NATIONAL ECONOMIC STRATEGIES AND INTERNATIONAL FINANCE

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Australia Reconstructed (*AR*) was released at a most turbulent time in Australian economic history. It was just one year after Prime Minister Keating's famous 'banana republic' statement, portending that the Australian economy would rapidly decline unless there were major structural changes. It was also the peak of a global speculative boom, and 4 months before the October 1987 stock market crash.

Those two historical factors stood largely at odds. The banana republic proposition framed the need for long-term planning and hard changes if Australia was to have economic success. The speculative boom showed that wealth and high living could come simply with bold commercial judgments (gambling). Of the two, the former was clearly the lasting reality. But there was another difference. The planning agenda was nationally-centred, while the gambling agenda was globally-oriented, involving fund raising in international capital markets to finance international (and domestic) takeovers.

From this perspective, there was a permanent change which came with the speculative boom: that the profitability of companies is tied more to their global financial positioning than to a healthy domestic economic structure. When the two go together, that's convenient, but if there is a conflict, global positioning will always win. This is currently being shown so clearly by BHP's decision to close its Newcastle steel works - in the conflict between BHP's global investment agenda and Australia's industry profile, the former wins hands down.

AR aimed to reconcile corporate profitability and national industry structure. The analytical proposition required for the reconciliation is that a well planned national economy can offer investment options which are profitable by international standards, and so entice capital to 'stay' and flourish. The question is how that enticement is constructed - what can national planning do to make industry more profitable than it would otherwise have been?

AR took this to be a much more straightforward question than it in fact is. In its consideration of how national planning of investment could be reconciled with corporate profitability *AR* showed a basic misunderstanding of the role of international finance.

AR focused on current impediments to 'productive' investment in Australia, and alternative long-term strategies to increase 'productive' investment. The report targeted the falling value of the dollar (increasing the cost of imported capital equipment; impacts on interest and inflation rates) and the growth of short-term, speculative investment (takeovers, especially driven by credit, and trade in financial assets supplanting investment in new plant and equipment) as particular obstacles. Its recommendation was for an inquiry into the pattern of investment in Australia, and its domination by speculation and the foreign exchange market and for a National Development Fund to oversee the pattern of investment in Australia (*AR*: 19-23)

Perhaps because of its mid 1980s context, *AR* conflated finance with the activity of speculation. Absent is an understanding of the globalisation of investment funds and the role of profitability in the direction of finance to investment. That absence leads to the ultimately naive suggestion that finance can be tamed for domestic industrial policies without negative repercussions. Before looking at the proposals, it is useful first to identify how 1980's specific the *AR* analysis was.

AR appeared at a time when companies such as Bond Corp., Elders and Quintex, and their high-profile bosses, were making paper profits as quickly as they could raise international credit. Almost everyone knew it couldn't last, and most people perceived that a lot of debt and asset shuffling was creating profits of dubious legality. On-going court cases seem to be confirming this belief. These glamour speculators may not have lasted for long, but they were part of a change that will last for the foreseeable future. In 1984 , the debt/equity ratio of companies in Australia was 0.4 (they held on average four dollars of debt to ever ten dollars of equity. At the hight of the speculators' activity the ratio increased to 1.2 for Australia overall and to more than 3.0 for some of the bold ones. By mid 1990s it is 0.7, and that is with all the 1980's highest geared companies out of the market (Mills, 1993). This change from 0.4 to 0.7 is a permanent change, and it locks companies in Australia into credit markets. Moreover, these are international, not domestic, credit markets. In 1984, there were new issues of Australian dollar Eurobonds to the value of $0.5 billion per annum. By 1996, the figure was $15 billion per annum (having reached $13 billion per annum in 1987, before falling steadily to $4 billion 1993) (RBA, data supplied). In general, what could be dismissed in the mid 1980s as speculative excess is now much more standard fare - not the extravagant leveraged buyouts, but the overall integration into global finance.

AR also appeared at a time when the value of the Australian dollar had fallen dramatically from the beginning of the 1980s. In 1981 the Trade Weighted Index (TWI) of the Australian dollar peaked at 96. It then fell steadily over the next 5 years, with the Reserve Bank maintaining a 'hands off' approach, bottoming at 49 in 1986. The effect was that movement on the Australian dollar was dominating macroeconomic policy settings, particularly inflation and interest rates. Yet since 1987 the dollar has been relatively stable, and in the 1990s the TWI has varied only between 48 and 58. Moreover, today the dollar is much more heavily traded than it was in 1987. In 1987, daily turnover on foreign exchange markets in Australia was $A15 billion. In 1995 it was $A50 billion. In addition, around 60 percent of trade in the Australian dollar now takes place outside Australia (RBA 1996).

Concerns expressed in *AR* about the effects of foreign exchange speculation on domestic investment must be seen as a reaction to short-term impacts of speculation which were particular to the mid 1980s. The fall of the dollar cannot be sheeted home to the level of foreign exchange dealings, as the dollar has stabilised and foreign exchange dealings, no doubt with significant speculative component, continue to rise rapidly.

Any suggestion that the exchange rate could now be 're-regulated' as a tool of macroeconomic management must be seen as fanciful.

Yet the peculiarly mid-1980s identification of the domination of speculation in investment dominated *AR*'s long term perspective. *AR* recommended plans for a National Development Fund, to provide a pool of resources to fund domestic investment. The source of the funds was to be a levy on the assets of Australia's superannuation funds (this is addressed in the article by Coates elsewhere in this issue). The apparent rationale for tapping into these funds was that in their privately managed state they were believed to be inherently speculative, playing the stock market, the property market and the foreign exchange market.

According to the proposed scheme, if the levy was 10 percent of superannuation assets, there would be a projected $1.7 billion dollars inflow in 1996 (and double under a 20 per cent scheme). In contrast with 1996 Australian dollar Eurobond issues of $15 billion, and private gross fixed capital formation of almost $80 billion (ABS 1995-96) in that year, the offerings of the proposed development fund look trivial.

The argument goes, presumably, that the role of a National Development Fund is to top up investment requirements - meeting the needs that the commercial market is not providing for. If that is the argument then two questions follow. First, what is the basis of the argument that such a small percentage of overall investment funds can reconcile the contradiction between corporate profitability and desired national industry structure? There is no mechanism spelt out either in *AR* or by other alternative economic strategists. Second, if the funds provided by a National Development Fund are to fill the gaps in the market not filled by commercial sources, there must be a systematic tendency for the rate of return on those funds to be lower than the rate of profit on commercially-sourced funds. When we add to the inevitable lower rate of return on commercial investment the *AR* aspiration that some part of the National Development Fund be allocated to soft loans, training and housing , it can be conjectured that the rate of return on the National Development Fund would be very low indeed. The fact that these funds are workers' (compulsory) savings then becomes a critical issue - a lower rate of return means lower pensions, and amounts to workers subsidising the profitability of industry. Nowhere in *AR*, nor in subsequent national investment agendas, is this concern addressed, other than by rhetorical notions that a well balanced economy will lead to growth.

One can only conjecture that this analytical gap derives from the perception that all financial investment is 'speculative', in the sense that it does not add anything to the value of production and hence can be seen as a supply of funds available to be directed at will. The formula followed by *AR* is that if these funds can be diverted away from 'speculation' and towards productive use there will be long-term gain for all. It is only on this formulation that there can be any notion that superannuation funds are dispensable - available to be commandeered for critical national investments.

But there are two stages to the argument: first that speculation is unproductive, and second that the funds are (therefore) potentially available for use elsewhere. The first may or may not be true - it depends on definitional matters. The second is certainly not true of the 1990s, and it was probably not even true of the 1980s, either. In the speculative boom of the 1980s, the entrepreneurs with access to (apparently) unlimited lines of credit were more creations of the financial system itself than its conquerors. For example, Hale (1990) contends that:

> The world's bankers purposefully nurtured entities such as Bond Corp. . . because the traditional heavy users of capital in the international economy (mining companies, oil companies, shipping companies, utilities, developing countries, government infrastructure builders) dropped out of the market place during the 1980s.

Things got out of control in the 1980s because the world's bankers lacked adequate prudential supervision of the likes of Bond Corp. But these were not funds on offer to 'Australia' *per se.*, and it does not follow that the funds could have been diverted elsewhere at the behest of the Australian state.

Moreover, the commercial lesson, it seems, has now been learned. While the levels of international finance are back to where they were in the late 1980s, it is now on a firmer footing. The Australian dollar Eurobonds are not now being issued by the likes of Bond Corp. and Bell Corp., but by the banks themselves, who control the use of those funds like hawks.

In short, while the criticism in *AR* of the profligacy of investment decisions in the 1980s may have been right, the likes of Bond, Elliott and Skase provided too easy a target. Their pursuits were unsustainable and in some obvious sense wasteful, and *AR* deserves recognition for making that case early and clearly. But the financial system is now a different beast. The arguments of unsustainability and waste are not so easy to make. The objective of a national investment plan now involves taking on not the excesses of an unchartered, speculatively driven financial system, but the substance of a formally-ordered and prudentially-supervised global financial system.

But for advocates of the national planning of investment the choice is not one of the profitability of capital or desired national industry structure. The objective of a national industry plan is , after all, to reconcile the two on the rationale that if investment is directed to the right areas, it will finish up being profitable. It was the capacity to combine these two agendas which was key to the success of the Swedish economy until the mid 1980s and, it is claimed, is currently the key to the success of industrialising countries such as South Korea. But both cases have their particularities.

In Sweden, the loss of profitability of key industrial sectors in the 1980s saw falling real wages and the progressive breaking down of a planned national industrial structure as capital started moving off-shore. Sweden, long the model of the social democratic alternative, and highly extolled in *AR*, has not been able to sustain a reconciliation of corporate profitability and national industry plans. The high levels of productivity which were secured by means of the social-democratic state, and which were at the basis of Sweden's capacity to sustain both high profits and high living standards, are now no longer exceptional by international standards. The rest of the world has caught up, and there is no longer the incentive of high productivity to induce capital to locate in Sweden.

In South Korea, the combination of state planning of national industry structure and the profitability of industry appear to have been highly successful in a growing economy. But to maintain the level of profitability of industry, the South Korean state has introduced laws making it easier for companies to sack workers. President Kim Young Sam believes that South Korea's future prosperity depends on making its labour more flexible, helping its firms to compete better internationally (*The Economist* 1997). The violence of the street battles in Seoul which ensued in January 1997, as unions responded to the new law, is some signal of the unions' recognition that corporate profitability is the top priority of state industry planning.

South Korea shows, like Sweden, that state industry planning and industry profitability are compatible, but only under certain circumstances. In Sweden, these circumstances were associated with global productivity leadership. With the loss of that leadership, the Swedish model is in decline. In South Korea, the compatibility of state planning and profitability is sustained only by repressive means to keep labour cheap and powerless.

These cases provide a clear implication for those who aspire to use the control over investment funds to manage the structure and composition of national industry. If such control is going to diminish the profitability of investment, the aspiration needs to address explicitly and head-on the political and economic size of that task as a fundamental assault on the principles of capitalism, and not simply a regulatory adjustment within a profit-driven system. If the control is not to diminish the profitability of industry, there is need for elaborate and detailed economic explanation of how that is to be achieved in the name of labour and not at the cost of labour, and how it is to be achieved in periods of recession (when profits are low) as well as in times of boom (when such planning is less necessary anyway). It is a most critical piece of analysis, for if the state controls go wrong and profits are too low, the burden falls directly to labour to prop up the profitability of industry. But it is an argument not spelt out in *AR*, nor since.

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Charter for big unions and big government

THE document entitled "Australia Reconstructed" issued yesterday by the Australian Council of Trade Unions will utterly disappoint all of those who expected that it would offer a blueprint for bringing greater flexibility into our industrial relations.

Under Mr Hawke's leadership the Australian Labor Party has abandoned its previous socialist and interventionist policies and has moved rapidly towards the deregulation and privatisation of the economy. The new manifesto of the ACTU shows that the leadership of the trade union movement has learnt nothing.

The ACTU proposes more, not less, regulation of the labour market and employer-employee relations. It offers no hope of the settlement of industrial disputes and wage claims on an enterprise-by-enterprise basis or of significant negotiations between individual employers and their employees.

"Australia Reconstructed" takes a position which is precisely the opposite. It asserts that "Australia should maintain a centralised wage-fixing system", and increases in wages other than national adjustments should be within a specified limit which is itself centrally determined".

Those pessimists who have predicted that this country is becoming transformed into a corporate State will believe their fears to be confirmed by the ACTU's demand that "Australia should develop a central national economic and social objective", and its advocacy of a "National Development Fund" funded primarily by superannuation funds and with power to influence future economic development by the application of its investment policy.

The means put forward for the financing of the "National Development Fund" are no less than authoritarian. The union leaders propose that all superannuation funds be required to make available up to [illegible] per cent of their future income to be drawn on by the "Fund" and "if insufficient funds are available through the superannuation mechanism, there should be a [illegible] per cent tax on all imports, supplemented by a surcharge on luxury imports".

Within the context of the other recommendations the ACTU's policy on union amalgamations acquires a sinister quality. [illegible] has the [illegible] and it is reasonable to argue that unions which wish to amalgamate should not have contrived obstacles put in their way. But this [illegible] in the ACTU [illegible] that union mergers should be compulsory under law.

"The Australian trade union movement should plan to have some 20 union organisations within two years," it proclaims, and in a textbook example of the corporatist mentality, "the ACTU and governments should initiate action to ensure that no further organisations can secure registration, other than those which are products of amalgamations." It is easy to imagine how 20 mega-unions would be able to dominate industrial relations.

The ACTU's document seeks to reconstruct Australia so that the economy is firmly in the hands of big government and big unions with a lesser role being played by the big centralised employer organisations. It goes against all of those aspects of Mr Hawke's administration which have won him the support of a large part of the business community and the middle ground.

It is a manifesto for corporatism which should be rejected by a plural and open society. [illegible] it is difficult to resist the conclusion that, after supporting the Government through two terms, the unions are now presenting the bill.