# Quo Vadis Australia?

**Ian Harper**

**For generations, Australians have lived off the bounty of the land. But in the era of globalisation, it will be the bounty of the mind that will build our future prosperity.**

Australia's first and foremost export commodity was wool. Sheep were an ideal choice for Australian climatic and soil conditions. In addition, given the vastness and emptiness of the land, there was little need to provide fencing or watering facilities or even to shepherd the sheep. There were no natural predators, and foxes were yet to be introduced.

With these opportunities for cost reduction, and given the natural suitability of the land for sheep raising, the wool industry grew rapidly from humble beginnings. Such was the success of the industry that by 1840, Australia had eclipsed Germany as the world's largest producer and exporter of wool. Wool is still a significant contributor to Australia's economic welfare more than 150 years later, ranking amongst our most highly valued export commodities. This is testimony to the enormous capital investment over the decades needed to improve the quality and quantity of the wool-clip, but also to the sheer efficiency of wool growing in Australia compared with just about anywhere else in the world.

After 1851, wool was joined by gold as a second major commodity export from Australia. Discovered first in New South Wales (by Edward Hargraves on his return from the Californian gold rushes) and soon afterwards in Victoria, gold drew people from far afield, swelling the populations of the two colonies. Exports of gold also swelled—between 1851 and 1861, one third of the world's gold output came from Victoria. Gold rushes continued into the 19th century as lucky prospectors struck pay dirt, first in Queensland in the 1860s and later in Western Australia in the 1880s.

The second half of the 19th century also saw the steady development of Australia's grain industry, based especially on wheat. The success of wheat and other grains reflects the same underlying suitability of climate and the emptiness of the land—although recurrent drought caused more problems for agriculture than for wool growing. Wool and wheat are natural companions given their complementary seasonal growth patterns. They are also commodities, like minerals, whose market value is high in relation to their bulk, making it feasible to export them over the great distances separating Australia from her major export markets.

By the end of the 19th century, Australia enjoyed the highest material living standard (as measured by per capita GDP) of any country in the world (with the exception of New Zealand, which also 'rode on the sheep's back'). This was due to the enormous productivity of our three major export industries—wool, minerals and grains. All three were intensive in the one factor of production that was (and is) in plentiful supply —land—which enabled them to operate at lower cost in Australia than in other countries where land was scarcer or more valuable in other uses.

Our top position in the GDP per capita stakes was also generously assisted by the small size of Australia's population. In 1900, the population of Australia was around 3.7 million. Given the bounty of our primary industries and our small population, it would have been

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amazing if Australians were not the richest people on earth, at least in terms of per capita income.

**'Populate or perish'**

Towards the end of the 19th century, stresses began to appear in the economic and social fabric of Australia. Our highly productive primary industries, by virtue of that fact, did not employ large numbers of workers. Those who were employed in these industries enjoyed high wages on account of the high productivity of their labour. Those who worked in secondary industry were paid comparatively less, since the productivity of manufacturing was substantially lower than that of primary industry. This in turn reflected the small size of Australia's domestic market and the consequent lack of scale economies in manufacturing.

The gap between the living standards of country workers and city workers might have been less of a problem had there not been the perceived need to increase Australia's population through immigration. Beginning with the French at the turn of the 19th century and moving to the Russians somewhat later, Australians had long feared foreign invasion. Many were convinced that Britain's European enemies would seek to invade and enslave Australia as part of their campaigns against Britain. Gun emplacements were installed at the entrances to Port Jackson in Sydney and Port Phillip in Melbourne as early as the 1880s to thwart anticipated sea-borne invasion.

The fear of invasion found voice in the popular cry of 'populate or perish'. And herein lay the dilemma—if Australia were to increase her population rapidly through immigration, and her major industries were not labour-intensive, how would the additional labour be absorbed? Where would the new immigrants find jobs? Clearly the only possibility was low-productivity secondary industry. And yet the growing numbers of low-paid city workers would eventually bring pressure to bear on the wages of their better-paid country cousins.

Long before any deliberate strategy was adopted to foster secondary industry, new immigrants were brought to Australia in increasing numbers. They found jobs for themselves in cottage industries in slum areas of the major metropolitan cities, especially Sydney and Melbourne. The labour intensity of these cottage industries kept labour productivity low. The wages paid by these industries were consequently also low. Meanwhile, labour employed in high productivity primary industries enjoyed commensurately higher wages. It was not long before people began to drift from the city into the countryside in search of higher-paying jobs.

Competition from lower-paid workers from the cities sparked industrial trouble. The 1890s witnessed a series of crippling strikes in key primary (or closely related) industries—wool-growing, mining and stevedoring. The shearers, miners and stevedores withdrew their labour in protest over the willingness of employers to undermine their pay and conditions in the face of competition from itinerant city workers. The strikes were ultimately fruitless, and were ruthlessly put down by the authorities operating in support of employers. This left a bitter taste in the mouths of employees, who resented less the competitive pressure of the 'Johnnies-come-lately' than the willingness of employers to exploit the pressure of labour supply to drive down wages and conditions.

**The Basic Wage**

Out of the furnace of the 1890s were forged two of Australia's enduring industrial and political institutions—organised trade unionism and its political 'comrade-at-arms', the Australian Labor Party. The ALP quickly established its presence, winning representation in colonial legislatures in the later 1890s. Following federation in 1901, it was a mere three years before the ALP formed a Commonwealth government under the Prime Ministership of John Watson.

Perhaps the most significant act of the short-lived Watson Government was to establish the Commonwealth Court of Conciliation and Arbitration. This body was charged with resolving disputes between employers and employees according to law. The searing experience of the 1890s convinced Australians that resolving such disputes through gunfire and bloodshed in the streets was unacceptable. Henceforth both sides would have the opportunity to press their respective claims before the Court, and the matter would be decided according to the principles of justice, not mob rule or state-sanctioned violence.

Three years after its establishment, in 1907, the Court delivered its best-known judgment in the famous Harvester Case. A Victorian manufacturer of agricultural equipment, Hugh Victor McKay, applied for exemption from excise duties so that he could export more cheaply to markets in Canada, the United States and South Africa. Such an exemption was available to employers on condition that they paid 'fair and reasonable' wages to their employees. Justice Henry Bournes Higgins found against McKay's Sunshine Harvester Company, establishing the standard for a 'fair and reasonable' wage as seven shillings per day—McKay was paying unskilled male labourers six shillings per day.

Higgins' judgment is famous because it established a precedent for calculating the 'basic wage', defined as sufficient to meet 'the normal needs of the average employee regarded as a human being living in a civilised community'. Justice Higgins arrived at the figure of seven shillings per day by setting down the weekly expenses that he judged necessary to keep a family of two adults and three children living in what he considered to be a civilised condition. Significantly, the decision was made without reference to the employer's ability to pay—in other words, without reference to the underlying productivity of the labour being paid the basic wage.

Far from obtaining relief from excise duties, McKay faced an increase in his wages bill estimated at 25%. The Sunshine Harvester, the pride and joy of the company and a strong contender in export markets for agricultural equipment, never realised its potential. The company eventually ceased manufacturing in Australia and entered an agreement with the Canadian multinational, Massey-Ferguson-Harris, to distribute Canadian-built harvesters in Australia. In 1955, the company sold out to the Canadians and became Massey-Ferguson (Australia). But for the Harvester Judgment, Massey-Ferguson might now be known as the McKay Harvester Company. Australia may have lost more than a homegrown harvester—we may have passed up the chance of owning a multinational agricultural equipment manufacturer!

Other countries, notably the United States, also faced the dilemma of developing beyond a highly productive primary sector. In the US case, they were also keen to grow their population through immigration, although not for defence reasons. The key difference between such cases and our own is that other countries did not try to divorce wages from the low levels of productivity characteristic of high-employment manufacturing industry. Employers in the sweatshops of lower Manhattan were not obliged to raise wages to 'fair and reasonable' levels. While this is no doubt partly responsible for the wider dispersion of wages in countries like the United States compared with Australia, growth of manufacturing industry in the United States did not require the systematic intervention from government which became the hallmark of attempts to nurture manufacturing in Australia.

**The protectionist legacy**

Having divorced the mechanism of wage determination from the market, Australian governments were faced with another dilemma—how could the manufacturing industry grow fast enough to employ the additional population when the wages it was obliged to pay rendered it uncompetitive with lower-wage manufacturers exporting to Australia? The solution, implemented as early as 1908 by the Deakin Government, was 'New Protection'—the systematic use of the tariff and indirect tax concessions to protect domestic manufacturers from foreign import competition, while obliging them to pay 'fair and reasonable' wages.

In reality, the standard of fairness and reasonableness was set by the higher wages paid (and afforded) by higher productivity primary industry. It was considered unfair and unreasonable to pay lower wages to those whose employers, through no fault of the workers, could not afford to pay wages at the same levels. Faced with the choice between greater wage dispersion and lack of international cost competitiveness, Australia chose the latter (while, faced with the same choice, the US chose the former).

Lack of international competitiveness could be dealt with via protection. Domestic manufacturers could afford to pay wages higher than the productivity of labour in manufacturing if they could pass on their higher costs to consumers in the form of higher prices. Domestic consumers could only be expected to accept this arrangement if they had no opportunity to opt out by purchasing cheaper imported substitutes. Hence the coalition of interest between the forces of centralised wage fixation and those seeking to protect domestic manufacturing from imported substitutes.

Australia's strategy of using the tariff to sustain wage levels divorced from labour productivity (at least in secondary industry) reached its zenith in the 1950s under the powerful influence of John 'Blackjack' McEwen. He famously declared that Australian industry deserved 'protection all round' and oversaw the development of the 'made-to-measure' tariff, under which tariffs were custom-built to maximise their impedance of imports.

While tariffs benefit the industries they protect, they impose costs on consumers and other industries that use the products of protected manufacturers as inputs. Consumers pay more than they need to for goods produced locally. Other industries, most notably export industries, pay more than they need to for inputs produced locally. The result is that Australian living standards are adversely affected, both because the cost of living is higher that it otherwise would be and because Australia's export performance is compromised as exporters face higher domestic costs.

The burden of tariff protection may have been more easily borne by the Australian economy had it not been for the steady decline, throughout the 20th century, of Australia's international terms of trade. Our terms of trade represent the buying power, in terms of imports, of the goods and services we export. Declining terms of trade mean that we have to export more to purchase a given quantity of imports—in other words, the prices of the goods we export are falling relative to the prices of the goods we import. Falling export prices reflect the dominance in Australia's export mix of primary commodities.

**Falling commodity prices are a phenomenon of rising affluence in the developed world.**

While we have been amongst the world's most efficient producers of commodities, their prices have steadily fallen relative to the prices of higher-value-added manufactured goods. Falling commodity prices and rising manufactured goods prices, and increasingly also services prices, are a phenomenon of rising affluence in the developed world. As people grow ever richer, their expenditure on basic foodstuffs like bread and rice falls, while their expenditure on more elaborate manufactured goods as well as sophisticated services rises. Hence the long-term trend for commodities prices is downward while that for manufactured goods and services is upward. As a seller of the former and a buyer of the latter, our terms of trade have suffered accordingly.

So Australia's exporters were caught between rising costs (thanks to the tariff on their imported inputs and the high cost of labour flowing from centralised wage fixing) and falling prices. As a result, throughout the near 70-year history of tariff protection, Australia's export performance steadily deteriorated—and took down with it Australia's relative standard of living. From first place at the turn of the 20th century, Australia's relative position among the developed nations had fallen to 14th by the mid-1970s.

Into the bargain, it became increasingly evident that tariff protection had neither fostered the development of an internationally competitive manufacturing industry in Australia nor maintained employment in that sector. On the contrary, employment opportunities in protected Australian manufacturing grew more slowly than elsewhere in Australian industry—especially in the services sector—as the 20th century rolled on. Australian manufacturing became progressively more backward, inward-looking and internationally uncompetitive.

The first move to unwind industry protection came with the 25% across-the-board tariff cut instigated by the Whitlam Government in 1973. Following an inter-regnum of eight years, during which the conservative Liberal-National Country Party coalition government of Malcolm Fraser made little progress, the ALP Hawke Government resumed tariff reform from 1983 onwards. Since that time, tariffs have been lowered to negligible levels in almost all industries (the notable exceptions being the textiles, clothing and footwear, and passenger motor vehicle industries). Also since that time, Australia's export performance has improved markedly (including, most especially, exports of manufactured goods), with exports rising from around 13% of GDP to more than 20% of GDP. Australia's relative standing in the per capita GDP league table has also crept upwards from 14th place in the 1970s to 12th place today.

Australia's abandonment of the tariff has been accompanied by reform of the centralised wage fixing apparatus. Without the tariff, wages bearing no consistent relationship with the productivity of labour would not be tenable. Nowadays, award wages are fixed by the successor to the Conciliation and Arbitration Court, the Australian Industrial Relations Commission, with a clear eye on labour productivity growth. The Commission now recognises the link between wages growth in excess of labour productivity growth and high unemployment. There is also greater scope for individual enterprises to negotiate above-award terms and conditions with their own employees through 'Enterprise Bargaining Agreements', thus linking productivity more closely with remuneration on a case-by-case basis.

**Future directions**

While such reforms have helped to arrest Australia's relative decline in economic performance, they have not yet reversed the secular decline in our terms of trade. In the final analysis, Australia's relative living standard will not rise appreciably unless and until our terms of trade deterioration can be reversed, not merely arrested. This in turn requires a change in our export mix, away from the commodities which have served us so well over the past two centuries.

If Australians are to maintain, let alone improve, their living standard relative to the rest of the developed world, we have no alternative but to expand our exports of goods and services whose prices will rise over time, not fall. These are goods whose value is enhanced by technological know-how, and services that are intensive in knowledge. To be able to sell such high-valued-added goods and services requires more than just producing them, however. They must be produced efficiently, that is, at costs no greater than those of our competitors.

Australia is not used to intense cost competition in export markets. Our efficiency as a commodity producer was such that we could sell as much as we wanted. The world in which Australia now finds herself is completely different. We have no natural advantage in the Knowledge Economy. There is no equivalent of the North-West Shelf or the Darling Downs in our knowledge sector. We will have to make our own comparative advantage. This requires reform of our domestic economic institutions and policies in ways that emphasise value creation and cost competitiveness. The goods and services we create must be attuned to the demands of our increasingly sophisticated export markets and at the same time produced at competitive cost levels. Our economic institutions and policies need to establish the correct incentives to facilitate these outcomes.

**Australia's export of education services are now occasionally worth more than the wool cheque.**

The transformation of the Australian economy is under way. Elaborately transformed manufactured goods are the fastest growing component of our exports, and services exports already account for 23% of total exports by value. Indeed, Australia's exports of education services now rank eighth in order of importance by value and are occasionally worth more than the wool cheque!

Australia is 'the lucky country' and may be in luck again with the emergence in the 1990s of the Internet and e-commerce. At a time when we need to export more high-value-added services, like education, financial, legal and consultancy services, the Internet is custom-built for a country like Australia, geographically distant from its markets but technically sophisticated and keen to adopt (and adapt) the latest technologies.

The world of new information and communications technology holds great promise for Australia—we speak English, the lingua franca of the Internet and e-commerce; we are technologically literate; we are amongst the world's most avid users of new ICT; and we have an appropriately sound legal, regulatory and accounting framework within which e-commerce should flourish. Above all, we need to develop new markets for our services exports and they need to be high-value-added services—the Internet will be to our New Economy what fleets of fast ships would have been to our Old Economy.

The future for Australia is bright provided we recognise and adapt to our changed circumstances. The indigenous occupants of this country lived off the bounty of the land, and later arrivals have done much the same. From here on, the land will yield less and less of commercial value and be more and more valued for its beauty and environmental amenity.

Australia's economic future lies in the Knowledge Economy. There will be ample scope for us to build an international export trade on high-value-added goods and services, thus improving our terms of trade over time and our relative standard of living. But to do so we must remain open, competitive and connected:

- open to the world's markets for goods, services, capital and labour—no longer seeking to protect ourselves from foreign competition;
- competitive in the global marketplace—a competitiveness assured by rewarding ourselves commensurately with the productivity of our labour, levying taxes commensurate with the value of public goods provided, and regulating markets in ways which enhance rather than destroy efficiency; and
- connected to the mainstream of global economic life through advanced ICT and transportation links.

**Conclusion**

The key to Australia's future is to appreciate the legacy of our past and yet to understand its limitations going forward. The bounty of the mind not the bounty of the land will build our future prosperity. Failure to orient economic institutions and policies towards this reality will betray the hopes of current and future generations of Australians.