DEINDUSTRIALISATION UNDER LABOR: 1983 -1996

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This year marks the twentieth anniversary of the Australian Labor Party's accession to power as the Federal government. It might be opportune, therefore, to revisit Labor's legacy in terms of industry/trade policies. Contrary to the optimistic assessments and the rhetoric about the ostensible benefits bestowed by Labor's 'reform' agenda, it will be argued that the Labor Party presided over a period of unprecedented structural decline and deindustrialisation. Although one can trace Australia's industrial stagnation as early as the mid-1970s, the neoliberal policies enacted during the Labor era accentuated this historical phase of structural retrenchment. This article does not evaluate Labor's industry policies in detail; rather its focus is on the effects of these policies on Australia's trade and economic performance. The statistical evidence is confined, as far as possible, to the years 1983-96. The aim is to debunk some of the prevailing myths about Australia's economic performance during the Labor years.

Industry/trade policy in Australia during the Labor era shifted from the McEwenist orthodoxy of 'protectionism-all-round' to the other ideological extreme - a neoliberal programme of liberalisation and deregulation that continues to be advocated by the neoliberal consensus in Canberra. Australia evolved from one of the most highly protectionist countries to one of the least protectionist in the OECD (Capling & Galligan, 1992). In the meantime, there has been a long-term structural decline of Australia's manufacturing sector, which has manifested the attributes of 'path-dependency'. Drawing from this experience, it will be argued that it is necessary to go beyond the simple free

trade/protectionist dichotomy that has informed industry/trade policy over the past two decades.

The issue of a coherent industry policy should be catapulted to the forefront of the national agenda. At stake is the question of whether Australia takes the 'high' road or 'low' road in its future economic development (Marceau, *et. al.*, 1997). The former implies a more sophisticated and interventionist industry policy, which promotes innovation and technological upgrading in order to generate demand for highly paid and skilled knowledge workers. The latter implies unfavourable terms of trade as Australia competes in world markets for commodity exports, with a continued dependence on low skilled, low paid work. The secular decline in the terms of trade tends to impart downward pressure on the exchange rate, which curtails Australia's capacity to import high value added, high technology goods and services. In other words, a fall in purchasing power inevitably imposes limits to future growth through the balance of payments constraint. It is the contention of this study that, if we are to preserve existing standards of living, the low road is unsustainable. The policy debate should be recast to provide the rationale for a more coherent set of structural and innovation policies aimed at making the transition towards the high value-added and high technology sectors (Genoff & Green, 1998).

Labor's Perilous Embrace of Neoliberalism

Confronted by the minerals-induced currency appreciations of the 1970s which had eroded the international competitiveness of the manufacturing sector, the competitive challenge posed by the industrialising countries of north-east Asia, and the OPEC oil price shocks, Australian manufacturing began to falter and entered an era of decline. This was highlighted by the *Jackson Report* of 1975, which had argued that manufacturing was suffering from a 'deep-seated and long-standing malaise'. Indeed, the increasingly important role played by the mining industry reinforced the view that protectionism should not be allowed to inhibit the expansion of Australia's rural and mineral exports and thus imperil Australia's international comparative advantage.

The Australian Labor Party (ALP) in opposition after 1975 and the Australian Council of Trade Unions (ACTU) were both struggling to conceive of a coherent industry policy. A more interventionist and sophisticated approach was embodied in the policy document released by the Metal Workers Union but these proposals were not implemented.[1] The ALP had come to the conclusion that further tariff reductions were inevitable, though it had supported a gradualist strategy in which the adjustment would be made with minimal social disruption. This approach was inscribed in both the 1975 *Jackson Report* and the 1979 *Crawford Report.*

Within the top echelons of Canberra's central bureaucratic agencies, however, there was a neoclassical ascendancy in economic thinking, which provided the intellectual ammunition for the final assault on protectionism. An earlier manifestation of this intellectual current was evident during the Whitlam years in which the Tariff Board was restructured into the Industries Assistance Commission (IAC) in 1974 and evolved into the Industry Commission (IC) under the Hawke government in 1989. Proponents of neoliberal doctrines sought to completely dismantle the post-war regime of protectionism. Their theories were informed by standard textbook microeconomics, which had supported the view that, to improve international competitiveness and more efficient resource allocation, Australian industry should be exposed to the rigours of free trade. The economic rationalists believed that it was essential to deregulate both the financial and labour markets and to privatise, wherever possible, state enterprises. The Chicago school of economics, which had viewed small government and lower taxes as high virtues, so that the market would allocate resources and prevent the 'crowding out' of private investment, influenced their ideas. Governments, these economists argued, could not 'pick winners'. Their ideology was imbued with a profound distrust of government intervention and an equally blind faith in the efficacy of the unfettered free market (Carroll & Manne, 1992).

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1 A summary of these AMWU proposals can be found in the *Journal of Australian Political Economy*, No. 17, November 1984; and the subsequent ACTU/TDC *Australia Reconstructed* proposals in the *Journal of Australian Political Economy* No. 39, June 1997.

> Of significance was that the ideological centre of gravity had moved substantially between mid-1983 and mid-1985...By 1985, the proponents of 'economic rationalism' were in the ascendant – supported ideologically by such concepts as the 'crowding out' and 'twin deficits' theses which pointed to fiscal austerity, privatisation and deregulation, and 'microeconomic reform' (Jones, 1994, p.16).

The policy commitment of the Hawke government to trade liberalisation intensified after the collapse in the terms of trade in 1985-86. In its wake, the government declared that it would support the virtual elimination of all tariffs by the turn of the century. However, this did not initially imply a curtailment of the role of the state but an emphasis on selective inducement to encourage industrial restructuring. This new approach took the form of sectoral plans advocated by John Button, the new Industry Minister. Labor promoted industry plans for specific industry sectors and increased government assistance to promote exports, skills training, R & D and improved access to investment and venture capital. The sectoral plans were designed to wean the most heavily protected industries from tariffs as the sole instrument of state support and to encourage an export-orientated culture. It should be stressed that the brief but ill-fated experiment to craft a more strategic industry/trade policy had complemented rather than undermined the neoliberal strategy of trade liberalisation. After the abolition of the Department of Trade in 1987, industry/trade policy had been informed by the tenets of liberalisation and multilateralism. These twin objectives were pursued through the Uruguay round of the GATT, which began in September 1986, and later through the Asia-Pacific Economic Co-operation (APEC) forum.

Senator Button's most notable achievement in his period as Industry Minister was to shift the focus of Australia's industry policy from a domestically introverted strategy to one that was based on fostering the development of innovative, export-oriented industries.[2] He developed a targeted sectoral approach which traded-off incentives such as bounties, industry modernisation schemes, support for labour retraining, R & D grants, tax incentives and so forth with a programme of winding back

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2 A more detailed treatment of these industry plans can be found in Capling & Galligan (1992).

protectionism. These industry-specific plans were quite sophisticated by Australian standards in the sense that government assistance was both time-limited and dependent on the commitment by those targeted sectors to restructuring. Yet these policies were to be anathema to the supporters of neoliberalism who had gained powerful positions within both the ALP and the bureaucracy.[3]

After the 1986 'banana republic' crisis, which involved a sharp currency depreciation triggered by a collapse in the terms of trade, the proponents of neoliberalism mobilised support for greater trade liberalisation. Senator Button responded to these demands by announcing his intention to focus on tariff reform in June 1987. This signalled a radical departure from the targeted sectoral policies and it established 'microeconomic reform' as the official policy template. Despite opposition from the ACTU, the Hawke government announced major tariff cuts from an average effective rate of assistance of 19 to 14 per cent by 1992-93. However, these cuts did not initially cover the most heavily protected industries in the automotive and the textile, clothing and footwear sectors.

In March 1991 the Hawke government announced a further programme of phased tariff reductions that would reduce the general effective tariff rate to 5 per cent by 1996. Prime Minister Hawke also endorsed the *Garnaut Report,* which had advocated a 'scorched-earth' policy of zero tariffs by the year 2000. This completed the mutation of industry policy under Labor from the market-driven sectoral adjustment policies in the spirit of the *Jackson* and *Crawford* reports to the neoliberal programme of microeconomic reform. Consequently, industry policy was now almost entirely governed by the imperatives of globalisation. The critical question that needs to be posed is 'what were the consequences and the legacy of this radical policy shift?'.

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3 A humorous example of this opposition by the economic rationalists was the statement by the former Secretary of the department of Prime Minister and Cabinet (PM&C), Michael Keating, that the very existence of an industry policy was akin to 'original sin'.

Negative Deindustrialisation

Rowthorn and Wells (1987) distinguish between *positive* and *negative* deindustrialisation. Positive deindustrialisation is defined as the normal result of sustained economic growth in a fully employed and highly developed economy. It entails productivity growth in the manufacturing sector, which is quite rapid and sustainable, with the result that employment in this sector tends to decline relative to services.[4] Most of the new jobs are generated in the 'knowledge-intensive' services that are linked to the productive sector. Maintaining a rise in output at the same rate in the two broad sectors would require a continuous shift in the pattern of employment (Cohen & Zysman, 1987). This form of deindustrialisation is not primarily caused by a shift in demand from manufactured goods to services, but is mainly due to the productive dynamism of industry and the high rates of productivity growth made possible by technical advances (Momigliano & Siniscalo, 1982).

Negative deindustrialisation, on the other hand, is a pathological condition, symptomatic of industrial decline. Since most of the labour shed in manufacturing is not entirely reabsorbed into high wage, knowledge-intensive services, the economy is characterised by high levels of structural unemployment. Most of these service activities are generally low wage and labour-intensive (e.g. tourism, hospitality). It will be argued that Australia is an exemplar of this negative deindustrialisation, experiencing the 'British disease' of negative deindustrialisation and a general run-down of capital stocks. During the Labor years, Australia's structural decline was also evident in the deterioration of the current account deficit and net foreign debt. The onset of adverse terms of trade has been accompanied by a secular decline of the effective exchange rate.

These fundamental structural problems are of long-standing. Australia's industrial anatomy has inherited dualistic features in which industrial

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4 This decline can be explained by the 'productivity price paradox' in which the relative price of the outputs of industries with higher productivity declines relative to those industries with lower productivity. Therefore even if the manufacturing sector increases its volume of output, its share of GDP may decline relative to other industries which exhibit a lower rate of productivity growth.

enclaves are dominated by foreign owned subsidiaries of Trans-National Corporations (TNCs) and are usually surrounded by a cluster of smaller, local enterprises which service these foreign subsidiaries. A deficiency of local investment has induced a type of 'dependent industrialisation' characterised by a dual industrial structure. This type of industrial bifurcation has inhibited the development of vertically integrated sectors, while the smaller domestic firms have found it increasingly difficult to compete with the large TNCs based in countries possessing large technological bases and greater market power. These relatively weak vertically integrated linkages suggest that the Australian economy lacks structural cohesion (Halevi, 1996). This is most evident in the absence of a well-developed capital goods sector.

As a relatively small, open economy, Australia continues to rely on the importation of high technology capital goods. In the more integrated, relatively closed industrial economies that enjoy the benefits of a large domestic market the impact of an increase in private investment provides a strong stimulus to growth as it increases the demand for domestically produced capital goods (Pasinetti, 1981). However, Australia does not enjoy these characteristics; the economy is neither fully integrated in the sense of having developed linkages within and between sectors, nor does it have a large domestic market. On the contrary, most industries are highly integrated into the world economy, while most capital goods and a rising share of intermediate goods are imported. The Australian economy is therefore quite vulnerable to external shocks, which are transmitted through the balance of payments.

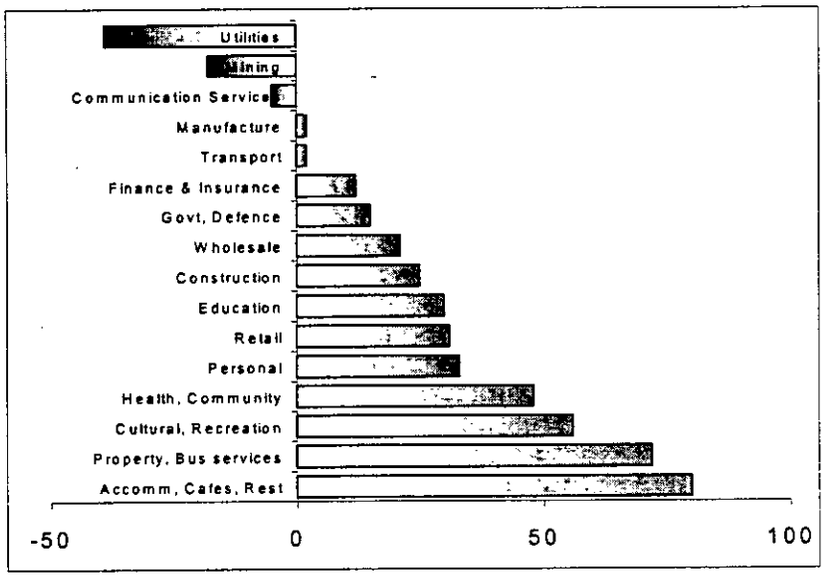
In the more developed capitalist countries, manufacturing exhibits closely integrated backward and forward linkages with other sectors of the economy (including other parts of the manufacturing sector). Forward and backward linkages can be revealed by means of input-output tables. These linkages encourage technological diffusion and technical know-how ('learning by doing') as well as increasing returns through networks, supply chains and industry clusters. However, Australia's industrial structure has not developed a coherent matrix of vertically integrated sectors. In a recent OECD report, an important source of Australia's structural weakness was identified in the lack of inter-industry linkages:

> Input/output analyses for Australia indicated a lack of inter-industry linkages. Many firms are unable to find partners to develop innovative products and processes. Reasons for the lack of networking include the low tech nature of most economic activity and the high degree of concentration. Industrial activity essentially takes place in vertically integrated large business (most of them being overseas multinationals) and as a consequence innovation takes place in hierarchies rather than in flexible networks or clusters. This creates a situation where production and knowledge flow links are not embedded in education, training and research institutions, creating gaps in the innovation networks on which innovation firms depend (OECD, 1998a: 47).

Employment in manufacturing in Australia peaked at about 27 per cent of total employment in 1950, remaining high throughout the 1950s and 1960s. Employment growth in manufacturing during this period was quite rapid, increasing from 890,000 in 1949 to 1,315,000 in 1967 (Bell, 1993: 24). By 1979, the share of manufacturing in total employment had fallen to 20 per cent and was only 13 per cent in 1998 (ABS, 1998a: 32). By contrast, the OECD average had a more modest decline from 28.3 per cent of GDP in 1970 to 20.6 per cent in 1998 (ABS, 1998a: 104). In the three decades between 1966 and 1995, manufacturing employment in Australia fell by less than 120,000 (down from 1.23 million to 1.12 million people). But this same period saw an increase in total Australian employment from 4.8 million to 8.1 million. Although annual manufacturing output is more than twice as large (in real terms) as it was three decades ago, manufacturing's share of GDP has fallen by around 11 per cent over the period.

The most rapid growth in employment has been in the tourism industry, while the sectors with the greatest job losses have been utilities and mining. As a general rule, the industries that have gained the most employment have clustered around the lower end of the innovation spectrum, whereas those with relatively poorer employment growth are concentrated at the higher end of the knowledge intensive scale (with the possible exception of business services). A sectoral breakdown of employment growth between 1985 and 1995 is illustrated in Chart 1.

Chart 1: Employment Growth by Industry, 1985-95 (%)



Source: ABS Labour Force, 1996.

This shift toward the lower wage end of the labour market in services is also reflected in the concomitant rise in part-time employment, with the share part-time jobs increasing three fold between 1973 and 1998. At the same time, full-time employment has fallen sharply - to about 20 per cent lower as a share of total employment over the same period.

Manufacturing accounts for 57 per cent of Australia's total business R & D expenditure. This share of R & D spending is almost 4 times greater than the sector's share of value-added production. However, the overall R & D intensity of Australian manufacturing was less than half the average of the 12 leading OECD countries in 1997 (OECD, 1998c). The last OECD survey before Labor's demise had ranked Australia's business expenditure on research and development (BERD) as a percentage of GDP at the very bottom rung (Table 1). This low level of private R & D

expenditure was offset, to a large degree, by R & D spending in the public sector. The pre-eminent role performed by manufacturing in terms of generating R & D expenditure is further reinforced by evidence of higher productivity growth in relation to other sectors. Between 1973 and 1993, Australian manufacturers' Total Factor Productivity (TFP) increased on average by 1.5 per cent a year. However, Australia's overall manufacturing productivity performance was still below the OECD average, which recorded a trend annual rate of TFP growth of 1.8 per cent between 1973 and 1993 (Clark, *et. al.*, 1996).

Table 1: Income & Technological Performance, 1995

	Income level	Indicators of Scientific and Technological Performance				
	GDP per head as a % of OECD average	Gross domestic expenditure on R & D as a % of GDP	Scientific & technical articles per unit of GDP#	Govt financed R & D as a % of GDP	Govt financing of R & D as a % of total R & D	BERD as a % business GDP
US	140	2.6	20	0.9	34.6	2.1
Japan	128	1.7	21	0.8	43.5	1.4
Canada	114	1.7	25	0.6	33.7	1.4
Australia	107	1.6	24	0.8	47.5	0.9
Germany	107	2.3	21	0.8	37.0	1.9
France	103	2.3	20	1.0	42.3	1.9
Italy	102	1.1	13	0.5	46.2	0.8
Sweden	100	3.6	41	1.0	33.0	3.9
UK	98	2.1	29	0.7	33.3	1.8
Korea	72	2.7	5	-	19.0	2.3

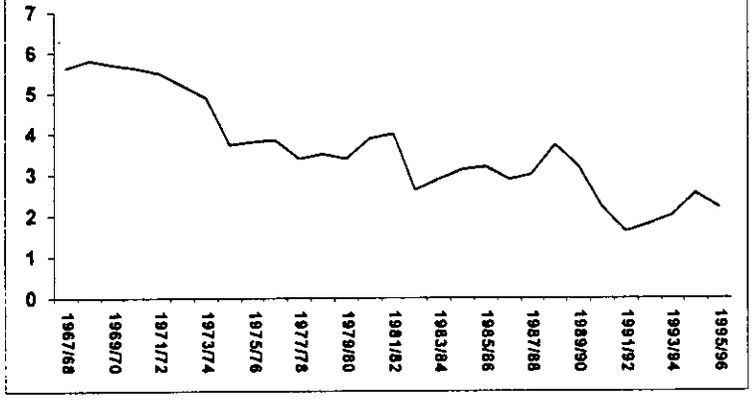
Scientific and technical articles per billion $US of GDP.

Source: OECD, 1998 (Ref No. DSTI/STP/TIP(98)6/REVI)

Negative deindustrialisation has also been evident in the gradual rundown of capital stocks. In the course of the neoliberal ascendancy, both state and federal governments reduced spending on physical infrastructure in order to reduce the stock of public debt. The imposition of this fiscal constraint has witnessed a concomitant increase in private

sector investment in infrastructure through successive policies of privatisation. Infrastructure accounts for one third of Australia's capital stock and one quarter of new investment. With assets valued at around $400 billion in 1995, infrastructure services make a significant contribution to economic growth in their own right.[5] Moreover, the competitiveness of Australian firms is determined to a large extent by the costs and quality of infrastructure services which, for most industries, make up between 10 and 25 per cent of total costs (BIE, 1995).

Chart 2: Growth Rate of Australia's Net Capital Stock (% of GDP, 1967/68 to 1995/96)

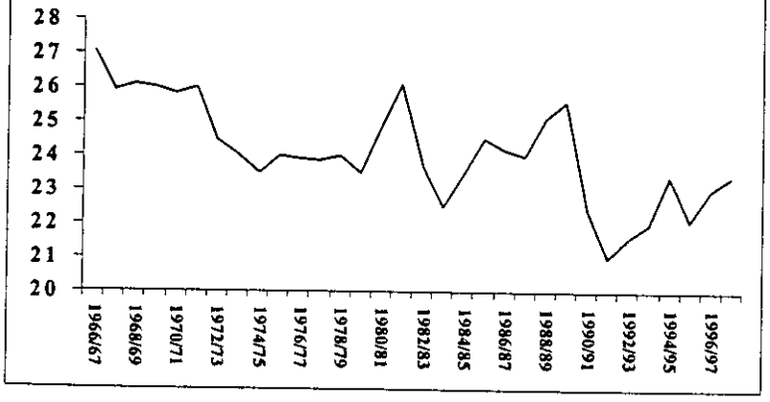


Note: Figures derived from fiscal year end Net Capital Stock at average 1989/90 prices.
Source: Australian National Accounts, Capital Stock (5221.0).

5 The provision of infrastructure in Australia is dominated by the public sector at every level of government, which accounts for around 90 per cent of all assets. Transport and communications facilities, together with the production and transmission facilities of electricity, gas and water, account for about 70 per cent of the stock. Social infrastructure such as hospitals, schools, police stations, prisons and so forth, account for the remaining 30 per cent. The Commonwealth is responsible for about 25 per cent of public infrastructure investment, while the State/local sector represents 75 per cent (Evatt Foundation, 1989).

At the same time, however, the fall in the growth of Australia's net capital stock (i.e., the accumulation of gross investment less depreciation of old capital) has led to a decline in Australia's *sustainable* rate of economic growth (Chart 2). Indeed, the size of the capital stock determines the limits on physical output. If the rate of growth of investment falls, constraints will be imposed on the rate of growth by placing pressure on inflation or on the balance of payments. A similar trend is evident in Gross Fixed Capital Formation (GFCF). In the mid-1960s, investment in GFCF accounted for as much as 27 per cent of Australia's GDP. However, by 1991/92, this figure had slumped to 21 per cent, only to recover slightly to 23.4 per cent in 1997/98 (Chart 3). The downward trend in the share of GFCF disguises a divergent trend between investment by the private sector and the public sector. While private sector investment in GFCF accounted for about 20 per cent of GDP, the share of public spending had halved, from about 8 per cent of GDP in the mid 1960s to only 4 per cent in 1997/98 (Allen Consulting, 1999).

Chart 3: National Gross Fixed Capital Formation (1966/67 to 1997/98, % of GDP)



Source: Australian National Accounts, National Income and Expenditure.

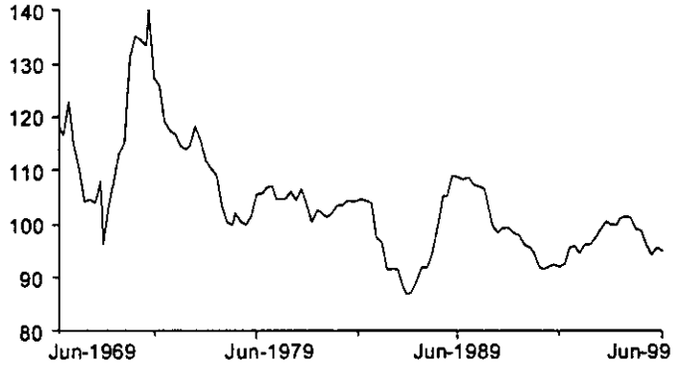
Note: Derived from data expressed in current price terms.

It can be surmised that the generally contractionary fiscal policies pursued during the Labor era had the effect of curtailing capital expenditure disproportionately in relation to recurrent expenditure. Expenditure on physical infrastructure has been adversely affected, which has negative consequences for output growth, productivity and future international competitiveness. In short, reductions in public investment lead over time to equivalent falls in private investment. There is a trade-off between contractionary fiscal policies in order to reduce the stock of public debt, on the one hand, and maintaining capital expenditure outlays in order to increase the stock of private capital, on the other hand (Kearney, *et. al.*, 1994). It has been this fiscal constraint that has governed the shift to greater private sector involvement in infrastructure over the past two decades.

The Collapse in the Terms of Trade

Australia's continued reliance on commodity exports has had a negative effect on the terms of trade as the prices of commodity exports have fallen in relation to those of the mainly manufactured and high technology imports. Declining terms of trade reduce the purchasing power of domestic economic output. Towards the end of the Labor era, manufactured goods in Australia had only accounted for 18 per cent of total exports (Hart & Richardson, 1993: 106). By stark contrast, manufactured exports accounted for 56 per cent of total exports on average in the 16 leading OECD countries. Almost two thirds of Australia's merchandise trade continued to comprise primary products - a ratio comparable with middle-income developing economies like Argentina, Brazil and Mexico. Indeed, over 70 per cent of what are officially classified as manufactured exports constitute semi-processed raw materials. As a result of this specialisation of exports whose prices have declined relative to manufactured goods, Australia has experienced a long-term decline in the terms of trade over the past 30 years (Chart 4).

Chart 4: Terms of Trade, 1969-99



Note: (1989/90=100)

Source: RBA Database, 1999

There have been some notable successes in Australia's exports of manufactured goods. In the ten years to 1995-96, annual manufactured exports (measured on an industry basis) grew in real terms at a trend rate of 8.7 per cent per annum. Encouraged to a large extent by the Button industry plans, the export propensity of Australia's manufacturing sector's output that is exported increased from 16 to 25 per cent over the period. On the other hand, imports of manufactured goods increased at an annual rate of 6.8 per cent over the same period; imports as a proportion of total imports increased from 26 to 35 per cent. Australia's total exports of goods and services grew at a trend rate of 6.9 per cent per annum in the decade to 1995-96.[6] Manufactured exports accounted for almost two thirds of total export growth over the period. This resulted in the value of manufactured exports tripling, increasing from $13.5 billion to $40.8 billion at current prices (ABS, 1998b). It should be noted, however, that this export boom was also induced by an estimated 30 per cent fall in the trade-weighted index of the Australian dollar over the same period (as shown in Chart 5).

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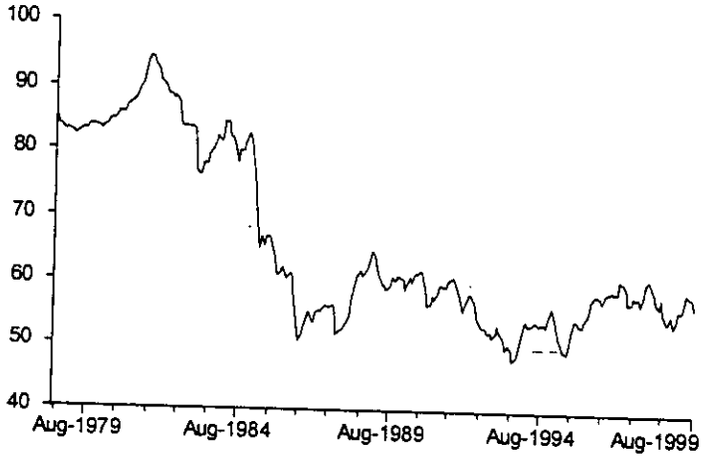
6 Measured in constant prices, on a balance of payments basis.

Chart 5: Trade Weighted Index of the Value of the A$, 1979-99



Source: ABS Time Series, 1999.

Note: (May 1970 = 100)

World trade in manufactured goods is increasingly knowledge-intensive. Since 1980, high technology exports and imports have grown faster than other manufacturing sectors. Whereas high technology trade accounted for only 10 per cent of total world trade in 1980, it accounted for about 17 per cent in 1994 (OECD, 1998c: 9). The OECD definition of high technology sectors includes aerospace, computers and office equipment, electrical machinery, pharmaceuticals and scientific equipment. World exports of high technology products grew by 15 per cent per annum between 1985 and 1995, compared to an average of 7 to 9 per cent for all other merchandise exports. If one extrapolates this sectoral trend, high tech exports would represent about 30 per cent of total manufactured exports by 2005 (Sheehan & Tichomirova, 1998: 41).

In Australia, by contrast, a high share of investment (around 55 per cent) is still in low technology industries, most notably in food processing,

paper processing, textiles, clothing and footwear and in basic metals. The value of elaborately transformed manufactures (ETMs) in Australia grew 14.2 per cent a year in current prices between 1987-88 and 1997-98, while imports increased by only 8.7 per cent per annum. The absolute size of the gap between ETM exports and imports, however, has increased. The trade deficit in ETMs rose by an annual average of 7.3 per cent over the same period (Sheehan & Tikhomirova, 1998: 120). In 1997-98, the trade deficit in ETMs was estimated at $A49 billion (as shown in Table 2).

Table 2: Components of Australian Commodity and Service Trade, 1977-78 to 1997-98

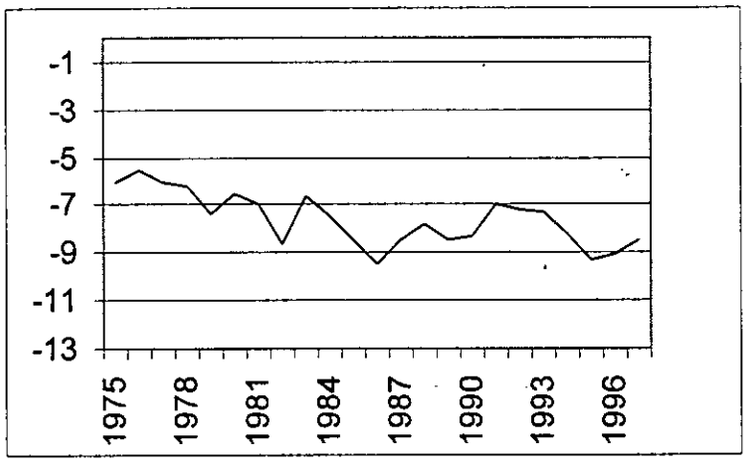
				Average annual change (% p.a.)	
	1977-78 (A$mil)	1987-88 (A$mil)	1997-98 (A$mil)	1977-78 to 1987-88	1987-88 to 1997-98
Exports of					
ETMs	1602	4406	16635	10.6	14.2
Other Manufactures	986	3933	7453	14.8	6.6
Other Commodities	9104	30630	58459	12.9	6.7
Total	11710	38968	82547	12.8	7.8
Imports of					
ETMs	9626	28529	65641	11.5	8.7
Other manufactures	1003	4375	7221	15.9	5.1
Other Commodities	2300	6992	11887	11.8	5.5
Total	12929	38996	84749	11.7	8.1
Balance of Trade					
ETMs	-8024	-24123	-49006	-11.6	-7.3
Other manufactures	-17	-442	232		
Other commodities	6804	23638	46572	13.3	7.0
Total	-1291	-28	-2202		
Services Trade					
Exports	2230	10168	25550	16.4	9.7
Imports	4593	12620	26314	10.6	7.6
Net balance	-2363	-2452	-764		

Source: Sheehan & Tikhomirova, (1998: 121)

Australia continues to be highly dependent on commodity exports. Consequently, the terms of trade tend not to be favourable in the long-term, while the persistence of excess capacity in these markets has imparted a secular decline in commodity prices. Commodity exports adjust more to changes in world income than to prices, and are relatively price-inelastic (Halevi & Kriesler, 1993). As an international price-taker, Australia is quite vulnerable to the cyclical fluctuations of commodity prices that have played a determinant role in the balance of payments and in the behaviour of the exchange rate. Since the onset of recurrent mining booms during the past two decades, there has emerged a direct relationship between the exchange rate and commodity prices. After the floating of the dollar in the early 1980s, the exchange rate has been determined largely by commodity prices, most notably in the key energy exports. The Australian dollar itself has become a tradeable commodity in foreign exchange markets and has been inextricably linked to international commodity prices.

This relationship between international commodity prices and the behaviour of the exchange rate has been described as the 'Gregory effect' (Gregory, 1991). Its central proposition is that growth of mining exports boom causes an appreciation of the nominal exchange rate. This had an adverse effect on the competitiveness of Australia's manufacturing exports during the recurrent mining booms of the 1970s and early 1980s. Similarly, with the liberalisation of the Australian economy, the manufacturing sector has encountered quite savage competition from cheap imports. This process of industrial restructuring has been evident in the decline of local investment in manufacturing and the gradual run-down of capital stocks (as a percentage of GDP) (Sicklen, 1997). Chart 6 illustrates the growing trade deficit in manufacturing as a percentage of GDP. Competition from Japan and later from the East Asian newly industrialised countries (NICs) has gradually displaced domestic manufacturing by cheaper imports. The policies of trade liberalisation have effectively condemned Australia to specialise in the export of commodities in the global market.

Chart 6: Australia's Trade Deficit in Manufactures, as a Percentage of GDP, 1975-97



Source: Sicklen (1997).

The openness of the Australian economy has also ensured that within this structural remoulding it has shared the short-term oscillations of the world economy. This 'boom-bust' syndrome has been closely synchronised with international trade cycles. As Australia has increased its share of manufactured imports and foreign investment over the past two decades, the structural imbalance has worsened. Each business cycle recovery has encountered the exchange rate constraint, which manifests itself in a balance of payments crisis and a cumulative increase in the current account deficit. A self-perpetuating cycle of low levels of domestic investment to generate endogenous saving has also increased Australia's dependence on international capital inflows. Consequently, Australia's net foreign debt rapidly increased and was equal to about 40 per cent of GDP by the end of the Labor era. Since the foreign debt is largely denominated in US dollars, the 'valuation' effect of a nominal depreciation of the Australian dollar has the effect of increasing the value of Australia's private and public debt.

A cursory analysis of the composition of Australia's foreign debt reveals the following attributes:

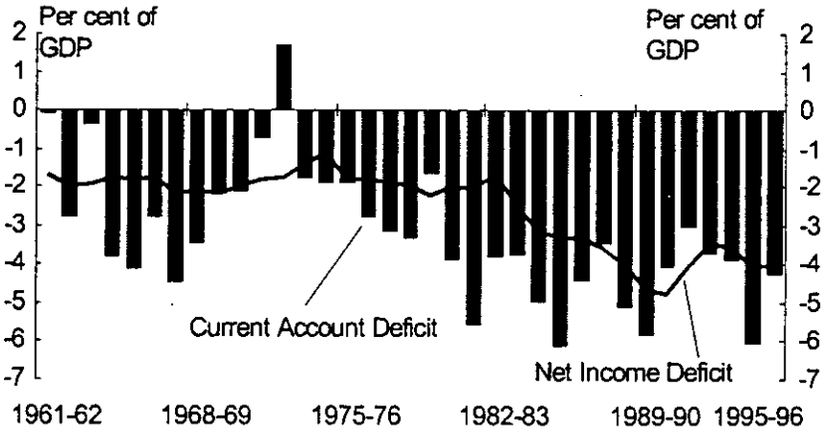
- 75 per cent of the net foreign debt has been incurred by the private sector;
- the domestic financial sector has intermediated an increasing amount of the foreign borrowing since financial deregulation in the early 1980s;
- 60 per cent of Australia's gross foreign debt is denominated in foreign currencies and about 60 per cent of this is denominated in the US dollar;
- the debt/equity ratio of foreign liabilites has risen sharply and has been accompanied by a decline in the maturity of the debt which places greater strains on the ability to service outstanding foreign debt (Kearney, 1993).

In other words, foreigners are financing Australia's current trade deficit by acquiring domestic assets. Overseas investment in Australia is growing faster than Australian investment abroad, which means that Australia relies more heavily on the importation of capital. Foreign investors acquire a return on their investment and these interest and dividend payments appear in the balance of payments as a negative entry in the net income component of the current account. This has consistently been the largest component on the current account deficit and implies that Australia has become more dependent on the inflow of foreign investment.[7] As a result, since the early 1980s, Australia's net foreign debt has risen quite rapidly, with the private sector's net foreign debt rising at more than twice the official rate. During the Labor era, net foreign debt rose from 10.6 per cent of total GDP in 1981/82 to 40 per cent of GDP in 1994-95 – almost four-fold. Australia's total net interest payments as a percentage of exports rose from 6.7 to 11.3 per cent over the same period, peaking at 20.6 per cent in 1989/90. Charts 7 and 8

7 In the financial year 2000-01, the foreign debt had risen to over $300 billion, or about 47 per cent of GDP. In the meantime, the Australian dollar had crashed to historic lows to be 50 cents against the US dollar in March/April, 2001. From mid-2000 until mid-2002, the Australian dollar was the worst performing currency in terms of the effective exchange rate with the exception of the Turkish lira.

situate this collapse of Australia's external balance during the Labor years in a more long-term context. They show a feature of Australia's economy which has worsened and become entrenched as a major structural problem.

Chart 7: Balance on the Current Account



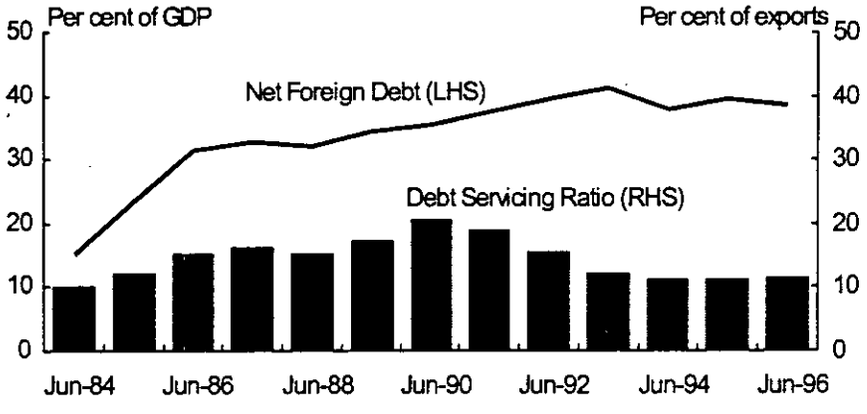
Note: Not seasonally adjusted.

Source: Budget Papers, 1997.

This severe external imbalance emerged during the era of the neoliberal ascendancy from the early 1980s onward. The advocates of this strategy claimed that market liberalisation and deregulation would encourage an increase in the level of productive investment and economic restructuring through the purgative forces induced by competition. The whole strategy hinged on the dismantling of national forms of capitalist regulation, protectionism and state support for local industries. The fatal flaw of the neoliberal programme, however, was the lack of a coherent structural policy to encourage industrial upgrading and technological reconversion. After two decades of economic 'reform', the evidence suggests that

Australia's export sector resembles that of a developing country in the upper-middle income. The long-term implications would appear quite dire.

Chart 8: Australia's Net Foreign Debt, 1984-96



Note: Not seasonally adjusted.

Source: Budget Papers, 1997.

Although Australia's manufacturing industries have become more competitive in world markets, the level of foreign investment and ownership has increased. The restructuring of the Australian economy and the policies of national deregulation set in motion the internationalisation of the Australian economy. The efficacy of national macroeconomic policies has been eroded as a result. A powerful trade-off has developed between the national objectives of full employment and macroeconomic stability, on the one hand, and the need to maintain an external balance, on the other hand. In order to resolve this structural problem, a more sophisticated and strategic industry policy is essential. Unless a coherent industry policy provides the basis for a shift towards high value-added and high technology sectors, Australia is destined to take the low road of 'genteel' decline. The *Goldsworthy Report* forecast

that the trade deficit in information technology alone will be about $46 billion annually by 2005 (*The Global Information Economy: The Way Ahead,* 1997). To be sure, the visible symptoms of regional decline have already generated a considerable political backlash in Australia. The long-term decline in commodity prices and the deterioration of the terms of trade can be expected to accentuate these regional disparities.

Conclusion

The Labor government abandoned the ethos of 'nation-building', which had guided the economic policies of the post-war years. Capitalist modes of regulation (i.e., industry intervention, financial regulation, centralised wage bargaining, etc.) were effectively dismantled by Labor's embrace of neoliberalism. Neoliberals argued that these national policies could no longer be sustained. Yet the two decades of 'economic reform' that Labor inaugurated have produced adverse outcomes. Neoliberalism has proved to be a disastrous experiment. It has singularly failed to restore the competitive dynamism of Australian capitalism through the purgative forces induced by market liberalisation. Labor's enthusiastic embrace of neoliberalism paved the way for its yet further extension by the Liberal-National Coalition led by John Howard. The end result has been the retrenchment of the industrial base; growing regional and income inequalities, which threaten to break out into social discord; a burgeoning current account deficit, a rise in net foreign debt and the sharp fall of the effective exchange rate.

In short, industry policy – if we are to use the term in its strictest definition as a type of long-term structural policy – had been a dismal failure. Indeed, it would be reasonable to contend that Australia is devoid of a coherent and strategic set of policies that are geared to promoting structural change and technological upgrading. Much of what is construed as industry policy is nothing more than an incoherent plethora of measures informed by neoliberal economic doctrines. Consequently, the policy debate is often mired in quite banal and sterile ideological disputes over 'picking winners' and providing the rationale for government intervention on the grounds of 'market failure'. An alternative view would simply acknowledge what economic historians

have always known; that the state has played a pre-eminent role in the entire process of Australia's economic development (Catley & McFarlane, 1981).

Structural change in the Australian economy during the Labor years led to quite profound sectoral shifts. The overall effect has been a process of long-term structural decline and negative deindustrialisation. Furthermore, the pivotal role of manufacturing has been downgraded and neglected. Although one should acknowledge the shift towards a knowledge-based economy, the myth that this implies a post-industrial society should also be debunked. Indeed, it is the knowledge-intensive sectors of manufacturing that exhibit the fastest growth rates and exports. Manufacturing still accounts for 57 per of business expenditure on research and development (BERD) in total output, even though it constitutes only 13 per cent of GDP. Similarly, manufacturing accounts for over 50 per cent of productivity growth in total private sector output (Toner, 2000: 24). The expansion of industrial exports would therefore contribute to overcoming the balance of payments constraint on future growth (McCombie & Thirwall, 1994).

This study reaffirms the pre-eminent role of manufacturing and the capital goods sector as the primary catalyst for growth in the economy as a whole. In contrast to the static *a priori* assumptions that govern conventional neoclassical accounts, the argument has been based on the 'stylised fact' that manufacturing acts as the 'engine' of growth (Kaldor, 1985, 1996). The implications of long-term structural change are far more pervasive and profound than suggested by the neoclassical analysis of static misallocation of resources resulting from monopoly power and tariffs. Unfortunately, the present focus of public policy in Australia is still on the latter while the former has been neglected.

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