the Stanley Street end or the Vulture Street end, we'd be bowling from either the *Temple of Heaven* end, or the *Long Live Marxism Leninism Mao Zedong Thought* end.

My preference was the latter – but I say that by way of self-disclosure in case a journalist from The Australian happens upon it in a further expose of my Chinese communist connections.

I was however made wicketkeeper on the robust assumption that there was a limit to the amount of damage I could cause there.

Alas, this assumption was again misplaced, as I soon became (affectionately, I hope) known as “iron gloves”.

Ross, by contrast, had a confidence in his stroke play that marked him as a natural – and as a sandgroper extraordinaire, this perversely was expected of him.

But after Ross’s successes on the pitch, today I relish the chance to even up the score.

Ross Garnaut is of course one of the architects of the modern Australian economy.

Ross is also one of Australia’s foremost public economists.

And his early work on the Australia-China economic relationship was a decade ahead of its time.

As economic adviser to Prime Minister Bob Hawke from 1983 to 1985, he helped build the framework for the opening up of the Australian economy.

As Ambassador to China, nearly a quarter of a century ago he pioneered China’s first significant foreign equity investment in a resource project anywhere in the world – the Channar mine in Western Australia – with the prescient assumption that it would be good for both economies if we began integrating our energy and resource industries with China’s long-term energy and resource needs.

He then sought to expand this concept into the future of our two steel industries.

And then to wool and textiles.

Ross then added to this already significant national contribution through his important work on climate change – the Garnaut Report – which has been an integral part of the Government’s decision making process on the Carbon Pollution Reduction Scheme.

Ross has served successive governments of all persuasions.

He’s always maintained his academic rigour, a strong independent voice and an overriding sense of public service.

And as *The Great Crash of 2008* demonstrates, Ross has a masterful capacity to synthesise matters of great complexity into a clear and compelling narrative.

It is of course only just a year since the collapse of Lehman Brothers, the largest bankruptcy in history.

The events of that weekend of September 13-14 2008 took us the edge of the abyss.

Two fundamental factual points have characterised this crisis – points which should continue to frame all our analysis.

The first is that this crisis was no ordinary crisis.

In fact, it has been the most severe global economic event in our lifetime.

On both financial and economic metrics, early stages of the current global crisis rivaled the severity of the Great Depression.

Consider these comparisons:

Global stock markets fell by just over 20 per cent in the first 12 months of the Great Depression. In the first 12 months of this recession, global stock markets fell by nearly twice that - more than 40 per cent off their peak.

Global industrial output fell by around 13 per cent in the first twelve months of the Great Depression – almost identical to the fall experienced from in this recession from the peak in April 2008.

Global trade fell by 10 per cent in the first 12 months of the Great Depression. This time it fell by 17 per cent.

There is still considerable uncertainty about how the global recession will unfold and how quickly the global recovery will occur, but on these metrics at least, it began with the same force and violence as the Great Depression three quarters of a century ago.

As Ben Bernanke and others have indicated, the incoming economic data in the first months of 2009 forecast the potential for an extraordinarily deep and protracted global downturn.

The second factual characteristic is that the magnitude of the crisis has also dictated the magnitude of the response that has been necessary on the part of governments.

It required unprecedented interventions in financial markets and in the real economy, amounting to over 16 trillion US dollars in fiscal, monetary and financial policy support from G20 economies, the equivalent to 24 per cent of global GDP.

Collectively, these government policy actions – fiscal, monetary and financial – amount to the largest and most coordinated government stimulus strategy in modern economic history.

And the crisis demanded such measures, as the chapter on ‘Depression Economics’ makes clear.

Again, the size of these interventions was matched only by the scale of the threat.

So are there any early conclusions we can draw from the crisis in terms of its causes, and how to avoid such crises in the future, and how to deal most effectively with such crises in the future should they re-occur?

For his part, Ross has got his own analysis in early, weaving together four strands of causation:

- the cycle of boom and bust in economies;
- the impact of global imbalances;
- the excessive complexity of financial derivatives and financial markets (the clever money thesis), and
- the greed of the corporate sector, especially of financial markets.

Of course there have been some earlier and more modest contributions to the debate – including my own.

And as Ross will attest, those contributions aren't the first time that I've exceeded a word limit.

I have argued that unfettered markets, particularly financial markets, are inherently unstable.

This is not a novel insight, but it is one that has been ignored at various times in modern history, often with devastating consequences.

In recent decades, economists began to believe in what some called the "Great Moderation" – a remarkable period of sustained growth in output, trade and living standards around the world which coexisted with low inflation and reduced volatility in asset prices.

Some economists declared that the business cycle had been conquered and that financial markets were inherently efficient.

This crisis has exposed the efficient markets hypothesis and contrasted it with the essential Keynesian insight that markets, especially financial markets, are inherently unstable and subject to the whims of sentiment.

Keynes was prudently skeptical of unfettered financial markets and warned that *"when the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done."*

A second conclusion from the current crisis is that the global recession would have been much worse without global government intervention.

In short, the lesson is that global Government intervention can work.

Governments can make a significant difference if they coordinate to act rapidly, decisively and effectively.

History offers us many examples of where government responses to economic crises have been too slow and too weak.

In the 1930s governments responded to the financial crisis by retreating from the global economy.

Government budgets were cut – withdrawing stimulus from the economy and compounding the weakness in the private sector.

Tariff walls were raised, choking off international trade.

Monetary stimulus was too passive.

The experience of the Great Depression allowed Keynes to deliver his core insight that market economies cannot function without governments playing a balancing role - to step in when the private sector is in retreat.

At various times, Keynes' insight has been lost.

Culminating in President Ronald Reagan's pronouncement that *"Government is the problem",* opponents of the Keynesian tradition have argued that free markets are the lesser of two evils, where the alternative is onerous government regulations that suffocate enterprise and stifle innovation.

The crisis has taught us that this is a false choice.

Effective regulation makes markets stronger.

Indeed, effective regulation is essential to ensure that our markets operate fairly and freely.

As Ross says, we need to avoid a future crash by finding the right balance of economic management, financial regulation and free markets.

A third conclusion from this crisis is that the global economy is increasingly interconnected.

Global economic shocks reverberate around the world as weaknesses in one part of the world spread rapidly across the globe.

As Ross says in his book, one of the primary mechanisms of this interconnection is the internationalisation of financial markets.

Over the last decade the value of financial derivative products issued around the world has reached one quadrillion dollars – that is one thousand million million.

Ross quotes former New York Federal Reserve President Gerald Corrigan who said in 2007 of the burgeoning financial derivative products:

> *"Anyone who thinks they understand this stuff is living in la la land."*

The growing interconnectedness of the global economy underlines the importance of globally coordinated responses to economic events.

That is why the emergence of the G20 leaders process as the primary global economic forum is important – a forum where Australia now has a permanent seat at the table.

In re-examining the global financial crisis, Ross also underscores the remarkable strength of Australia's economic performance compared to the Major Advanced Economies:

- the only economy not to go into recession;
- the second lowest unemployment rate of the Major Advanced Economies, and
- the lowest debt and lowest deficit of all the Major Advanced Economies.

And we have achieved this while maintaining strong public finances – keeping our AAA Credit rating, keeping our borrowings lower than any of the Major Advanced Economies and laying out a clear plan to return the budget to surplus as the economy recovers.

These outcomes are the result of many factors – but government policy settings have played a critical but not exclusive role.

Our economic intervention strategy reflected three core pillars.

First, stabilising our financial system – in particular through the timely provision of the guarantees for bank deposits and wholesale bank borrowings. Our banks weren't without their problems, and the book shows that decisive action in providing guarantees for wholesale funding made the difference.

Second, supporting real jobs in the real economy through our stimulus strategy with its focus on investing in productive infrastructure.

Third, a local skills, training and employment strategy to support those who have lost their jobs or who have been unable to enter the workforce.

This intervention strategy has served us well during the past 12 months.

It has helped cushion the economy from the severe global downturn, saving hundreds of thousands of Australians from losing their jobs.

It is worth noting that in devising the Government's stimulus strategy, we were guided by Treasury advice on what worked and what did not when Australia wrestled with the recessions of the early '90s.

Mindful of these painful lessons – and through economic history of the more searing pain of the Great Depression half a century before – we were steeled by the experiences of the past, and the economic and human costs of high and sustained levels of unemployment.

But as Ross makes clear, there are many challenges ahead.

Those challenges include the prospect of a long and slow recovery in the developed countries – while also dealing with the long-term slide in productivity growth, the decline in Australia's terms of trade, and what Ross describes as the "substantial structural deficit" (p185) inherited from the previous Government, after the squandering of the revenue gains from the mining boom.

An important feature of *The Great Crash of 2008* is that it doesn't just look to the events of the past – it also looks to the future.

Ross cites many reasons why the road ahead won't be smooth.

Overcoming the large imbalances in the global economy will be an enormous challenge as we move into recovery.

This point was reinforced by Chairman Bernanke in his remarks last weekend – and I quote:

> *As the global economy recovers and trade volumes rebound, however, global imbalances may reassert themselves… policymakers around the world must guard against such an outcome. We understand, at least in principle, how to do this... [but] just as increasing private saving in the United States is challenging, promoting consumption in a high-saving country is not necessarily straightforward."*
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> *US Federal Reserve Chairman Ben Bernanke, "Asia and the Global Financial Crisis", 19 October 2009*

Adjusting from these profound global imbalances from the past will not be easy.

As Ross notes, major structural changes in the global economy will be inevitable.

And inevitably, they will be hard.

Another challenge is the risk of a return to protectionism around the world as domestic industries struggle under the weight of tighter credit conditions, constrained consumption and consequently weaker growth.

Protection is always the cheap card to play at time of economic difficulty – cheap politics, disastrous economics and with appalling consequences for trade, growth and employment.

As someone who helped drive trade liberalisation in past decades, Ross understands the importance of free trade to sustainable global growth and long-term prosperity.

As I have argued in many forums both here and abroad, it is fundamental that the global downturn does not lead nations to raise their barriers to trade, as happened in the 1930s.

Another challenge arises from governments around the world exiting from their current large ownership stakes in their financial systems.

This process will not be easy, given the importance of sustaining confidence in the stability of financial institutions.

As Ross notes, Australia has been spared the need to rescue our banking institutions by direct budgetary provisions.

Indeed, of the nine 'AA' rated banks in the world at the moment, four of them are Australian.

Australia has nonetheless been active within the G20 in developing coordinated policy positions to harmonise the exit over time from the extraordinary financial market interventions including sovereign guarantees of term funding.

Related to the challenge of withdrawal from extraordinary financial market interventions is the parallel global challenge for governments to exit over time from the extraordinary fiscal stimulus that has been necessary to keep the global economy going during a recession, and to reduce global public debt.

Large fiscal deficits around the world (averaging nearly 10 per cent of GDP across the OECD) are a significant part of the global imbalances which must be addressed if the global economy is to move towards a path of long-term sustainable growth.

Again, Australia is better placed than most other nations – with the lowest debt and deficit of the Major Advanced Economies.

We nevertheless face a challenging period of adjustment in the years ahead, with lower terms of trade than in recent years, and the prospects of a weak global recovery.

The Australian Government has established a clear set of fiscal rules that will see Australia return to budget surplus - by holding real growth in spending to 2 per cent per annum once recovery has been confirmed and allowing tax revenues to recover.

This fiscal consolidation strategy was outlined in the Budget.

We intend to adhere to it.

It will be tough.

And it is unlikely to be popular.

It means no return to the lazy days of the mining boom, when the Liberals spent almost all of the additional revenue from the commodity boom – some 314 billion of the 334 billion dollar windfall revenue.

314 billion dollars, with almost none of it on investment to drive future productivity growth.

All about unsustainable short-term consumption, not productive long-term investment.

The great opportunities of the boom years were squandered, while the nation's need for investment in education and infrastructure to turbocharge the next generation of productivity growth were ignored.

Ross has referred to this period as the "Great Australian Complacency of the Early 21st Century".[1]

The four years from 2004-05 to 2007-08 witnessed the largest expansion in Commonwealth government spending since the recession of the early 1990s.

What is remarkable is that this spending increase occurred when economic growth was strong and the economy was not in need of stimulus.

Reversing the unsustainable spending of the boom years will require many difficult choices.

As opposed to sustaining the pro-cyclical fiscal policy settings of our predecessors from 2003 to 2007, when the public revenue was awash from the proceeds of the global mining boom.

The Government's objective is to entrench Australia's current globally competitive position for the future.

With world-class skills, world-class infrastructure, world-class knowledge industries, world-class resource and energy sectors and world-leading macroeconomic management credentials.

Professor Garnaut's book also adds to the important debate on the future role of government in the market economy.

As I have noted in my earlier remarks, I believe the crisis has fundamentally discredited the neo-liberal ideology that said markets would always be self-correcting.

Ross questions some of the different labels applied to various schools of economic thought in this debate.

[1] Ross Garnaut, "Breaking the Great Australian Complacency of the Early 21st Century", 2005 Economic and Social Outlook Conference, University of Melbourne, 31 March 2005

As I have said since my first speech in this place more than a decade ago, open markets at home and abroad are the most powerful and efficient generators of long-term economic growth, employment and prosperity.

But as I also said in both my maiden speech and a decade later in *The Monthly*, markets also fail.

The best model for government in our time is that of the enabling state:

- maximising the opportunities for enterprise and initiative;
- maximising productive growth by investing in the great productivity drivers of education and infrastructure;
- reducing the tax and regulatory impediments to business;
- enhancing competition policy at home and open markets abroad;
- and all the while, acting decisively on market failure when it occurs rather than indulging in the ideological self-delusion that it has not.

Ross has been a core player in the open market tradition of the Hawke and Keating governments.

On exchange rate policy.

On interest rate policy.

On dismantling the walls of protectionism.

This is a tradition that has simultaneously advanced both economic and social reform.

A tradition that helped workers to re-train and up-skill when their industries were affected by the phasing out of tariffs.

And that delivered the social wage, universal health care and the expansion of our university system, while building a sophisticated, internationalised and globally competitive economy.

The Hawke and Keating governments understood that prosecuting an economic reform agenda without a social reform agenda dooms both to failure.

They showed that you could build a strong economy while also building a decent society.

That in managing our economy, we do not need to make a choice between extremes - the invisible hand of market forces, or the dead hand of state socialism.

Or as I have said before, there are more options than just choosing between Friedrich Hayek and Leonid Brezhnev.

The challenge now is to get the lessons of the crisis right.

Neither to ignore the need for effective market regulation, nor lurch back to heavy-handed state paternalism.

The new reforming centre of politics must bring together the power of market forces to unleash incentive and innovation, provide a fair go for all and address market failures through the agency of the state.

The Government that I lead stands proudly in this reform tradition of past Labor governments.

As I've said before, still borrowing from Paul Kelly, a government and a nation of hard heads, soft hearts – and most critically, one of enabling hands.

Congratulations to Professor Garnaut and to David Llewellyn-Smith for an authoritative and accessible account of what history might ultimately judge as the single most significant economic event of our lifetimes.

It's also a great read.

Congratulations also to Louise Adler and Melbourne University Publishing – your imprint is an increasingly familiar item on the bookshelves of discerning readers.

I am delighted today to launch *The Great Crash of 2008*.

On balance, Ross, I give it a Distinction.

For the government at large, I'd be happy if we were to be awarded a Credit.

Ross – well done on a timely and important volume.

I hope your sales in Australia and throughout the world contribute to the nation's economic recovery and export revenues in the months ahead.