BUY AUSTRALIAN?

myths and realities

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To Jenny, Sandra and Susan

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Foreword

Around the world nationalist feeling is on the rise. In Australia, this is on prominent display in the republican movement, which seems more concerned with issues of Australian national identity than with republican constitutional principles. Even though the republican movement is the most obvious manifestation of Australian nationalism, the major practical effect of the nationalist mood is in economic policy. Despite some reforms in recent years, Australia has in place a range of policies designed to make people buy Australian made goods. Tariffs, quotas, anti-dumping laws and, since 1986, the 'Buy Australian' advertising campaign are the institutional manifestations of Australian economic nationalism.

These policies are all warnings of how easily nationalist feeling can go wrong. There is a constant danger of attention focusing on an abstract entity, 'the nation', rather than the well-being of those living within the nation's borders. In *Buy Australian?: Myths and Realities* Terry Black redirects our thinking back to the fundamental issue of living standards.

Buying Australian goods, simply because they are made in Australia rather than because they are the best value goods, can only undermine Australian living standards. Whenever Australians pay more than they should or receive second-rate products their standard of living is reduced. The effects of buy Australian policies are, however, more serious than just this immediate loss to consumers. One of the perverse consequences of all forms of protectionism is that resources are misallocated. Instead of capital and labour being invested in those industries in which Australia has a comparative advantage, they are put into industries that are profitable because protected in some way. The result is that income is distributed away from consumers to inefficient industries.

Ironically, in the end buy Australian policies can only undermine Australia as a nation. They make Australian industry weaker and Australian consumers poorer. Policies that neither make economic sense nor advance Australia as a nation lack any rationale. I hope Terry Black's *Buy Australian?: Myths and Realities* helps persuade policy-makers to abandon their quest to make us buy Australian, and let us as consumers decide which goods suit our individual tastes and needs.

Greg Lindsay
Executive Director

Author's Note

This monograph was written because of the one-sided view presented in the popular media that buying Australian is good for Australia. Rarely has this view been challenged. In addition to articles and editorials in newspapers and magazines being pro-buy Australian, consumers are bombarded with taxpayer funded advertisements on television and in newspapers exhorting them to buy Australian. These advertisements use emotional messages such as 'buy your kids a job'. Without denying that unemployment is a major problem in Australia, this monograph rebuts the claim that buying Australian will reduce Australia's unemployment.

In addition to unemployment, the popular media continues to predict doom and gloom for Australia due to persistent current account deficits and the build-up of foreign debt. Buying Australian is offered by the federal government as a solution. Again, this view is rarely challenged in the popular press.

Given the one sidedness of these views, I was motivated to balance the scales by analysing these claims. As will be seen by various references, the views I present are consistent with contemporary economic thinking in the academic literature. While I have drawn on academic theory and research, the monograph is written for the general reader.

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About the Author

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Chapter 1

Introduction

In 1986 Prime Minister Bob Hawke initiated the Buy Australian Campaign and appointed the Advance Australia Foundation as its licensing agent and administrator. In recent years, Buy Australian publicity has increased significantly, due to federal government funded advertisements such as 'buy your kids a job' and 'the buck stops here' and advertising by firms licensed to use the green and gold logo.

While most people think of television advertisements and supermarket labels when referring to the Buy Australian campaign, Australia in fact has, for many years, had other policies which promote buying Australian. These policies include an extensive range of tariffs on imported products and anti-dumping legislation. In addition, a government report *Buying Our Future* (HRSCIST 1994) recommends that preference be given to Australian made products by government purchasing officers. While this monograph concentrates on the taxpayer funded Buy Australian advertising campaign, it also analyses tariffs, anti-dumping legislation and the proposed changes in government purchasing, since they too have a strong buy Australian effect.

Much has been written in the popular press claiming that buying Australian is desirable for Australia. Since the Buy Australian advertising focuses on jobs, there is little doubt that Australians consider this to be the major reason for buying Australian made products in preference to imports. The Advance Australian Foundation in *Australian Made Good Business* (undated:5) claims that 'over 90 percent of consumers agree that Buying Australian made creates jobs for Australians'. In addition to jobs, buying Australian is said to be a solution to Australia's current account deficit and foreign debt problems.

It is likely most Australians interpret the buy Australian message to mean they should buy Australian, even when the price is higher or the quality is lower. This view is reinforced by surveys which ask consumers whether they would be prepared to buy Australian if it cost ten per cent more than overseas made. Despite possible price premiums a large and increasing proportion of Australians appear willing to buy Australian.

To a large extent the claim that buying Australian is good for Australia has not been questioned, at least in the popular media. Accordingly, the general public have been left with a one sided view. It is the purpose of this monograph to analyse the various claims that buying Australian made is in Australia's best interest. While the analysis goes against the conventional wisdom of the popular media, it is consistent with contemporary views in the academic literature. Although most people consider that 'Buy Australian' is a recent phenomena, it has in fact been around several times in the past. It has a history of failure:

> The view that we should and could drastically reduce our dependence on imports has wide appeal. It encourages a warm inner glow of patriotism and national pride. ... The instruction to 'Buy Australian' has had a long but sadly unsuccessful history. It was first used in the 1920s with little success, revived in the 1960s and now, in a new green-and-gold rather than red-white-and-blue livery it is going through yet another metamorphosis (Clark 1989:18).

Is it worthwhile for Australia if Australians buy Australian made when the price is higher, or the quality is lower, or both? Will Australia's unemployment reduce if Australians switch from buying better value overseas made products? Will buying Australian solve Australia's current account deficit and foreign debt problems? Are they problems? Do taxpayers get value for money from buy Australian policies? This monograph provides answers to these questions.

Australia's Standard of Living

We would normally expect Australians to choose products based on value for money – comparing price, quantity and quality and making choices in their best interest. In spreading their income as far as it could go, Australians were not concerned whether goods were Australian made or not. But now Australians are bombarded with television and newspaper advertisements stating that what they have been doing all their life is wrong, and that they should buy Australian.

Will buying Australian made, rather than overseas made, improve Australia's standard of living? The larger the quantity of goods and services available to a country's citizens the higher living standards become. The

Buy Australian policy, by substituting higher priced Australian made products for better value overseas made products results in a reduced quantity of goods and services being available to Australians. The Buy Australian policy, like tariff protection, substitutes inefficient Australian production for efficient overseas production, and results in a decrease in the total goods and services available to Australians and thereby lowers Australian living standards.

Unemployment

Neither the Advance Australia Foundation, nor advertisements for buying Australian, nor the federal government's report *Buying our Future*, refer to an increase in consumption by Australians as a consequence of buying Australian. Instead they focus on unemployment. They argue that, if Australians switch from overseas made to Australian made, unemployment will fall. In Chapter Two, doubts are raised as to whether buying Australian will reduce unemployment.

Buying Australian made will increase employment in firms producing for the domestic market. However, this will be offset by job losses in other businesses. The switch away from imports will reduce the employment of Australians by importing firms. Further, the reduction in imports will result in a reduction of exports, and thereby a reduction in the employment of Australians by export firms. Also, to the extent the policy results in the substitution of relatively high price Australian made products for low priced imports, then Australians have less to spend on other goods and services. This in turn will result in less Australian employment. Taken together it is unlikely the Buy Australian made policy will have any significant effect on Australia's unemployment.

Since Australia's current level of unemployment is extremely high, the appeal of the jobs claim is not difficult to understand. While acknowledging Australia has a major unemployment problem, Chapter Two asks the question *is reducing unemployment or increasing consumption the objective of consumers when buying goods and services?* It concludes that the real issue for most Australians is not unemployment but consumption. By encouraging the purchase of overpriced Australian goods, the Buy Australian campaign brings consumption and employment objectives into conflict. What is required instead is a policy which increases employment through supplying competitively priced goods and services.

Free Trade

Buy Australian made policies go counter to the economic progress that has been achieved over centuries from specialisation. Each person does not attempt to be self-sufficient by growing and making everything themselves. Each person's standard of living is vastly higher by specialising and exchanging their output with that of others. This has long been recognised within Australia, with the Constitution guaranteeing access to free interstate trade. On the logic of the Buy Australian campaign, we could ask if buying Australian is good, is buying Queensland better? If so, is buying Brisbane made better still, or is buying in one's postcode area, or street, or from one's next door neighbour even better? Is it best of all if every Australian is totally self sufficient, making/growing everything they want? The standard of living of every Australian would be little better than that of the stone age if buy Australian was taken to its logical conclusion.

Just as no person or region within Australia attempts to be self-sufficient by producing all the goods and services they want, so too it is not in Australia's interest to attempt to be self-sufficient. Just as each Australian specialises and exchanges their output with others, so too does Australia when it trades with the world. The result is that specialisation improves the living standard of each Australian, by producing only those goods and services in which Australia is comparatively efficient.

Chapter Three explains the benefits of free trade. It addresses common concerns such as unemployment and a flood of imports. Various arguments for restricting the buying of overseas made products are considered and rejected.

Current Account/Foreign Debt

Aside from unemployment, the current account deficit was the main target of the federal government's economic policies in the 1980s and 1990s. It is claimed that buying Australian will reduce this apparent problem. Chapter Four argues that the current account deficit and foreign debt are not problems, and that therefore one of the fundamental assumptions behind the Buy Australia policy is mistaken. This assumption has done Australia great harm, since it prompted the federal government to utilise an extremely high interest rate policy in 1988-89, causing the worst recession since the Great Depression of the 1930s.

The private sector component of foreign debt is not a problem for Australia, since the debt of each private firm is limited to that firm. Firms which incur foreign debt (and domestic debt) expect that the benefits of the investment will exceed the debt. If a firm makes a poor investment decision, such that the profit is insufficient to cover the cost of borrowing, then either the firm re-finances or divests, or else the firm will go into receivership.

Critics of Australia's foreign debt warn that the level of indebtedness could cause a future foreign exchange crisis. They argue that even if firms generate sufficient profit to cover their debts, it is irrelevant if there is insufficient foreign exchange to make the repayments. Prior to the 1983 floating of the Australian dollar, shortages of foreign exchange were very real problems. On occasions, the demand by Australians for foreign exchange exceeded its supply at the then fixed exchange rate. These foreign exchange crises led to devaluations of the Australian dollar. Since the float of the Australian dollar, Australia has not had any foreign exchange crises, nor are they possible. Under Australia's floating exchange rate, the exchange rate is continually changing so that the demand for and supply of Australian dollars are always equal – there is always sufficient foreign exchange to make foreign debt repayments.

Even if the basic policy assumptions had been correct, the Buy Australian policy would still have been misconceived. Indeed, the fact that the federal government had to resort to a high interest rate policy in an attempt to reduce imports confirms the failure of the Buy Australian campaign. This failure is not surprising, since a reduction in imports causes the Australian dollar to increase, thereby reducing exports which have now become more expensive. The result will be no change in the current account deficit. Why will the reduction in imports be exactly offset by a reduction in exports? Since buying Australian affects neither the government's budget deficit nor the private deficit (shortfall between investment in Australia and savings by Australians) then the current account deficit/ capital account surplus does not change.

The Cost to Taxpayers of the Buy Australian Campaign

Buy Australian policies are not giving the taxpayer value for money. At best the Buy Australia campaign is paternalistic; no Australian adult needs to be told how to shop. At worst, if people do follow the campaign advice, the total goods available to Australians is decreased and thereby Australian living standards lowered. This is not the kind of policy in which the taxpayers' money should be invested.

The failure of the Buy Australian campaign to create social benefits is shown up in the response of business. Chapter 5 considers the objectives of the Australian made campaign as stated by the taxpayer funded Advance Australia Foundation. To a large extent these objectives could be achieved by private firms either individually or collectively. When private firms provide an unsubsidised service and earn a profit doing so, then we know the value to society exceeds the cost to society of providing the service. When a government funded organisation provides a service, particularly when it is totally subsidised by taxpayers, we no longer have a reliable method of knowing whether the service is beneficial to society. Given that private firms did not provide the service, strong suspicion exists that the taxpayer funded system does not provide net benefits to Australia.

Given that taxpayers and not business pay for 'Buy Australian' advertisements, business benefits at taxpayers' expense. It is not taxpayers, consumers or citizens that benefit from buying Australian, but business. There is no justification for taxpayers paying business advertising costs. It is in the interests of taxpayers to end the subsidisation.

In 1994, a House of Representatives Committee investigated whether the government buys Australian made products. The report *Buying our Future*, recommends that government purchasing procedures be modified, at significant cost to the taxpayer. The proposed procedures give preference to Australian manufacturers, and, to the extent more expensive or lower quality local products replace imports, taxpayers will have to fund the additional expenditure.

Australian Owned Companies

Chapter Six considers the question of buying Australian made but only from Australian owned companies. The issue of Australian ownership is considered so important by some Australians that an organisation called the Australian Owned Companies Association has been formed. It provides *AusBuy* guides which identify Australian owned and foreign owned companies and argues that Australians should only buy from Australian owned companies to 'keep Australia Australian owned'.

One of the arguments for only buying from Australian companies is that otherwise the profits go overseas. However, foreign shareholders do not keep hold of pieces of paper with Australian dollars written on them. Instead, they sell them to banks, who sell them to other foreigners who buy Australian exports, come to Australia as tourists, invest in Australia etc. Accordingly, the Australian dollars return to Australia, benefiting Australians in the process.

There are many firms, even industries, which exist in Australia largely because of foreign investment. If Australia had refused to accept this investment, then some of these industries would either not be in existence today, or their arrival would have been significantly delayed. Foreign finance has enabled more investment to occur, and sooner, than if only Australian savings were used.

It is claimed that the sale of an Australian business to overseas owners is contrary to Australia's interest since '... profits and dividends which previously remained in Australia go overseas...' (*Choice* 1994:8) When an owner sells a business, the owner receives the present value of the future profits, today. As far as the profits are concerned, it does not matter that the business is sold to an overseas owner, since the profits are still available to be spent by the former owner, just as they were when the business was Australian owned.

Concern with the foreign ownership of Australian business is misplaced. It must be realised that the level of foreign ownership of Australian business is consistent with the wishes of Australians. This is because these businesses are available for purchase but Australians choose not to do so. The fact that Australians have not purchased these businesses indicates that Australians prefer to spend their money on other things rather than reducing foreign ownership.

When Should Australians Buy Australian?

Is buying Australian good for Australians? It is when Australians buy Australian made products because they are the best value for money. In this way the living standards of Australians are the highest possible. If Australians buy higher priced Australian made products because of the claim that it will reduce unemployment, then Australians are mistakenly reducing their standard of living. Buying the best value product, irrespective of whether it is Australian made or made overseas, is best for Australians.

Chapter 2

Will Buying Australian Reduce Unemployment?

Advance Australia Foundation Executive Director Norm Spencer states in *Australian Made Campaign News* (March 1993) that buying Australian made is all about jobs: 'Australian shoppers are increasingly aware that buying Australian Made means jobs for Australians.' This view of the benefits of buying Australian is reflected in the slogans of the federal government's national television advertising campaign, 'Buy your kids a job' and 'The buck stops here'. This chapter questions key assumptions of the advocates of buying Australian. It asks whether consumption or reducing unemployment is the objective when Australians buy goods and services. It then casts doubt on whether buying Australian can reduce unemployment.

Reducing Unemployment or Increasing Consumption?

According to advocates of buying Australian made, reducing unemployment is a good reason for buying Australian, but is it? There is little doubt that unemployment is the most important economic problem facing Australia today. However, the objective of buying goods or services, be they Australian made or overseas made, is consumption, not employment. Surveys conducted by the Advance Australia Foundation and retailers such as Coles indicate that reducing unemployment is a major reason for buying Australian made products. However, what people say and what they do can be two different things. As a result of massive Buy Australian television and other advertising it is likely that most Australians are aware of the claim that buying Australian will reduce unemployment. Consequently, if a researcher asks supermarket shoppers 'do they buy Australian and why?' the likely reason given for a yes answer is 'to reduce unemployment'. But actual purchasing requires an assessment of real costs and benefits. Answering a survey requires no such assessment. A spur of the moment estimate of reasons may bear little resemblance to the real reasons behind actual purchasing. Even among those people who genuinely consider Australian unemployment when buying goods and services, consumption is still likely to be their first priority. It is more plausible that even devoted buy Australian consumers first decide to buy (the consumption decision), then consider Australian unemployment second. It is unlikely that many people place unemployment ahead of consumption. To do so requires that they buy products with a high Australian employment content, even though they may not want the product. It would be surprising if many Australians so behaved.

The objective of work is the goods and services it produces – this is the case both for each person and for a country as a whole. Just as an individual would not consider successful any work which failed to produce, nor does a country. Employment is a means to an end, and the end is the production of goods and services for consumption. Any increase in employment which fails to increase production (consumption) is undesirable, both for an individual and for a country. When the government endeavours to create jobs, it is missing the point. It is not jobs that need to be created, but goods and services for which there is consumer demand.

Buy Australian policies, by injecting an inefficient allocation of resources, can 'create' employment, but in the wrong industries. The outcome is that while unemployment may fall, production will also decline. This fact was pointed out by Bastiat in 1845 in a satirical example he called 'The Negative Railroad'. A Bordeaux newspaper suggested that the proposed railroad from Paris to Spain should break at Bordeaux because forcing goods and passengers to stop would be profitable for 'boatmen, porters, owners of hotels etc'. Bastiat points out that if Bordeaux profits from a break and if this profit is consistent with the public interest then all other cities and towns between Paris and Spain ought to have breaks too. The result will be a 'greater amount paid for storage, porters and cartage at every point along the way. By this means, we shall end by having a railroad composed of a whole series of breaks in the tracks i.e. a negative railroad' (1964: 95). John Logan has run various scenarios of the Buy Australian policy on ORANI (a macroeconomic model of the total economy). Although unemployment fell under all scenarios, more importantly, because of the second round effect on imported inputs to manufacturing, the balance of trade worsened.

The employment justification for buying Australian made overlooks the fact that employment can be a cost, not a benefit. From the viewpoint of employers, employment is a cost of production. From the viewpoint of consumers, employment is the cost of obtaining goods and services. Even for employees, although work can provide many benefits, it is nevertheless at the cost of alternatives such as leisure time. Throughout history, people have endeavoured to be liberated from work. The worldwide push to reduce working hours during this century bears witness to this fact. People have always endeavoured to devise labour saving devices. Living standards rise when output rises and inputs such as labour decrease. If buying Australian reduces output and increases input (employment) then it goes counter to the basis of economic progress worldwide. The argument that creating employment is not the legitimate objective of economic activity is well made by Forbes (1992:19):

> Robinson Crusoe, marooned on his desert island, needed a plank for his hut. He took his axe and went to find a suitable tree. He then noticed a plank dumped on the beach by the tide. (Contrary to the anti-dumping regulations).
>
> Then he began to worry: ' If I use my axe to cut a new plank, it will provide me with 15 days of employment. The work will blunt the axe, and sharpening it will provide more employment. 'I will also consume my food stock, and replacing it will provide more employment. Economists say that Labour is Wealth. Clearly I would ruin myself by using the dumped plank. In fact, I can add to my wealth by spending some time in throwing it back.'
>
> It is obvious, even to senators and sociologists, that Robinson's reasoning was absurd. It would also have been absurd if a native in a canoe had offered him a plank for a pretty shell which littered the beach, for a gold coin, a surplus coconut, or for any item which had less value to Robinson than the plank.
>
> What is absurd for an isolated individual does not become enlightened when imposed by force on all individuals.
>
> Labour is not an end, except for workaholics. Its purpose is production, whose sole purpose is consumption. Wealth in any society consists in an abundance of the things which are valued by its people, be it horses, cars, beer, pristine parks, football stadiums or opera houses. Wealth is determined by production and trade per capita, plus or minus international gifts. (Political dumping).
>
> Tariffs attempt to prevent people from picking up dumped planks and always reduce the general prosperity. How can it be otherwise?

The Buy Australian policy indicates that a one-for-one switch of imports for Australian made is desirable to decrease Australian unemployment. However this outcome is not necessarily in Australia's interest. Firstly, if buying Australian has similar effects to 'make work' type jobs, then it is undesirable since people obtain more dignity, security, etc, from 'real' productive jobs. Secondly, the additional jobs created are the result of inefficiency. Work is a cost of production. The greater the number of Australians that are required to produce the former imports, the lower Australia's living standards become. If anyone is in doubt on this point, one need only think of life in some third world countries where humans do the type of work that is typically performed in Australia by machines.

Australian unemployment could be solved by requiring that all firms replace machines with people, or alternatively by requiring firms to take on additional staff, including firms that are not seeking staff. The result of the substitution of people for machines would be a reduction in production. The requirement for firms to take on staff would result in no change in production, but firms would incur the additional cost of employing unnecessary staff. Both the replacement of machines with people and the requirement that firms take on additional staff will cause the cost of production to increase. Given that the costs of production of some firms will increase more than other firms, then their prices will increase relatively.[1] The result would be a reduction in the standard of living of those currently employed. This fact is also measured by the reduction in the production of other goods as a result of having to spend more on Australian made products compared to imports. In other words, Australians have less goods and services to consume after switching to Australian made than they did when they imported cheaper overseas made products.

While it is accepted that unemployment is a problem in Australia, buying Australian, when it involves the substitution of higher priced products for lower priced imports, is not the solution. It is in Australia's interest for resources to be allocated efficiently. Australia, like all countries, and Australians like all nationalities, have limited resources – it is necessary to use them wisely in order that their standard of living is maximised. Even if buying Australian creates some jobs, these will be in areas of comparative disadvantage for Australia. Buying Australian, when lower priced imports are available, is not the way to maximise Australian consumption.

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1 For the general price level to increase requires an accommodating expansion in the money stock. It is likely that the demand pressures generated by this employment 'solution' will cause monetary authorities to respond with adverse inflationary consequences.

Has the Buy Australian Campaign Reduced Unemployment?

The federal government has, since 1986, financed advertisements exhorting Australians to buy Australian made. By 1993 the number of licensed firms was over two and half thousand. These firms also advertise their products as Australian Made. Few people today would be unaware of the Buy Australian campaign. The Advance Australia Foundation (*Australian Made Good Business*:5) claims that 'sixty-one per cent of consumers now buy Australian Made products whenever possible compared to 43 per cent in 1989 and 24 per cent in 1986.'

Given these impressive statistics, and given that the reduction of unemployment is the Buy Australian policy's major rationale, it is reasonable to expect that unemployment would have fallen as a consequence of the enormous publicity advocating the buying of Australian, particularly in the past four years when the number of licensees doubled. However, in the last ten years, unemployment reached its lowest level in 1989, when it averaged 509,000 persons. It stood at over 800,000 in late 1994.

Despite almost ten years of the Buy Australian campaign, it has had no obvious impact on Australia's unemployment problem. No doubt supporters of Buy Australian will claim that unemployment would have been an even bigger problem without the government support for the campaign. This defence is an admission that the Buy Australian policy is unable to make a significant improvement in unemployment, for if it could it would have succeeded in doing so in the past decade. Despite its sponsorship of Buy Australian advertising, it is evident that not even the government really believes buying Australian will significantly reduce Australia's unemployment problem. A study of *Restoring Full Employment*, which was commissioned by Prime Minister Paul Keating to look at various options to overcome the unemployment problem, is revealing. A reading of this report failed to find any reference whatsoever to buying Australian. Clearly the expert committee did not consider that buying Australian would have any significant effect on reducing unemployment. Is this not surprising, given that for almost 10 years the federal government has spent taxpayers money on Buy Australian advertisements, which claim that buying Australian will reduce unemployment? The federal government's own appointed experts do not agree with this claim.

We have to look to causes other than imported goods to explain Australia's massive increase in unemployment in the 1990s. The increase is the result of recession caused by the federal government's attempts to reduce the current account deficit. Buying Australian is not the solution to a recession. By encouraging the substitution of high priced Australian made products for low priced overseas made goods, buy Australian policies can only further reduce living standards.

Could Buying Australian Solve Australia's Unemployment Problem?

The federal government funded advertisements such as 'Buy your kids a job' and the 'Buck stops here' suggest that buying Australian will partly solve Australia's unemployment problem. 'It is undeniable that by replacing imports with home grown goods we are able to create real jobs. For every $1 million of imports we replace, 30 new jobs are created for Australians, Mrs McHugh [the federal Minister for Consumer Affairs] said (Advance Australia Foundation 1993a).

Even if we accept that the estimate of 30 new jobs for every $1 million of imports replaced is correct, it does not mean that buying Australian made will increase total employment levels. Employment by Australian producers for the domestic market will increase. However, this must be balanced against job losses in other firms. There are several ways in which buying Australian will cost jobs.

At present many Australians are employed in firms which import. If consumers reduce spending on imported goods, the result will be fewer Australians working for importing businesses. Further, if Australians switch from imports to Australian made products then, given Australia's flexible exchange rate, the Australian dollar will appreciate. In turn, the higher priced Australian dollar will cause a reduction in the purchases by foreigners of Australian made products which are now more expensive to them. The result of Australians reducing the quantity of imports will therefore be a reduction in the quantity of Australian exports.[2] 'A policy that reduces Australian demand for imports also reduces foreign demand for Australian exports (Hartley 1993:55).' Consequently, employment of Australians by Australian exporters will reduce. To a large extent the shift in spending from imports to Australian made will result in a switch in the employment of Australians, from both importing and exporting firms, to firms which produce for Australia's domestic market.

If the Buy Australian campaign successfully persuades consumers to shift their spending from low-priced imports to higher priced Australian made products, consumers may reduce the quantity they buy. While a net increase in Australian employment may occur if a given quantity is made in Australia instead of being imported, it is not obvious that this is so if a

[2] In the long run the value of imports will equal the value of exports so that any tax on imports is also a tax on exports – the Lerner Symmetry Theorem.

smaller quantity of Australian made products replaces a larger imported quantity. Alternatively, Australians, rather than reducing quantity, may continue to buy the same quantity, with the result that they have less to spend on other goods and services. This reduction in spending will in turn reduce Australian employment across many industries:

> a switch of expenditure from imports to domestic goods can produce price rises, as a result of the increased demand for the locally produced product. Worse, if this product serves as an input to other goods or services, this price rise can be passed on to other sectors. ... The second effect comes through the impact of price rises on wages and hence on employment (Clark 1989:18).

Even if total unemployment remains unchanged some Australians will become, and will remain, unemployed as a result of the Buy Australian policy. Australians presently employed in importing and exporting businesses will have lost their jobs. To these can be added some Australians employed in firms producing Australian made products, because Australians will have less to spend after buying relatively high priced Australian made products. Although new jobs will be created by Australian firms producing for domestic consumption, this will not mean that the Australians presently employed in import or export jobs will necessarily become re-employed. The reason is that the skills required by Australian producers will not necessarily be the skills possessed by Australians who are currently employed by import and export firms. The Buy Australian policy may condemn many of these Australians to long term unemployment even if, in the best case scenario, total unemployment reduces. This problem is exacerbated in the more likely scenario that there is no change in total unemployment.

Taken together it is unlikely that Australian unemployment will fall as a result of the Buy Australian policy. Indeed it is possible that putting Australian products first may cause an increase in Australian unemployment, but more likely the policy will have little effect either way on unemployment.

A study by Horridge et al. (1987) supports this conclusion. They utilised '...a detailed general equilibrium model of the Australian economy [ORANI] to simulate the operation of a 'Buy Australian' advertising campaign which persuades domestic residents to reduce their expenditure on imports and to increase their spending on domestic commodities. The results cast doubts on the common presumption that such a policy will necessarily...increase aggregate employment' (p.245). The reason given by Horridge et al. for doubting an increase in employment and a reduction in the trade deficit is that buying Australian '...may be offset significantly by induced demand for imports as domestic production expands and by the inflationary effects of domestic expansion which erode the international competitiveness of exports and import competing products (p.231).'

Destruction of Local Producers?

Various myths exist regarding the effect of buying imports rather than buying Australian. Firstly it is claimed that the buying of imports will result in the destruction of local producers. It appears that the Buy Australian Made message has been so successfully sold by advertisements and media articles that in Queensland the 'Australian Products First' group (APF) has taken matters into its own hands by putting arsenic into imported pineapple.[3] Its stated intention is to have supermarkets remove imported pineapple from the shelves. It is likely that they want the removal of all imported items when there exists an alternative which is Australian made. While this group no doubt sincerely believes that buying Australian is good for Australians, it has unfortunately been misled by the federal government funded advertisements into believing that buying Australian will reduce unemployment.

An APF group media release claims that: 'More and more Australians are realising that the destruction of local producers and industry equates to total reliance on the whims of foreign countries and guaranteed unemployment for themselves and their children. Be warned.' To enforce their wishes the APF mistakenly singled out Pizza Hut, when in fact most of the pineapple supplied to its Queensland stores is produced by Golden Circle, a local producer.[4]

The APF, in addition to incorrectly claiming that buying Australian will solve Australia's unemployment problem, objects to the 'destruction of local producers and industry'. However, if buying cheaper imports results

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3 This group sent several cans of imported pineapple to the *Courier Mail* and the Minister for Primary Industries, Simon Crean in mid-1993. These cans were adulterated with low levels of arsenic as a demonstration that they could seriously poison imported pineapple if supermarkets continued to sell it.

4 Consequently, Pizza Hut announced that it ceased to put pineapple on pizza. The APF's action harmed the Australian pineapple producer which has said that Pizza Hut is one of its biggest customers. Following on from full page advertisements in the *Courier Mail* by major supermarkets to inform the APF group that any further action against imported pineapple would result in supermarkets not selling any canned pineapple, Australian made or imported, Pizza Hut has re-introduced pineapple on their pizzas. There has been no further responses from the APF group.

in local producers going out of business this result is good, not bad, for Australia in the long run.[5] Clearly consumers benefit from buying lower priced imports, but in addition the Australian economy will benefit from capital and labour moving out of industries where they are inefficiently employed to industries which are efficient. Australian firms which export unsubsidised goods and Australian firms which sell to Australians despite competition from imports, are likely to be efficient firms. The shift of capital and labour to efficient industries will benefit Australians. Let us use pineapple as an example. If Australians spend on average, say $50 p.a. on Australian pineapples, find that they can buy imported pineapples for say $30 p.a., then Australian consumers clearly benefit from buying overseas made, as they now have the same quantity of pineapples plus $20 to spend on other goods and services. Let us assume that Australian pineapple producers, being unable to compete with imports, go out of business. It is unlikely that the owners (or receivers or liquidators) would leave the land idle. Instead it will be used to produce other products – paw paws, or bananas or grapes etc. Australia is now better off than previously, as it has both pineapples (imported) and the production of paw paws (or bananas etc.).

However, buy Australian advocates are likely to claim that almost everything can be made more cheaply overseas than in Australia. They might except some farming (wheat, wool, etc.) and mining, but claim that almost everything else can be made at lower cost overseas. This is suggesting the impossible – it is not possible for Australia to import everything and produce nothing. If that were possible, then Australians would be giving pretty pieces of paper (called Australian dollars) in exchange for real goods. While Australian dollars normally represent claims against future consumption, in this unrealistic scenario there is no claim since Australia is importing everything and producing nothing. Overseas firms will export to Australia only if they receive payment in the currency of their country. However, banks would be unwilling to exchange other currencies for Australian dollars, as nobody would want Australian dollars, since they cannot be used to buy Australian goods (in this scenario they are non-existent).

What is overlooked by those who claim that almost everything can be made more cheaply overseas is that the exchange rate changes as Australia's demand for overseas products changes. If Australians supply more and more Australian dollars to buy overseas made products, then the value of

[5] In the short run there will be adjustment costs as capital and labour flow to industries in which Australia has a comparative advantage.

the Australian dollar will fall, causing overseas made products to become more expensive. Accordingly, based on the exchange rate there are many Australian made products which are cheaper for Australians to buy than imports.

More realistically let us assume that Australia is producing a wide range of products (as it is today). As the supply of Australian dollars for imported pineapples increases, the value of the Australian dollar falls, thereby acting as a natural brake on the amount imported. At the lower value of the Australian dollar, imports become more expensive, relative to domestic production. Consequently, Australian producers of pineapples (or bananas or grapes) may face only minimal competition from imports. While imports can destroy inefficient domestic industries for which imports are better value than Australian made, other domestic industries will arise in their place. The land and other resources previously used to produce pineapples are released to produce something else – to make a contribution to Australia's total consumption of goods and services in addition to the imports. The effects of exchange rate changes on the composition of Australian production are not random. Those industries in which Australia has a comparative advantage will be the ones to survive. The total goods and services available to Australians increases as a result of overseas trade, just as each Australian benefits from trading their production (for which they receive wages or profits) for the goods produced by others.

Does Buying Australian Avoid Technological Unemployment?

If Australians buy imports produced by modern technology and large scale production, then are Australian firms motivated to also utilise similar technology? Does this then lead to technology induced unemployment in Australia? Is technology the cause of recent large increases in Australian unemployment and consequently will full employment never be achieved again? Arguments that machines are destroying jobs have been around for centuries. Hazlitt (1979:50) provides an example from the Industrial Revolution in which operators of hand looms, fearing for their jobs, destroyed spinning machines: 'Arkwright invented his cotton-spinning machinery in 1760. At that time it was estimated that there were in England 5,200 spinners using spinning wheels, and 2,700 weavers – in all, 7,900 persons engaged in the production of cotton textiles. The introduction of Arkwright's invention was opposed on the ground that it threatened the livelihood of the workers, and the opposition had to be put down by force. Yet in 1787 – twenty-seven years after the invention appeared – a parliamentary inquiry showed that the number of persons actually engaged in the spinning and weaving of cotton had risen from 7,900 to 320,000, an increase of 4,400 per cent'. Rather than destroying jobs, the industry in fact increased the number of jobs. This occurred because the greater efficiency of mechanisation dramatically reduced price. Consumers responded and total spending on clothing rose, with the result that employment in the industry increased.

Technology creates jobs just as it destroys jobs. For example, when the motor vehicle replaced the horse and buggy, a whole new industry developed which employs tens of thousands today. When computers were developed, particularly low cost PCs, jobs on bookkeeping machines were destroyed and hand written methods greatly reduced. Today the computer industry employs tens of thousands.

Heyne (1973: 52) puts the technology argument into perspective: 'The fear that our society or any society may run out of jobs is an odd kind of fear. A job, after all, represents an obstacle to be overcome. A society that had run out of jobs for people to do would have come very close to overcoming scarcity; and that would be something to cheer not to fear. We are not in any such fortunate situation. As technological innovations increase the productive potential of our economy, labour resources are released from some employment and made available for others.'

The history of human progress is characterised by a never-ending search for more efficient methods of doing things. There are countless examples demonstrating this point including the invention of the wheel, electricity and computers. With each technological discovery, jobs involved with the old way of doing things were destroyed, but in every case new jobs were created. If it were possible to transport people through time, people from a hundred years ago would be amazed at the diversity of jobs and technology that exists today.

While the use of technology by Australian firms is not the cause of Australia's unemployment, does buying low cost overseas made products based on modern technology cause Australian unemployment? Can overseas firms with their large scale production take advantage of technology denied to small scale Australian firms and thereby cause Australian unemployment by exporting cheap goods to Australia?

Firstly, since some Australian firms lag behind overseas firms in the use of technology with its lower cost production, then the Buy Australian made campaign in effect denies Australians the benefits of overseas technological progress. Secondly, the more Australians import, the lower the value of the Australian dollar, and consequently, the higher the price of imports. Accordingly, there is a limit to imports and therefore a limit to the job losses. Also, the lower the value of the Australian dollar the cheaper

Australian exports become. Consequently, additional export jobs are created. Overall, the effect of technology in both overseas and Australian firms on total Australian unemployment is likely to be small.

The Cause of Unemployment

If buying overseas made products rather than buying Australian is not the cause of Australia's high unemployment in the 1990s what is the cause and what is the solution? The federal government's December 1993 paper *Restoring Full Employment* states that full employment is 5 per cent unemployment, and argues that a return to the unemployment level of 1-3 per cent of the 1950s to the early 1970s is not achievable. The government's 'job compact' guarantees work for the long-term unemployed if they agree to training. The cost of this will be $4.6 billion and aims to create approximately 600,000 jobs.

Leeson (1993: 86) points out that Australia's record unemployment was caused by the federal government's high interest rate policy which targeted the current account deficit and foreign debt: 'Two recent papers, by Peter Brain (1992) of the National Institute of Economic and Industry Research and Chris Murphy (1992) of Access Economics, both concluded that the major cause of the post-war record levels of unemployment was the tight monetary policy pursued at the end of the 1980s. The policy-induced recession was heralded, by the Treasurer, as a solution to the current-account imbalance and the associated record levels of foreign debt...'. Given that one of the objectives of the Buy Australian campaign is the reduction of the current account deficit, Chapter Four considers the question of whether attempting to solve the so called current account and foreign debt problems is worth causing the enormous economic and social cost of the highest levels of unemployment since the Great Depression.

If wages were less rigid during recessions, when demand by employers for staff significantly declines, then wages for the unemployed could reduce, thereby acting as a brake on unemployment. However, the award wage system is a price floor below which wages cannot fall, which accordingly prices many people out of work. The federal government implicitly recognises that unemployment results from award wages being too high for those who are unemployed, by allowing training wages to be paid to employees, and very large subsidies to be paid to employers to encourage them to employ otherwise too costly employees.

However, it is politically impossible for a Labor government to publicly recognise that the real cause of unemployment is the fact that legal minimum wages plus legalised oncosts, including payroll tax and compulsory superannuation, price the services of hundreds of thousands of Australians beyond their benefits to employers. Whenever minimum wages are set, which are above the wages that employers are prepared to pay low skilled or inexperienced employees, those employees are condemned to unemployment. In addition, the March 1994 unfair dismissal legislation is likely to cause employers to be very reluctant to employ new staff since their dismissal, if they turn out to be unsatisfactory, is very difficult and potentially could cost employers thousands of dollars. Instead of acknowledging the real causes of unemployment, the government promotes the myth that buying Australian will solve unemployment.

Chapter 3

Will Buying Australian or Free Trade Improve Australia's Standard of Living?

Most Australians would cite television and other advertisements, together with Australian made product labels, as the visible face of the Buy Australian campaign. Australia in fact has long had in place a less obvious range of buy Australian policies. These include a range of import restrictions: tariffs, quotas, and subsidies. A tariff is a tax on imports, thereby increasing the price to domestic consumers. A quota is a limitation on the quantity that can be imported. A subsidy is paid to the domestic producer and results in imports being relatively more expensive. The Buy Australian campaign is also a restriction of trade: 'Generally, any attempt to change preferences in favour of locally produced goods is a form of protection. Some examples of the forms that such an attempt may take, are exhortations to buy Australian... (Collins et al. 1984:167).'

Are Australians better off buying Australian made or are they better off buying overseas made? Is overseas trade good for Australia, or is it better to increase tariffs and other barriers to stop imports? This chapter considers these questions, and others, by analysing free trade and anti-free trade arguments. Most economists and politicians agree that free trade is best, not only for Australia, but for the world. The majority of the Australian public, if we observe their behaviour, support overseas trade, since relatively few Australians consistently reject better value overseas made products. Instead, when Australians regard overseas made products as the best value, they purchase them.

Binswanger (1987: 2) referring to the Buy American campaign, points out that such campaigns are a form of economic nationalism:

> In principle, the idea of giving preference to American-made products over foreign made products is the same as the idea of giving

> preference to products made by whites over those made by blacks. Economic nationalism is, like racism, a form of collectivism because it means judging men or their products by the group to which they belong, not by their own, objective attributes.

The larger the quantity of goods and services available to a country's citizens the higher living standards become. The Buy Australian policy, like tariff protection, substitutes inefficient Australian production for efficient overseas production, and results in a decrease in the total goods and services available to Australians and thereby lowers Australian living standards. 'Currently tariffs reduce the annual disposable income of the average Australian household by around $1,600. Import protection inflates the price of the average family car by around $4,000. As tariffs fall this puts more money into the hands of the consumer, stimulating demand for consumer products and employment creation across the board. The result will be more real jobs which contribute to national income as opposed to unproductive jobs in protected, inefficient industries or "green logs" public sector employment (Crowley 1992:5).'

Australians' standard of living will not be enhanced through economic nationalism. When choosing goods and services, the major consideration should not be where they were made. Comparing price and quality is the way to get the best goods and services and achieve value for money. Australians will buy Australian where Australian goods and services can compete on price and quality. These will be those goods and services in which Australian producers have a comparative advantage.

Comparative Advantage

Why do countries trade? Early economists concentrated on the cost of production and whether a country had an absolute advantage whereby it could produce some goods cheaper than other countries. Adam Smith, as early as 1776, provided the example of Scotland which could produce grapes for wine but Italy could do so more efficiently. Smith explained that it would benefit Scotland to import wine from Italy and pay for it with goods which it could produce more cheaply than Italy.

However, Adam Smith's analysis is unable to explain trade between two countries when one country can produce every commodity more cheaply than the other country. Would the more efficient country benefit from trading with the less efficient? The solution to this question was provided by David Ricardo, who formulated the theory of comparative advantage.

When one country has an absolute advantage in the production of all goods, its absolute advantage will be greater for some products than others. This means it has a comparative advantage in some of the goods it produces. For example, the USA may be able to produce all goods more cheaply than Australia – the USA has an absolute advantage. While both the USA and Australia could be more efficient in the production of swimming pool chemicals than they are in the production of wool, it is relative efficiency across countries that is important. For example, the USA may be much more efficient in the production of swimming pool chemicals than it is in the production of wool. The USA then has a comparative advantage in the production of swimming pool chemicals. If the USA were to produce wool, this would be very costly in terms of swimming pool chemicals forgone. In other words, compared to Australia, the USA is inefficient in the production of wool, and Australia compared to the USA, is efficient in the production of wool, despite the fact that the USA has an absolute advantage in wool production. Australian wool production is less costly than USA wool production in terms of swimming pool chemicals forgone. When countries exploit their comparative advantages, then resources shift into industries where productivity is highest. Since resources cannot move internationally to take advantage of technology differences, trade consistent with comparative advantages is 'as if' resources had moved internationally. Accordingly, higher living standards for both Australia and the USA result when Australia produces wool, and does not produce swimming pool chemicals, and vice versa for the USA.

The theory of comparative advantage explains that trade occurs because comparative costs differ. The result of trade consistent with each country's comparative advantages, is that both countries have more of both products. Accordingly, in this example because of trade Australia would have more wool and swimming pool chemicals than it would if it remained self-sufficient. Similarly, the USA benefits from trading with Australia by having more wool and swimming pool chemicals than it would if it did not trade.

However, the Advance Australian Foundation (1993a:7), implies that Australians should buy Australian made goods rather than entering into international trade:

> Buying Australian made goods means, simply, that the money you spend goes back into Australian industry to employ Australian workers to make more Australian goods, and so the cycle continues.

This statement describes Australia as an island with no contact with the outside world. The Advance Australia Foundation claims that restricting Australians to Australian made products is desirable. However, when Australia trades with other countries it benefits from being able to buy cheaper overseas made goods as well as benefiting from greater choice. Foreigners also benefit as they can now buy exports of Australian made goods, thereby increasing Australia's income. Accordingly, the quotation above needs to be amended: 'buying Australian made goods *and overseas made goods* means, simply, that the money you spend goes back into Australian industry to employ Australian workers to make more Australian goods for *both Australian consumption and for export*, and so the cycle continues'. The standard of living of Australians is improved by trading with the world.

The Reason for the Existence of Comparative Advantages

Natural resources differ between countries. Australia has a relative abundance of flat land and has a dry climate which gives it cost advantages in the production of goods such as wool and wheat. Because other farming such as rice requires relatively more labour and rainfall, Australia is at a comparative disadvantage. The USA has a relative abundance of capital which gives it a cost advantage in manufacturing. Accordingly, trade occurs because of these international differences in factors of production. Exports will consist of goods which use the country's relatively abundant factors and imports will consist of goods which use the country's relatively scarce factors of production.

Trefler (1993) shows that differences in wages and other factors of production such as land and capital are a feature of international trade. Factor price differentials exist because of differences in productivity 'For example, it was necessary to assume that British labour productivity is only two-thirds of US labour productivity in order to make the modified HOV theorem fit exactly. Correspondingly, British wages were found to be about two-thirds of US wages (p.981).' Trefler points out that 'the US productivity edge is known to be most dramatic in agriculture ... in productivity-equivalent terms, the developed countries are capital abundant, a pattern that accords with the well-known link between capital formation and development (pp.975 - 977).'[1]

[1] 'In the original explanation of the Leontief paradox, Leontief maintained that the United States is labour abundant when labour is measured in productivity-equivalent workers: one person year of US labour is equivalent to several person years of foreign labour with inferior technology...An implication of my empirical work is that Leontief was right in maintaining that...the United States was labour abundant as measured in productivity-equivalent workers' (Trefler 1993: 962).

Comparative Advantage and Living Standards

The Buy Australian policy attempts to persuade Australians to buy Australian made products in preference to overseas made products. If it were successful, there would be an increase in Australian production, but a reduction in Australian living standards as cheaper overseas products are replaced with more expensive Australian made products. The Buy Australian policy goes counter to the enormous economic progress that has been achieved over centuries in every country in the world from specialisation.

The Buy Australian made policy is contrary to the way most Australians conduct their everyday life. Each person does not attempt to be self-sufficient by growing and making everything themselves Our standard of living is vastly higher by specialising and exchanging our output with that of others. Why does trade occur? It occurs because each party to the trade benefits. Voluntary trade occurs because each person is willing to give up something they own in exchange for something owned by someone else.

When we refer to trade, imports and exports come to mind, but in fact Australians trade not only with foreigners but with fellow Australians. How do Australians trade with other Australians? They do so by specialising. Few Australians are self-sufficient and produce everything they want – food, clothing, golf clubs, etc. Instead Australians trade (spend) their income on goods and services produced by other Australians. Each Australian's standard of living is higher when they specialise and trade. This occurs when Brisbanites buy not only goods produced elsewhere in Queensland but also goods produced in Sydney, Melbourne, etc. Few Australians would deny that they benefit from buying goods and services that are produced in a state other than the one they reside in. One only has to observe the huge number and size of interstate trucks on Australia's major highways to realise the amount of interstate trade. Similarly, with rail and air freight.

Imagine if the Constitution was amended so that states could impose a tax (tariff) on all goods coming across their border and the taxes were sufficiently high that the price of these goods was then higher than the price of goods produced within the state. Would Australians then be better off, than they are when the Constitution guarantees them free trade? Clearly not, since Australians would be worse off from having to pay higher prices for goods made interstate. While producers within the state benefit, from the increase in business caused by the state tax, the vastly greater number of consumers (including other producers who must pay higher prices for imported inputs) are significantly worse off.

The greater the restrictions on interstate trade the more Australians suffer. For example, imagine if tomato growers, say in Queensland, were successful in imposing such a small quota on interstate shipments, that for months of the year no interstate tomatoes were available in Queensland. Since federation, Australians have benefited from the Constitution guaranteeing free trade between states. Free interstate trade is optimal for all Australians, who then have a choice between goods made in the state and goods made in other states. Any restriction in free interstate trade results in a reduction in the standard of living of Australians.

The framers of Australia's Constitution recognised that Australians benefit from trade. Section 92 of the Constitution states that 'duties of customs, trade, commerce and intercourse among the states, whether by means of internal carriage or ocean navigation, shall be absolutely free.' Although there have been numerous referendums to change parts of the Constitution, there has been none on the free trade section. Clearly, no government has considered that the free trade section of the Constitution is contrary to the public interest. It is likely that the vast majority of Australians would oppose any referendum which attempted to restrict the free movement of goods and services within Australia.

Similarly, if Australia produces goods in which it has a comparative advantage and trades them for goods in which it has a comparative disadvantage, then Australia will benefit by being able to consume more of all goods, than it would if it did not trade.[2] Some goods are not made in Australia and other Australian made products are higher priced than imports. Australia's standard of living is enhanced by the opportunity to buy goods from all over the world.

This view may be different to that sometimes presented in the media which claims that importing cheap foreign goods reduces our standard of living. This claim is incorrect. Australia (as does every country) imports 'cheap foreign goods' because Australians benefit from buying such goods in preference to more expensive Australian made goods. Dr Hooke of the National Farmers Federation has estimated that if the Buy Australian policy succeeded in persuading Australian consumers to substitute more expensive local products for cheaper imports it could reduce living standards by $10 billion, or $2,000 per Australian family.

Because domestic producers benefit from the increase in production and profits, the tariff in effect redistributes wealth from consumers to producers. The wealth of consumers reduces by the increase in price caused by the tariff. Because tariffs and Buying Australian results in greater domestic production, Australian living standards decline by the increase in

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2 For a numerical illustration refer to any standard economics text, for example, Barron & Lynch 1986: 465-467.

the price of domestic production over that of overseas production. This increase in the quantity of domestic production is inefficient production since overseas producers have a comparative advantage in its production. In addition to the deadweight production loss there is a consumption loss. This arises because the tariff increases the price paid by consumers, who in turn reduce the quantity they purchase. For the technically minded there is an appendix showing the resource misallocation effects of tariffs and buying Australian.

Trade Sanctions

What would happen to living standards if the Buy Australian campaign was, from the point of view of its advocates, a huge success – large reductions in imports and large increases in Australian made? Evidence of the effect on living standards of this scenario comes from the imposition of trade sanctions on countries which previously enjoyed imports. When world opinion is opposed to the actions of a government, the step taken, that is just short of war, is trade sanctions. Recent examples include Rhodesia (Zimbabwe), South Africa and Iraq. In an effort to force the governments of these countries to change their policies, trade sanctions including blockades have been put in place. As a result of the trade sanctions, these countries have to buy only locally made products. If Buy Australian is beneficial, then we would expect that the living standards of countries subjected to trade sanctions would improve. However, forcing these countries to rely on domestic production causes its citizens great hardship. Ask the citizens of these countries if 'buying ... made' was beneficial, when previously they enjoyed low cost production from all parts of the world. There is no doubt that being forced to buy 'home made' products greatly reduced their living standards.

Rather than buying Australian and reducing imports benefiting Australians, it harms Australians. Governments use restrictions on imports to harm a country, not benefit it. For example, exiled President Jean-Bertrand Aristide of Haiti asked the United Nations in October 1993 to impose a full trade embargo against Haiti to force the army to allow his return.

While the objective of trade sanctions is to harm the targeted country, sanction imposing countries are also reducing their living standards. The taxpayer funded advertisements which attempt to persuade Australians to buy Australian made, when they presently enjoy the benefits of overseas made, is a case of a country 'shooting itself in the foot'.

Import Restrictions Hurt Australian Exports

Import restrictions such as quotas and tariffs, have the same objective as the Buy Australian campaign – to make Australians buy Australian made products. Once the quota has been imported, Australians are absolutely denied further imports and have no option but to buy Australian or do without. Tariffs, by increasing the price of imports, cause Australians to buy Australian made products. While it is correct that consumers suffer from tariffs on imports, it is incorrect to argue that such tariffs benefit all producers. Although they benefit the protected industry, it is at the expense of other Australian producers. Producers who must compete on the international market are at a particular disadvantage.

Suppose Australia were to increase tariffs so that no imports came in from overseas. As overseas firms find their market in Australia unavailable, and therefore do not receive any Australian dollars, they will be unable to buy any Australian goods. Australian firms will suffer depending on the amount of sales previously exported. By reducing imports buy Australian policies such as quotas and tariffs also reduce exports.

Over time, the value of a country's exports must broadly equal the value of its imports:

> ...Tariffs and import quotas are designed to restrict imports by raising the prices consumers pay for imports, thus allowing unprofitable industries to compete against imports. But by restricting imports though tariffs and import quotas we necessarily restrict exports. Tariffs are a tax on exports (Crowley 1992: 3).

Snape (1993) points out that South Korean exports in 1990 were a very high 32% of GDP, and that imports were a similar proportion. In fact, due to aid and capital inflow from the end of the Korean war until the early 1970s, imports were a higher proportion of GDP than exports. ' In order to import, a country must export. The other side of this coin is that in restricting its imports a country also restricts its exports ... The basic point here is that a country cannot have an open economy on the side of exports and a closed economy on the side of imports. If a country wishes to export it must import (p.28).'

If tariffs did not effectively prohibit imports but merely restricted them, the above results would occur, albeit to a lesser extent. If import restrictions such as the Buy Australian policy and tariffs were relaxed, or better still removed, then the increase in imports would cause an increase in exports.

> There is no more striking example of practice confirming theory than the phenomenal response of exports of manufacturers to unilateral trade liberalisation in Indonesia in the last few years... Even Australia demonstrates the point. As tariff and other protection has been reduced, exports of manufacturers have taken off. Manufactured exports, ... rose at an annual rate of 17 percent between 1983/84 and 1989/90 and by 26 percent in 1990/91(Arndt 1992:121).

The Buy Australia policy and tariffs, by reducing imports which consequently reduce exports, changes the structure of the economy. They make Australia's efficient export industries smaller, and inefficient industries, which would not survive but for this protection, larger.

Do Import Restrictions Protect Australian Jobs?

Free trade, by increasing economic growth, generates additional jobs. However, it is also claimed that tariffs and import reducing policies such as Buy Australian protect Australian jobs. Which is right?

Let us assume an Australian clothing manufacturer says it would throw people out of jobs if the tariff on imported clothing was reduced. Assume a shirt is sold for $30 by Australian firms but Asian producers could sell it for $25, and therefore a tariff of $5 is necessary to keep the Australian firm in business.[3] Let us further assume that the tariff is repealed and that Australian firms go out of business and Australians become unemployed. While this is the immediate effect of the tariff's repeal, there are other effects. Australian consumers can now buy shirts for $25 and have $5 left over, since under the tariff they were paying $30. By buying the imported shirt, Australians have $5 – the spending of which will increase employment in any number of other Australian industries. But the results do not stop here. By buying Asian shirts Australians supply Asians with dollars to buy Australian goods (exports). Because Australians buy more from Asia, Asians are able to buy more from Australia, and in fact they must do so if the dollars are not to remain perpetually unused.[4] The result of importing Asian shirts is that Australia exports more. Although fewer Australians are employed in the Australian clothing industry, more people are employed and more efficiently employed in other Australian industries in which Australia has a comparative advantage. Australian employment on net

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3 This example and the discussion is indebted to Hazlitt (1979:76-77).

4 While this example simplifies the complexity of real world trade, since Asians can sell the Australian dollars to other countries, eventually the Australian dollars will be used to buy Australian exports assuming the exchange rate is unchanged – refer to Chapter Four for a discussion of changes in the value of the Australian dollar.

balance need not decrease, but Australian (and Asian) production/consumption on net balance will increase. People are more effectively and efficiently employed doing the things each country does best, rather than things they do inefficiently. Consumers in both Australia and Asia are better off when Australian tariffs are reduced.

What would happen if a new tariff, quota or subsidy came into being? Suppose there was no tariff on imported shirts and Australians were accustomed to buying shirts from overseas without duty. Assume an Australian clothing industry came into being due to the imposition of a duty of $5 on imported shirts. Australians would then be employed in the new Australian clothing industry. Because Australians have to pay $5 more for Australian made shirts, they will have that much less to spend on other things. In order that the clothing industry grows, other Australian industries must shrink. Because the new clothing industry is visible and the shrinkage of many other Australian industries is difficult to see (due to the imposition of a tariff in another industry), the overwhelming majority of people would suffer from the delusion that the new industry had cost Australians nothing. However, the tariff imposed on one industry causes reduced spending and thereby unemployment in other industries.

The long run effect of import reducing policies such as Buy Australian and tariffs on employment is to reallocate jobs from industries that Australia has a comparative advantage to those it does not. Since the IAC (1982) concludes that tariff reductions would result in only a small net loss of jobs the justification provided for Australian protection policy is empty. Crowley (1992: 4-5) argues that the 'widely held view that protection is needed to maintain employment and that tariff cuts will add further to the dole queues...' is false. Indeed, he points out that:

> Import protection has not been successful in creating employment in the past. In fact, job losses have been greatest in the most heavily protected industries. Over the period 1978-79 to 1988-89, prior to the current recession, while employment growth in Australia was relatively strong, employment in the manufacturing sector fell by 3.6 percent. Employment in other sectors, many of which are adversely affected by manufacturing industry protection, grew strongly. In some lightly protected industries, employment actually increased. ...For industries with low levels of import protection, those with effective rates of assistance of less than 10 per cent, employment increased by 6.5 per cent over 10 years. In the industries receiving high levels of protection, total employment fell by 9.5 per cent. This decline was not caused by tariff reductions. Overall manufacturing

industry protection did not fall significantly over this period and in textiles, clothing and footwear, effective rates of assistance actually rose. In spite of decades of being heavily subsidised, the competitiveness of these industries continued to decline.

Worldwide Support for, and the International Benefits of, Free Trade

International free trade is widely supported throughout the world.

> Economists often do disagree but that has not been true with respect to international trade. Ever since Adam Smith there has been virtual unanimity among economists, whatever their ideological position on other issues, that international free trade is in the best interest of the trading countries and of the world (Friedman & Friedman 1980: 39).

The prominent American economist Paul Krugman once remarked that 'If there were an economist's creed, it would surely contain the affirmations "I understand the principle of comparative advantage" and "I advocate free trade" (Krugman 1987:131).'

The benefits of trade are increasingly recognised in international agreements. In November 1993 the USA, Canada and Mexico signed the North American Free Trade Agreement (NAFTA) eliminating tariffs and other barriers to trade between them, thereby creating the world's largest and richest trading bloc. Other Latin American countries are expected to jump aboard and turn NAFTA into AFTA – an American Free Trade Agreement. Other examples of such agreements include the Australian-New Zealand Closer Economic Relations (CER), the European Community (EC), the Association of South East Asian Nations (ASEAN), and the General Agreement on Tariffs and Trade (GATT).

These free trade agreements promise substantial economic rewards:

> Despite its imperfections, the GATT deal is a potentially massive boost to the Australian and world economies. By cutting tariffs, liberalising or removing quotas and opening markets, it will hugely increase the size of the global economic cake when fully implemented over the six years from mid-'95. According to OECD estimates, by 2002 national incomes will increase by $52 billion in North America, $162 billion in Europe, $62 billion in Japan and $130 billion in the rest of the world.
>
> Australia stands to gain $5 billion a year in exports, 50,000 jobs and a $3.7 billion boost to its gross domestic product (Fray 1994: 70).

The Australian government holds high hopes for APEC (Asia Pacific Economic Cooperation).

> Mr Keating is one of the strongest supporters of APEC, believing that free trade will mean new jobs, new investment and higher economic growth for Australia (Charlton 1994a).
>
> Australian officials estimate free trade with APEC countries could boost Australia's annual economic output by $7 billion and create hundreds of thousands of jobs (Charlton 1994b).

The APEC free trade agreement, which aims to remove all preferences for domestic producers including Buy Australian, tariffs and other trade restrictions, will unite about half of the world's economy into free trade. There is little doubt that it:

> is likely to be one of the great economic landmarks of the 20th century ... Professor Bersten said APEC had the potential to be more important in trade terms than the recently completed General Agreement on Tariffs and Trade (GATT) (Charlton 1994c).

Comparing APEC with GATT 'Mr Keating has estimated that free trade in the Asia-Pacific region could bring benefits to Australia of more than double the Uruguay Round of trade negotiations' (Gordon & Walters 1994).

International Harmony

Not only does free trade generate enormous economic benefits, but it also reduces conflict between countries. Much conflict between countries has an economic basis, with disputes occurring over 'unfair protection' due to policies such as Buy Australian, tariffs, subsidies, and government purchasing preference for domestic producers. Free trade, by removing this major source of conflict between countries, is one of the biggest steps mankind can make for international harmony. The ramifications of the APEC agreement for the EC and other trade blocs could be significant. It is likely that other free trade areas such as NAFTA and the EC will wish to join APEC. World wide free trade will significantly increase every country's living standards and reduce international tension. Parochial, nationalistic and petty minded policies such as Buy Australian, lower every country's living standards and through institutionalising conflict between countries, poses a threat to world peace.

Free Trade: An Argument Not Yet Won

Despite the strong arguments in favour of free trade, protectionism remains a force in Australian politics. Phased reductions in protection were announced by the federal government in March 1991, but many industries including motor vehicles, textiles, footwear and clothing retain extensive protection. In 1993-94 the consumer tax equivalent of industry assistance to the manufacturing sector amounted to $6.5 billion (IC 1994: 304). Possibly unaware of the costs of protectionism, more than 60 per cent of voters believe Australia should continue to use tariffs to protect industry (Jones et al. 1993: 70).

Perhaps there are Australians who support the Buy Australian campaign who would otherwise favour import restrictions for which Buy Australian is a less costly and less effective substitute? If the only choice facing society is either import restrictions or the taxpayer funding of the Buy Australian campaign, then the Buy Australian campaign is preferable as the lesser of the two evils. However, the choice is not 'either/or' since Australians who prefer Australian made can, at no cost to taxpayers, simply not buy imports. Neither import restrictions nor the Buy Australian campaign is necessary for these Australians to not buy imports.

Given that the living standards of Australian consumers are reduced by tariffs and non-tariff distortions such as the Buy Australian campaign, what justifications are given for their imposition? The general public is aware that almost every country in the world protects its own producers by way of tariffs and other import restrictions. While the early part of this chapter argued that free trade is best, the reader may believe that there are circumstances which justify governments restricting trade, by policies such as Buy Australian and tariffs. It is therefore necessary to briefly consider these arguments. The conclusion is that all restrictions of trade including the Buy Australian policy are to the detriment of Australian consumers.

The Level Playing Field and Buying Australian

It is said that international trade is not a 'level playing field' because countries support their producers with unfair subsidies and import restrictions. Free trade would be good if other countries did not support their producers, but as long as they do Australia cannot remove restrictions on imports such as the Buy Australian policy and tariffs. This argument has no validity. Australia benefits from reducing its tariffs, even if overseas countries maintain theirs. Clearly, Australians benefit if overseas countries reduce their support for their producers (this is the basis of free trade agreements and Australia's support of GATT), but Australia benefits from reducing support for Australian producers even if other countries do not reciprocate.

A study by the Centre for International Economics (Stoeckel 1990: 69) supports this outcome:

Table 1

Trade Policy Payoff Matrix Changes in GDP in 1988 (US $billion)

	North America no change	North America protects (retaliates)	North America liberalises
EC no change	—	EC -80 Asia-Pacific -2 Nth America -24 WORLD **-106**	EC 94 Asia-Pacific 54 Nth America 93 WORLD **241**
EC protects ('fortress')	EC -52 Asia-Pacific -16 Nth America -40 WORLD **-108**	EC -132 Asia-Pacific -18 Nth America -64 WORLD **-214**	EC 42 Asia-Pacific 38 Nth America 53 WORLD **133**
EC liberalises	EC 117 Asia-Pacific 9 Nth America 31 WORLD **157**	EC 37 Asia-Pacific 7 Nth America 7 WORLD **51**	EC 211 Asia-Pacific 63 Nth America 124 WORLD **398**

Note that if North America liberalises (reduces its tariff and non-tariff barriers to imports, including support for buying US made) and the EC (European Community) makes no changes to its trade restrictions, then North America (USA and Canada) benefits – their GDP (Gross Domestic Product) increases by US$93 billion (in 1988 prices). Similarly if the EC liberalises and North America makes no changes to its trade restrictions, the EC benefits by US$117 billion. In addition, when one group liberalises and the other makes no change, not only does the group liberalising benefit, but also so do the no-change groups. For example, when North America liberalises both the EC and Asia-Pacific benefit by US$94 billion and US$54 billion respectively, despite neither group making any change to their trade restrictions. This is also the case when the EC liberalises and North America makes no changes: North America benefits by US$31 billion and the Asia-Pacific by US$9 billion. However, the gains to all groups are maximised when both North America and the EC liberalise: the EC benefits by US$211 billion, the Asia-Pacific by US$63 billion and North America by US$124 billion.

Note that when restrictions on trade are increased the opposite picture emerges. If, for example the EC moves to a 'fortress' Europe mentality by increasing restrictions on imports and if in turn North America retaliates, then everybody is a loser: the EC by US$-132 billion, Asia-Pacific by US$-18 billion and North America by US$-64 billion.

The Infant Industry Argument

This argument claims that if industries are protected from overseas producers, then in time they will develop comparative advantages. Will the Buy Australian policy, by supporting these firms, enable them to become 'value for money' firms? If industries have potential they can obtain finance from the private market to support them until they become profitable. In many cases, Australians working in financial institutions judge that it is not in Australia's interest for these firms to be financed. If private suppliers of capital do not judge that the industry will succeed, then there is no justification for the government to support such firms, particularly given the costs to consumers. The Finance paradigm[5] explains that private suppliers of funds have strong incentives to make correct decisions, for if they do not, non-survival is their punishment. If private lending institutions do not finance an industry, then it is because they judge that the 'infant' industry will not become sufficiently profitable to become an adult. Given there exists a large number and great variety of private sources of capital, all competing to lend to industries (old and new), then the non-financing of an industry is not a matter of concern but an acknowledgment that there exists limited resources which are better utilised elsewhere.

It is generally accepted that the infant industry argument has little validity in Australia today:

> The essence of the 'infant industry' argument is that as industries reach maturity the level of protection given to them should be reduced. In Australia, this has not happened. Many 'infant' industries are demanding and receiving assistance long after the 'infant' stage is passed (Collins et al 1984: 280).

The Buy Australian campaign encourages Australians to support inefficient local firms. Efficient Australian firms can stand on their own

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5 The Theory of Finance is concerned with how individuals and firms allocate (and choose among alternatives) risky cash flows through time to achieve a desired goal. It centres on two facilities for the exchange of cash flows through time. First, exchange through borrowing and lending in the capital market and second exchange through production. ...By providing capital funds for the productive activities of firms, individuals are exchanging cash flows now for claims to cash flows in the future. These future cash flows result from the sale of productive output of firms (Bishop et al. 1984:1).

feet without the Buy Australian campaign or other import restrictions. They can compete with imports without taxpayer subsidies. Australian living standards are lowered by the Buy Australian support of inefficient Australian firms.

Cheap Foreign Labour

The popular media has misled the public into believing that Australian firms cannot compete with the 'sweat shops of Asia' due to their low wages. It is suggested that if we do not buy Australian, then Australia will be flooded with cheap imports and Australian firms will go out of business. This emotional argument finds favour with Australian businesses and unions, both of whom support the Buy Australian campaign. If the cheap foreign labour argument were pursued to its logical conclusion then Australia would, for example, refuse to trade with New Zealand, most of Asia, Africa, South America and significant parts of Europe including Great Britain, as wages in these countries are below that of Australia. The fallacy in this argument is exposed by the theory of comparative advantage. If all countries have the same costs of production there would be no gains from trade. Instead, low priced imports benefit Australian consumers and producers in other countries who willingly supply their goods at relatively low prices compared to Australian made.

While it is often claimed that Australia cannot compete with Asia as their wages are much lower than Australia's, the facts deny this claim: 'In 1974, Australia's exports to ASEAN were worth $350 million or less than 6 percent of our total exports. In 1992-93 they were valued at $8,700 million or 14 percent of the total. This makes ASEAN our second largest regional market (after north-east Asia) and puts it ahead of Europe and North America. In addition, the trade balance with south-east Asia is almost two-to-one in Australia's favour despite all the fears about a flood of cheap Asian imports that would follow our lowering of protective tariff barriers (Brown 1994:98).

Wages are only one aspect of labour costs. Labour productivity is also important. Overseas made products may be produced at lower labour cost due to either lower wages or greater productivity. Either way Australian consumers benefit from imports of low priced overseas made products.

Strategic Trade Theory

Strategic trade theory argues that government needs to encourage the development of particular industries or particular firms. The logic underlying strategic trade theory is that government has the ability to decide which industries to support and which not to support. The record of

Australian state governments in 'picking winners' is not good. Nor does overseas experience provide much support for strategic trade theory in Australia:

> Advocates of strategic trade policies often point to the experience of Japan and South Korea, countries that have had remarkable economic growth while following interventionist trade strategies. But such casual empiricism proves little. Some countries, such as the Philippines have poor growth records despite following similar interventionist trade strategies; and some, such as Hong Kong, which have been less interventionist have enjoyed rapid economic growth (Bates 1990:2).
>
> The lesson for Australia should be clear. Strategic trade policy is a very unpredictable tool that has its greatest chance of success in highly concentrated capital-intensive industries with substantial economies of scale – industries in which Australia does not have a comparative advantage (Vousden 1992:4).

In any case, the arguments of strategic trade theory can provide no support for the Buy Australian campaign. Buy Australian does not try to support those industries in which Australia might have some comparative advantage. Rather, it indiscriminately supports them all. Given that strategic trade theory cannot even pick a few industries as winners, there is no justification for the Buy Australian made policy which attempts to pick all Australian industry as a winner.

Anti-dumping Laws

When foreign governments subsidise their producers, which enables them to sell in Australia below cost, then that is described as 'unfair competition' and is called dumping. Australia has legislation empowering customs officials to stop this practice. Anti-dumping laws are a form of buy Australian since they deny Australian consumers these low priced overseas made products and thereby cause Australians to buy higher priced Australian made products instead.

Is this legislation in the interest of Australians? Who benefits and who bears the costs of such subsidies? For a foreign country to pay subsidies to its producers, then its government must tax its citizens – they are the ones who bear the costs. Australian consumers benefit from the reduction in the price of the subsidised imports. Suppose subsidised sugar entered Australia (it cannot at present due to legislative restrictions) then the imports of sugar would reduce the price of sugar in Australia, and reduce sugar production, causing unemployment. But this is only the first round effect. Products made of sugar would be cheaper and Australian buyers of these products would have additional money to spend on other things. This would result in production and employment in a wide range of industries increasing. There need be no net loss of Australian employment, but there would be an increase in consumption of a wide range of goods by Australians. In effect, dumping means that overseas citizens act like Santa Claus and Australians benefit from their generosity.

What if the result of subsidised sugar being allowed to come into Australia is that the Australian sugar industry is destroyed? Surely this cannot be permitted? Won't the overseas producers, no longer facing competition from Australian producers, then put up the price, perhaps even above the domestic price prior to the subsidised imports being allowed into Australia? Firstly, we have seen that Australians benefit from the subsidised imports. Secondly, what would the owners of the land and sugar producing equipment do when they no longer produce sugar? Obviously, they will turn to other products – land used for sugar production is extremely fertile and capable of producing many other things. Thus Australians benefit from this increased production. Finally, what about the concern that the overseas producers may increase the price perhaps above that prevailing before subsidised sugar entered Australia? Firstly, there is world wide competition to export sugar, so if one country attempted to increase the price to Australia, a dozen other countries would take their place, without increasing the price. In the unlikely event that all overseas producers put up the price above the price previously charged by Australian producers, then there is nothing stopping Australian producers from switching back to sugar and undercutting the overseas suppliers' excessive price. The likelihood of overseas producers succeeding in increasing prices in Australia above the world price is negligible. The writer is unaware of such occurrences in the real world.

Kirchner (1993) points out that Australia is one of the world's best at denying its citizens the benefits of dumped goods: 'By international standards, Australia is certainly a major user of international dumping measures... Australia, for several years in the mid-1980s, had more anti-dumping cases than any other country and seems to have regained that position in 1990-91 (p.23).' Kirchner also points out that dumping complaints are usually initiated by Australian firms which have a monopoly over the Australian market and do not wish to face competition from imports: 'The [Industry] Commission found that in the two years to the end of 1990 [anti-dumping] complaints were usually initiated by firms which produce all of Australia's production of the relevant good, and that domestic producers commonly sought action against imports from all sources (p.25).'

Is the Buy Australian Policy Voluntary?

This chapter explains that free trade enables Australians to make voluntary choices between Australian made and overseas made products and thereby maximise their standard of living. Tariffs are a form of coercion to buy Australian since they increase the price of imports. Is there a justification for a buy Australian advertising program on the grounds that it is a voluntary change in preferences? Presumably if citizens come to believe that buying Australian is a good thing and a patriotic duty, they will get satisfaction from buying Australian. In the light of their new-found tastes they are better off even if they would be worse off if evaluated in terms of their previous preferences. Few would dispute that consumers are entitled to change their minds, and so I have no debate with the argument that consumers are better off if advertising of buying Australian causes them to believe that they are better off.

The issue that is important is whether the taxpayer funded buy Australian campaign can be classified as voluntary in comparison with tariffs, which are classified as coercive. Because taxation is compulsory, taxpaying consumers are coerced into paying for buy Australian advertisements. While some taxpaying consumers obtain benefits, it is argued that the majority do not. If there were large numbers of Australians who value the Australian made image, then the benefits of advertising would exceed the cost. In this case, private firms would have voluntarily incurred the costs of the campaign and there would be no need for taxpayers being compelled to fund the campaign every year since 1986. The fact that private firms did not fund the campaign prior to the government coercing taxpayers indicates that private firms did not consider that the benefits exceeded the costs. If private firms incur costs of advertising Australian made, then those costs are passed on to the purchasers of the firm's products. In this case, consumers are voluntarily changing their preferences since they value the benefits of buying Australian made more than the costs. Firms would continue to advertise 'Australian made' only so long as consumers switch their spending from imports. Given that business firms have judged that consumers were unwilling to voluntarily pay for the attribute of 'Australian Made', then the compulsory taxpayer funding of the Buy Australian campaign is no less coercive than that of tariffs.

Conclusion

The Australian government contradicts itself with its Buy Australian made policies. While advocating the purchase of locally produced goods the federal government also pushes for reductions in tariffs and other impediments to international trade. Bob Hawke initiated the Buy Australian Campaign at the same time that he argued for more world trade. In fact, Hawke was one of the strongest supporters of GATT and the formation of the so-called Cairns Group of fair agricultural traders, which had its inaugural meeting at Cairns in 1986, the same year he initiated the Buy Australian Made campaign. Prime Minister Keating has also maintained strong support for both the Buy Australian Made campaign and GATT. On the arguments of this chapter, the government should resolve this inconsistency by abandoning its buy Australian policies. These policies reduce Australians' standard of living without providing any clear benefits to the one group they are claimed to benefit – the unemployed.

Chapter 4

Buying Australian, the Current Account Deficit and Foreign Debt

The living standards of Australians are improved by Australia's involvement in international trade. However, it is claimed that trade results in Australia having a current account and a foreign debt problem – and that buying Australian made is a solution.

In the past decade, Australia's current account deficit and its associated foreign debt has achieved more media attention than any economic issue other than unemployment. Each month's current account figures are awaited with bated breath, and often receive headline coverage in newspapers and on television. The theme is consistent, invariably prophesying doom and gloom for Australia.

The media's response matches that of other participants in the debate. For example, the Australian Owned Companies Association Limited, in their *AusBuy Guide No.3*, argues that Australia is borrowing too much overseas (the foreign debt problem) and is spending it excessively on imports (the current account problem), together with the related claim that Australian savings are too low. Their solution is to buy Australian made, but only from Australian owned firms.

More importantly, there is little doubt that the current account deficit has been, in the eyes of the federal government, the major economic problem of the 1980s. This has been particularly true since the mid-1980s. However, the federal government contradicts itself by supporting more world trade and more trade by Australia, but also arguing that Australia has a current account problem (imports being greater than exports). Nevertheless, the federal government has put much policy effort into attempts to reduce the current account deficit, including the high interest rates of the late 1980s and the Buy Australian campaign.

The questions which this chapter seeks to answer are: Is the current account deficit a problem? Is foreign debt a problem? If these are problems, is buying Australian the solution? To answer these questions we need to discuss the balance of payments.

The Balance of Payments

All transactions with foreigners either earn or use foreign currency and when converted to Australian dollars are recorded in the balance of payments. Under a floating exchange rate system, which Australia has had since 1983, the exchange rate continually adjusts throughout the day (and night) so that the supply of foreign currency measured in Australian dollars equals the demand for foreign currency measured in Australian dollars. Accordingly, a country's balance of payments (under a floating exchange rate system) always balances, and thus a country cannot have a balance of payments problem. When the balance of payments is subdivided into a current account and a capital account there is a balance on each account of equal and offsetting amounts. For example, a current account deficit equals a capital account surplus and vice versa.

The Current Account

Transactions which relate to the current accounting period (usually one year) are recorded in the current account. Examples include the sale of Australian wheat (an export) which results in a receipt of foreign currency which gives rise to a demand for it to be converted to A$. The supply of A$ to pay for the import of petroleum, TVs, clothing and machinery etc. gives rise to a demand for foreign currency. The difference between imports and exports is called the balance of trade. The excess of the value of exports over imports is referred to as a 'favourable' balance of trade. However, 'this use of the term 'favourable' can be misleading as it tends to imply that the economy is unhealthy if imports exceed exports ... some countries may compensate [those with a floating exchange rate do compensate] for a shortfall on their current account with a strong capital account (Collins et al. 1984:174).'

In addition to imports and exports, the current account also includes so called 'invisibles'. Examples include the cost of insurance and freight on imports and exports, tourist expenditure and the cost of servicing foreign investment (profit and interest paid to foreigners). Combining the balance of trade with invisibles gives the balance on current account which can be either a deficit (payments exceed receipts) or a surplus (receipts exceed payments).

Financial commentators in the popular media in Australia often single out the balance of trade part of the current account for particular attention. However, the academic literature considers this to be misguided. For example, Pitchford remarks that 'It has never seemed to be a concept of any great significance (1990:10)'. Similarly, Heyne: 'What is significant about the relationship between merchandise exports and imports, taken by itself? I do not know how to answer that question, because I do not think it has any significance, and I do not recall ever encountering an explanation that went beyond vague rhetorical alarms (1989:356).'

The import side of the current account records the decisions of Australians who decide to buy overseas made rather than Australian made. These decisions are voluntarily made by each Australian who compares price and quality. Until somebody explains why these individual decisions are wrong, it is reasonable to assume that each Australian knows best how to spend their own money. Imports are not an inherent problem – rather, they are a way of increasing the standard of living.

On the export side of the current account, all firms have the opportunity to export overseas, and will do so, if the additional sales revenue covers the additional costs. Providing there are no taxpayer funded subsidies, exports are beneficial to Australia, since the export price exceeds the cost of Australian resources used to produce the product. Export subsidies are contrary to taxpayer interests because they put Australia in the giving away business, exporting goods whose price does not cover their cost of production. No business can survive if it sells goods for less than cost. A country can do so only if it taxes successful businesses so that inefficient firms can export subsidised goods.

Concern with the current account deficit reflects a mistaken view that exports are beneficial and imports are harmful.

> Almost everyone would agree Australia should be constantly seeking ways to increase the competitiveness of Australian exporters so that we can export more. Exporting is regarded as virtuous. It allows Australia to earn foreign exchange. But what else can we do with this foreign exchange but use it to buy imports? Imports are the reward of exporting (Crowley 1992:3).

If only exports are regarded as desirable, and imports are regarded as undesirable, consider for a moment the situation if Australians exported large quantities but refused to import. This would mean Australians working to provide goods for foreigners. Foreigners would be pleased to receive these goods giving in return pieces of paper (foreign currency).

But, it might be said, cannot Australians then invest the foreign currency overseas, for example, buying shares or debentures? Given that the dividends and interest are not needed for imports or for overseas trips (assume that Australians holiday in Australia consistent with the buy Australian view) then the overseas investment accumulates over time. If Australians never spend the money invested overseas, then in effect the exports were given away for nothing.

If exports were not used to pay for imports then Australia would again be in the giving away business – sending exports overseas and receiving nothing in return – hardly the way to make Australia better off.

The Capital Account

This account records changes in the liabilities to overseas citizens and changes in the liabilities of overseas citizens owed to Australians. For example, if an Australian were to borrow overseas, this is an inflow of capital (foreign exchange). A capital outflow would occur for example, if an Australian were to purchase shares on the Japanese stock exchange. Since 1973-74, Australia has had a surplus on capital account and a deficit on its current account. A capital account surplus means that the inflow of capital from overseas (foreign investment in Australia) exceeds the outflow of capital overseas.

When Australia has a current account deficit, its flexible exchange rate adjusts so that it has an equal but offsetting capital account surplus (the balance of payments balances). When overseas residents invest funds in Australia, which can give rise to a capital account surplus, there must be an equal current account deficit. In both cases Australia's foreign debt increases. For Australia to send capital overseas (a capital account deficit) to reduce its foreign debt, we need to have a current account surplus. Those media commentators who simultaneously criticise Australia's current account deficits but favour Australia utilising foreign investment are being contradictory. Future foreign investment can only occur if Australia has current account deficits.

> For Australia to reduce its foreign debt in absolute terms would require Australians to either sell assets to foreigners or export capital in the form of loans to foreigners. Exporting capital would mean that Australians would be financing investment in other countries. It would also imply a much higher rate of saving or lower rate of domestic investment than has traditionally been achieved. It should be hoped that the combination of Australia's rich endowment of resources and growing productivity would see rates of return in Australia sufficient to justify ongoing capital inflows. As a large part of that inflow would be in the form of debt finance (so that Australians retain control of a substantial proportion of Australian assets), it

> is almost inevitable that the dollar value of Australia's foreign debt continues to increase (White 1993:9).

It is an economic contradiction to say that a capital account surplus (foreign investment) is good and say that current account deficits are bad.

AusBuy Guide No. 3 states that 'the only way to buy back Australia and the only way to keep Australia Australian owned is to buy from Australian owned companies.' Will buying Australian from Australian owned companies reduce Australia's foreign debt? No, because private foreign debt results from firms and individuals signing contracts with overseas lenders. Buying Australian can reduce imports and thereby reduce exports, but it will have no effect on the capital account in which foreign borrowing is recorded.

Causation?

Buy Australian advocates argue that the current account deficit causes Australia to increase its foreign debt. *AusBuy Guide No.3* describes the increase in foreign debt 1982-1992 as a loss: 'Australia's total real loss of $160 billion for the ten years . . .'. AusBuy also argues that it is a cost of each taxpayer: 'The total cost of foreign debt for each Australian taxpayer over the last ten years has been $20,500.' The *Guide* points out that Australia paid out in 1992 $8 billion more in interest and dividends than it received and says 'If we only paid out the same amount as we received in interest and dividends, then there would be no need for the recession.' Similar comments have been widely reported in the popular press that interest and dividends on the foreign debt cause an increase in Australia's foreign debt. For example, Petersen (1994:9): 'it [dividends and interest] adds yearly to the national debt, payments overseas of $14 billion last year helping bring Australia's total foreign debt to $233 billion.' Buying Australian is claimed to be a means of reducing the current account deficit, foreign debt and interest and dividends paid thereon.

Notice Petersen refers to payments – this is correct as borrowers consistent with the terms of the loan are required to pay interest. How then does the foreign debt increase? After all, loans that individual Australians incur usually require payment of interest and principal. If the borrower pays in accordance with the terms of the loan, the debt decreases. Some loans are interest only, meaning that the principal remains fixed. How then can Australia's foreign debt increase if Australian borrowers comply with loan requirements? Ignoring changes in the debt due to changes in the value of the Australian dollar, then loans do not increase. They would only do so if the lender approved the non-payment of interest and allowed the loan to increase, but this rarely occurs.

Petersen and *AusBuy Guide No 3* incorrectly claim that because part of the current account deficit includes payments of interest and dividends, then such payments cause an increase in foreign debt. They are correct when they point out that a current account deficit/capital account surplus means that foreign debt has increased by that amount. However, that is not the same as saying that the current account deficit caused the capital account surplus/addition to foreign debt. The current account and capital account record the separate decisions of thousands of Australians. When an Australian buys an imported product (current account) that does not cause another Australian to borrow overseas (capital account). Instead, Australians borrow overseas only if they consider they will benefit more than if they borrow domestically. If the supply of Australian dollars for imports exceeds the demand by foreigners for Australian dollars either to buy Australian made products (exports) or to invest in Australia, then the exchange rate will adjust – the Australian dollar will fall until supply and demand are equal. At this equilibrium value of the Australian dollar, the current account deficit will equal the capital account surplus and foreign debt will rise by this amount. This does not mean that the current account deficit caused the capital account surplus. In fact, if Australian firms decided not to borrow overseas and instead Australia had a capital account deficit, then Australia would have a current account surplus. In other words, causation could be said to flow in the opposite direction. However, because each transaction, be it current account or capital account, is independent of all other transactions, with the exchange rate being the adjusting mechanism, then it is invalid to attribute causation to either.

It is well known that increases in net financial liabilities to the rest of the world are the accounting counterparts of current account deficits when international capital flows freely and the exchange rate floats cleanly. Less well understood is that there is not necessarily a causal relationship between continuous deficits and the growth in the level of foreign debt. In particular, the excess of current account debits over credits does not, of itself, force Australia to incur external debt since foreign currency borrowings are often completely unrelated to current account transactions (Makin 1988:200).

Flexible Australian Exchange Rate

Australians clearly benefit from imports. Some buy Australian advocates fear, though, that if support for buying Australian made is removed, Australia will be flooded with imports and local firms will go out of business. This fear existed prior to the Buy Australian campaign. For example, Bastiat in 1845 said 'assume, if it amuses you, that foreigners flood our shores with all kinds of useful goods without asking anything from us; even if our imports are infinite and our exports nothing, I defy you to prove to me that we should be the poorer for it' (1964:55). Regrettably this cannot occur, since Australia's exchange rate will reduce, thereby placing a natural brake on imports.

In 1983 the Australian dollar was floated. Since then, the exchange rate has been in the main determined by the forces of supply and demand. For simplicity, assume trade between only the USA and Australia (this example draws on a similar one by Friedman & Friedman 1980). Let us consider an extreme example whereby Americans can produce everything for fewer Australian dollars than Australia, at an exchange rate of US$1 equals A$1. If free international trade existed, then Australia would attempt to buy everything from the USA. No doubt buy Australian made advocates would be most upset with this situation. But how would Australia pay for these imports? Australia would export pieces of paper called Australian dollars in return for TV sets, cars, wheat, ice cream, etc. What would the Americans do with these pieces of paper? Australian dollars can be spent only in Australia. However, we have assumed that at one US dollar to one Australian dollar everything is cheaper in the USA so there is nothing in Australia that Americans would want to buy.

Clearly, Americans would not give Australia useful goods in return for useless pieces of paper. American exporters would try to exchange their Australian dollars for the equivalent number of US dollars in order to buy the cheaper American goods. But no American would be willing to exchange the same number of US dollars for Australian dollars, if a US dollar will buy more of everything in the USA than an Australian dollar will buy in Australia. American exporters, finding that no one will buy their Australian dollars, will offer to take less than one US dollar for an Australian dollar. The price of the Australian dollar will go down – to ninety cents US, or eighty cents US or seventy cents US or...? In other words, it will take more and more Australian dollars to buy US dollars. American goods are priced in US dollars so their price in Australian dollars will rise. Consequently, Australians will reduce imports of American goods. Australian goods are priced in Australian dollars so the more Australian dollars the Americans get for a given number of US dollars, the cheaper Australian goods become to the Americans, in terms of US dollars.

The price of the Australian dollar will fall, until on average the Australian dollar value of goods the Americans buy from Australia equals the Australian dollar value of goods Australia buys from the USA. At that price, everybody who wants to buy US dollars with Australian dollars would find someone who was willing to sell US dollars for Australian dollars.[1]

What is the likely effect on the exchange rate if Australians decide to buy only Australian made?

The Exchange Rate Effect of Buying Australian Made

Australia's exchange rate is affected by the tens of thousands of people who import and export. Every day the exchange rate varies so that every Australian who wants overseas currency for imports can buy it with Australian dollars. Similarly, every Australian who has overseas currency from exports can sell it for Australian dollars. Competition between firms worldwide results in Australian exporters continually assessing where and what to sell, taking into account the exchange rate of Australian dollars with other currencies. Similarly importers face competition, both from Australian producers and from other importers, who seek out the best value products throughout the world.

Let us assume that Australians significantly decide to buy Australian made in substitution for imports. What will be the effect on the exchange rate? If we consider the Australia – USA example again, then there would be fewer Australians wanting US dollars. In other words, the value of the Australian dollar will increase. The technically minded can refer to the appendix on the determination of the Australian dollar exchange rate.

Because the value of the Australian dollar would increase if people followed the Buy Australian campaign, Australian exports would become more expensive to foreigners – who will consequently cut down on their purchases (Australian exports). 'The smaller imports we have, the smaller exports we can have. Without imports we can have no exports, for foreigners will have no funds with which to buy our goods. When we decide to cut down our imports, we are in effect deciding also to cut down our exports (Hazlitt 1979:85).'

The Effect on the Current Account

It is argued in the media that Australia must reduce its current account deficit, and that the Buy Australian campaign by reducing imports will assist us in doing so. But if reducing imports also reduces exports, what is

1 The real world is more complex than this example as it involves many countries, not just the USA and Australia. However, the principle is the same. Another complication is that trade includes not only the import and export of goods and services (the current account) but also financial transactions affecting more than one accounting period – the capital account. This complication does not affect the conclusion reached that the exchange rate adjusts so that only some overseas made goods are cheaper than Australian made.

the likely effect on the current account deficit? The effect on the current account deficit will be zero:

> Measures that restrict imports or somehow promote exports ...will fail, as the main consequence of restricting imports ... is to reduce exports, ... leaving the deficit unchanged (Sjaastad 1989:29).

The capital account surplus (current account deficit) is the source of finance employed to fund the differences between both (a) investment in Australia and savings by Australians and (b) Australian government spending and taxation. For the current account deficit (capital account surplus) to change requires a change in either or both of these. If neither of these change, then tariff changes and buying Australian will have no effect on the current account deficit.

Consider a numerical example:

If imports are \$1000 and exports are \$600 then the current account deficit is \$400. The balance of payments always balances so the capital account must have an offsetting surplus of \$400. Now assume that Australians buy Australian and reduce imports to \$700. The question is what will be the level of exports? We have seen that reducing imports causes the Australian dollar to increase and thereby exports to reduce but by how much? The answer is by precisely the drop in imports, i.e. \$300. Accordingly, the current account deficit is unchanged (Imports \$700 – Exports \$300) at \$400. Why is this so? The reason is that the capital account surplus is unaffected by the shift to buying Australian. To understand why, we need to look at the determinants of the capital account surplus/current account deficit.

Following convention

$$Y = C + I + G + X - M$$

where
- Y = national income,
- C = consumption spending,
- I = investment spending,
- G = government spending,
- X = exports,
- M = imports.

National income can also be represented by what can be done with it:

$$Y = C + S + T$$

where S = saving and T = taxes. Then,

$$(M - X) = (I - S) + (G - T)$$

(M - X) is the current account deficit,
(I - S) is the private deficit and
(G - T) is the federal government's (budget or fiscal) deficit.

Accordingly, the capital account surplus (current account deficit) represents the inflow of capital from overseas to finance (a) investment in Australia which is not financed by Australian savings and (b) the federal government's excess spending not financed by taxes. In the scenario above, we considered only the effect of buying Australian in substitution for imports. If the federal government's deficit and the shortfall between investment in Australia and Australian savings remains unchanged, then the reduction of imports will be exactly offset by a reduction in exports, leaving the current account deficit/capital account surplus unaffected. This is the most optimistic view. It is possible that Australian based firms faced with an increase in the buying of Australian products will increase their investment in machinery and consequently borrow from overseas. This could result in the capital account surplus increasing and accordingly an increase in the current account deficit.

While it is generally agreed that, in the long run, restrictions on imports restrict exports (the Lerner Symmetry theorem), there is less agreement on the short run effect. Some economists consider that the effect of buying Australian, in substitution for imports, will take time to affect exports. Consequently they believe that the current account deficit would reduce in the short run. A study entitled 'Buying Australian', by Horridge et al. (1987: 231-232) concluded:

> The replacement of imported commodities by their locally produced equivalents implies a reallocation of domestic resources, generating both increased imports of other commodities and reduced exports. These effects partially or wholly offset the direct gains for employment and the balance of trade, which would apparently be generated by a switch from imported to local goods.

Irrespective, though, of the short run effects on the current account, the critical issue is whether or not the current account deficit is a problem.

Foreign Currency Reserves – Misplaced Concern

Since 1983, when the Australian dollar was floated, the current account and the capital account have offset each other, so that the balance of payments balances. This was not always the case. On occasions, when Australia had a fixed exchange rate, the supply of Australian dollars (to exchange for foreign currency) exceeded the demand for Australian dollars by overseas residents. The excess of supply over demand meant that the Australian dollar was overvalued. Until the Australian dollar was devalued, the excess supply of Australian dollars could only be converted to foreign currency by running down Australia's foreign reserves. This occurred, for example, during the period 1973-74 to 1979-80. In this case, the current account deficit exceeded the capital account surplus, and devaluation was required. Since the floating of the dollar, Australia no longer has foreign currency crises. Instead, the balance of payments balances, with the current account deficit offset by the capital account surplus. It appears that financial commentators and the federal government overlook this fact when they prophesy doom for Australia from continually having current account deficits.

But if foreign investors decide that Australia's prospects have taken a turn for the worse and want to withdraw their funds could this precipitate a foreign exchange crisis? The answer is no. Most foreign investment is not in liquid investments. For example, much is tied up as loans with contractual agreements which preclude demanding repayment while the terms are not breached.

However, let us assume that a major withdrawal occurs. Will this precipitate a foreign exchange crisis? Under a floating exchange rate, a foreign exchange crisis (insufficient foreign exchange) is virtually impossible. If a major outflow of Australian dollars for conversion into foreign currency were to occur, then the value of the Australian dollar would fall until supply equals demand – the balance of payments balances. It would take some unlikely event, such as a hyperinflation of the Australian dollar similar to that in Germany after WWI, to reduce the demand for Australian dollars to zero.

Another fear of opponents of foreign borrowing is a sudden plummeting of the exchange rate as foreigners seek to sell their Australian dollar assets. Given that the lack of foreign reserves is basically impossible in a floating exchange rate regime it is very unlikely that foreigners would suddenly and in mass try to sell their assets and convert to foreign currency. Provided overseas investors continue to receive interest or dividends on their investment then they have little reason to dispose of their investment. However, opponents of foreign debt claim that, in a panic, foreigners will sell at any price, thereby causing the foreign exchange rate to fall significantly.

There are several points here. Firstly, for a major panic to occur requires action by the government which affects all foreign investment. An announcement that assets will be nationalised, or that no remittance of funds to foreigners will be permitted at some future date, are examples of events that could precipitate a panic. Such events have occurred overseas, but not in Australia. The problem is not with foreign debt, but the possible though unlikely future action of Australia's government. Critics of foreign debt have focused on the wrong target.

Secondly, is it possible that a dramatic collapse of the Australian dollar against other currencies could occur even if it is not rationally based? In this case, rational investors realising that the Australian dollar is irrationally low can earn profits by buying Australian dollars. This will bid the price up until only normal returns can be made from currency investment.

Third, while a fall in the exchange rate adds to the costs of Australians who need foreign exchange, they have the opportunity to buy forward exchange contracts to guard against future changes in the exchange rate.

Fourth, a fall in the exchange rate is not all bad for Australians. Australian exporters are likely to benefit as their goods become cheaper on the world market. If foreign investors panic and sell assets at heavily discounted prices this is more of a problem for them than Australians – who can benefit by acquiring assets cheaply.

These are the possible effects of a sudden plummeting of the exchange rate – but it must be stressed that opponents of foreign borrowing have provided no plausible explanation as to why a sudden fall would occur. Until they do so, it must be concluded that such a fall is unlikely.

It is also argued that individuals cannot keep increasing their debt and nor can Australia continue to have a current account deficit, since this results in foreign debt increasing. Why not? Consider an individual who borrows to buy a new car every three years. Every triennium the loan enables spending to exceed income. Also through time the debt increases due to inflation of car prices. Real increases in income enable debt to increase and the type of car to change from, say, a Holden to a BMW. Similarly with houses. Borrowing allows individuals to spend more than their current income, and increases in income allows debt to increase through time. What is true for individuals is also true for Australia, particularly when business borrowing is considered. Business borrowing, in contrast to most personal borrowing, generates future income. Businesses borrow because they expect that the present value of the benefits from buying an asset will exceed the cost of borrowing. Continuing current account deficits and increases in foreign debt are sustainable, since they result in Australia's assets growing even faster. As long as Australians and overseas lenders regard investment opportunities in Australia to be superior to those overseas, Australia will continue to have capital account surpluses (current account deficits).

> Maybe it is time we switched the topic of macroeconomic policy debate from the undesirability of current account deficits and the associated external debt to the desirability of private foreign investment and the associated capital account surplus (Makin 1989:8).

Private Sector Debt

The capital account surplus can be due to an excess of private sector spending on investment over that of private saving (although savings equal investment from the perspective of the world economy, each country's savings need not equal its investment). The private sector consists of households and businesses. In aggregate, throughout the 1980s and 1990s, Australian households have been net savers and Australian businesses have been net borrowers. When investment in Australia exceeds savings by Australians, private sector firms finance the additional investment spending by borrowing overseas (foreign debt).

AusBuy Guide No.3 is opposed to Australia borrowing from overseas, referring to the increase in foreign debt from 1982 to 1992 as 'Australia's total real loss of $160 billion for the ten years'. This criticism is only half of the story as it concentrates on the costs but overlooks the benefits. For example, when Australians borrow to buy a house or a car they do so because the benefits to them exceed the costs of the debt (why else do they borrow?). So too with Australia's foreign debt. Overseas borrowing by the private sector is used to finance investment to earn income which covers interest payments and generates profits for shareholders. Borrowing from overseas enables firms in Australia to undertake investment projects sooner. If investment were limited to Australian savings, Australian investment would not merely be delayed but some might never occur. If investment finance was limited to Australian sources in the late 1980s, then the extremely high interest rates would have resulted in the rejection of much investment.

Australian borrowers benefit from the world wide competition in finance. Since 1983, Australia has not been constrained in obtaining overseas finance. This is likely to be a major reason why 'in the 15 years from 1969-70 to 1983-84, Australia experienced unusually poor (2.2 per cent annual growth) investment performance, while in the past 5 years the average increase in business investment has been 10.8 percent (Ferguson 1990: 4).' When foreigners lend to Australians, the capital account surplus is actually a vote of confidence in Australia's future. Foreigners prefer to supply capital to Australia rather than invest in their own country since they believe they can earn higher returns here. Australia's importation of capital over the past twenty years enabled considerably more investment to occur than would have if only Australian savings had been utilised. White (1994:16) points out that:

> the current account balance is the difference between domestic saving and domestic investment. Australia's investment to GNP ratio is higher than in most OECD countries. In the latter part of the 1980s it was 26 per cent, compared with 22 per cent in Italy and France, 21 per cent in Germany, 19 per cent in the United Kingdom and 18 per cent in the United States.

Further, while it is true that the total value of Australia's foreign debt significantly increased in the 1980s, it is also true that the total value of Australia's assets also increased, and increased more than the increase in foreign debt. Considering foreign debt by itself it is not very helpful. Since debt is used to acquire assets, then debt needs to be related to assets. This point was overlooked by policy advisers and commentators who largely focused on the foreign debt in isolation from the assets it financed: 'Although the rise in the external debt ... was the principal focus of policy concern, it is evident that in fact real national asset values grew by substantially more than total external liabilities. Throughout the 1980s Australia became better off in terms of wealth (Makin 1993:54).'

For there to be a problem with the private sector component of the capital account, then there has to be widespread incompetence by Australian management when deciding to borrow and in choosing between domestic and foreign debt. While after the event, it is possible to identify some, although relatively few, examples of sub-optimal borrowing, nobody can borrow with hindsight. Of course at the time of borrowing all firms expect that borrowing will be beneficial. Management of private firms have strong incentives to finance investments which can repay the loan, or else the receivers take control and management become unemployed.

It is claimed that foreign debt will result in more firms not surviving, particularly during recessions. The basis of this claim is that foreign debt contracted for in foreign currency has exchange risk that domestic debt does not. However, exchange risk is two sided – it can confer costs (when the Australian dollars loses value) and benefits (when the Australian dollar rises). Firms can and do hedge with forward exchange contracts to avoid the risk of exchange losses. The claim that firms with foreign debt are more likely to fail in a recession than firms with domestic debt has not been demonstrated. 'But even if it were true, does it matter? ... If an increment of private capital stock is financed from unhedged foreign currency loans, this may make the project more vulnerable to bankruptcy in a recession, but the presumption must be that the expected return from this project is higher than with other forms of financing (Pitchford 1990:49).'

Public Sector Debt

As the current account deficit means that national spending exceeds national income then it has to be financed by borrowing from overseas. Both the public (government) sector and the private sector can spend more than their income. Australian governments finance their spending by taxation and borrowing from Australians or from foreigners. The capital account surplus (current account deficit) can thus be due to foreign debt being used to finance the government's budget deficit.

In the last few years in Australia, the current account deficit has largely been driven by the budget deficit. Is this public borrowing for consumption a matter for concern? This comes down to the issue of whether the public sector is saving (tax receipts exceed spending) or dissaving (spending exceeds tax receipts). The Fitzgerald report on national savings argues that the federal government needs to change from currently dissaving to become a saver. Is this desirable for Australians?

If Australian savings were the only source of investment in Australia, then a problem would exist if the federal government's deficit constrained investment. Even in this scenario, markets respond to the increase in demand for funds by increasing interest rates, which in turn increases the amount of loanable funds. However, firms undertaking investment have access not merely to Australian savings but to savings from around the world.

Despite the fact that there is no shortage of finance for investment, Fitzgerald and others want the federal government to become a saver. To do so requires either an increase in taxation or a decrease in spending. The most likely outcome is an increase in taxation. Faced with the choice of an increase in tax or no change, most Australians would choose not to pay higher taxes.[2]

However, there is reason to be concerned that the public sector's borrowing is sub-optimal. The major difference between private and public foreign debt is the incentives driving the borrowing. Private debtors, unlike public debtors, are motivated by the threat of non-survival for the firm if it makes poor investment/financing decisions. Lenders similarly

2 While few if any Australians wish to pay more tax, many Australians benefit from taxes levied on other Australians. Since we are considering only a tax increase to switch the budget deficit into surplus, with no increase in spending, there is no incentive for recipients of government spending to support the tax increase.

have incentives to ensure borrowers are successful, since if borrowers fail, lenders may receive only part repayment of their loan. In contrast, since government debt has recourse to taxpayers' funding (if the costs of the loan exceed the benefits), the incentive to ensure the loan provides net benefits is greatly reduced relative to the private sector.

Accordingly, while the private sector component of the capital account is not a problem, this may not be the case with the public sector component. Public sector borrowing by governments and government owned organisations such as Telecom are not subjected to the discipline of non-survival if they make unprofitable financing decisions. It is likely that the portion of the capital account surplus due to public sector borrowing is partly sub-optimal for Australia, with the benefits derived from the borrowing being less than its cost.

Since public borrowing is a significant component of the current account deficit, and since such borrowing is not necessarily optimal, then reducing public borrowing is likely to be desirable. It is in the public's interest if government spending is reduced rather than taxation increased. One method of reducing government indebtedness, and which has been done extensively overseas, is privatisation. Not only would this raise revenue for the government, but, if combined with deregulation, will encourage the efficient provision of services preferred by consumers.

Opponents of foreign debt suggest that the increasing foreign rather than domestic indebtedness is a reason for seeking fiscal responsibility (switching the budget deficit into balance or surplus). Critics fear that Australia could be caught in a 'debt trap' – an ever increasing ratio of debt to GDP. While various South American governments of the 1980s showed that this is possible, it is unlikely for countries like Australia with exemplary records for paying foreign debts. It is in Australia's interest if government borrowing is driven by cost minimisation. If this is the case, then the current level of foreign borrowing is optimal.

Who Owes the Debt?

The popular media often claims that each and every Australian is burdened with the foreign debt. For example, Petersen (1994:9): says 'each Australian taxpayer earning more than $300 a week could, if the sale of Australia continues, be liable for $58,000 in debt to foreigners by 2001.' Similarly, *AusBuy Guide No.3* says: 'The total cost of foreign debt for each Australian taxpayer over the last ten years has been $20,500.' Both Peterson and AusBuy indicate that every Australian taxpayer owes money to foreigners. Is this correct?

When Australians borrow to buy a house or a car etc. they, and they alone, are liable for the debt. When a company borrows, it is liable for the debt and not the shareholders. The debt is constrained to the assets of the company, over which the debt is secured, irrespective of whether the debt is foreign or domestic. Other Australians are not liable for these private debts. In the case of private debt, it is quite absurd to talk about Australian taxpayers being liable.

In the case of public debt incurred by state and federal governments it is valid to refer to Australian taxpayers, as ultimately they have to pay for all expenditure by governments. However, it is misleading in that the chance of overseas lenders having recourse to taxpayers is almost zero. Australian taxpayers have to fund the repayment of interest as part of their taxation commitments each year, and this represents the full extent of their liability.

Federal Government Policies

AusBuy Guide No.3 blames foreign investment for Australia's 1990 recession: 'If we only paid out the same amount as we received in interest and dividends then there would be no need for the recession.' As we have seen, AusBuy's solution to Australia's foreign debt and current account deficit is to buy from Australian owned companies. This is a mistaken view of the cause of the recession. In fact, it is the federal government's misplaced concern with the current account deficit that is both the cause of the recession and the rationale for the Buy Australian policy.

> In the 1985-86 Budget Speech the Treasurer, Mr Keating, argued the Government's prime concern was to 'set in place the preconditions for a turnaround in the current account deficit' (p.26) thus confirming that the goal of external balance had been put at the top of the Government's macroeconomic policy agenda. Treasury echoed this concern in Budget Statement No. 2 of the Budget Papers, the main message of which was that the strategy of fiscal restraint was essentially directed towards 'a lasting solution to Australia's external account problems ...' [Commonwealth Treasury (1985) p.62]. Treasury further noted that 'failure in these efforts would make virtually inevitable the path of serious recession as the sole remaining means of correcting Australia's external imbalance' [Commonwealth Treasury (1985) p.55]. The Reserve Bank of Australia (RBA) has assessed the position in much the same way by stating that 'the outlook remains dominated by the need to restore external balance' [Reserve Bank of Australia (1985) p.2] (Makin 1988:199).

However, as this chapter has argued, the current account deficit and the foreign debt are not problems. Both reflect rational decisions on the part of consumers and borrowers. Nevertheless, since the mid-1980s, the federal government has initiated the Buy Australian made campaign, in addition to its two major policy instruments of monetary policy and fiscal policy in an attempt to reduce the current account deficit. In 1985, the federal government employed monetary policy in an effort to reduce the current account. It increased interest rates on the basis that this would slow down the economy and thereby reduce imports. The high interest rates succeeded in putting the economy into recession. The government then relaxed interest rates and the economy came out of recession. The federal government failed to learn the recession lesson, and in 1988-89 again increased interest rates, which became some of the highest in the world, with disastrous consequences – Australia went into the worst recession since the Great Depression.

Bewley and White (1990: 32) point out 'that higher interest rates are more likely to increase rather than decrease the current account deficit.' When interest rates were increased by the federal government, the current account deficit actually became larger. This is because high interest rates induce large capital inflows and thereby large capital account surpluses (current account deficits). Capital inflow occurred because overseas investors sought high interest yielding Australian securities, and also Australian firms borrowed from relatively low interest rate foreign lenders.

In addition to Buy Australian and monetary policies the federal government also utilised fiscal policy[3] to overcome the current account deficit. The federal government argued that if its budget deficit was eliminated, then the current account deficit would reduce and be equal to the private deficit. In the late 1980s the federal government succeeded in largely eliminating its fiscal (budget) deficit. But the current account deficit actually increased, because the government's assumption that other things would remain the same did not occur, since investment in Australia significantly increased relative to savings. Undaunted, the federal government today has its budget deficit reduction program as a major policy objective, since the government induced recession caused a massive increase in unemployment, and its budget went into deficit due to unemployment and other social welfare payments.

The federal government has also employed the buy Australian campaign in an attempt to reduce imports and thereby the current account

[3] This is the manipulation of government spending and taxation receipts (the difference i the budget deficit/surplus) to 'manage' the economy.

deficit. Given that the current account remains significantly in deficit, this approach, like monetary and fiscal policy, has failed to reduce the current account deficit.

Despite this record of failure the government continues to target the current account. If the federal government again resorts to tight monetary policy, it will doom the Australian economy to low growth. Is a reduction of the current account deficit worth losing, say, one percent growth per annum – about $4 billion? Where are the offsetting benefits from reducing the current account deficit? The government has not identified any such benefits.

Chapter 5

The Cost to Taxpayers of Buying Australian

The government's support for buying Australian made has cost the taxpayer considerable sums of money. The taxpayer has heavily subsidised the campaigns exhorting Australians to buy Australian. In addition, a recent report on government purchasing recommends that the value for money criterion be replaced by an Australian industry development criterion. This chapter looks critically at whether this expenditure is in the best interests of taxpayers, and looks at the real beneficiaries of the government support for buying Australian.

The Advance Australia Foundation

As I have argued in the previous chapters, the major arguments presented in favour of buying Australian are at best weak, and in fact may be counterproductive by encouraging industries in which Australia lacks a comparative advantage. Even if we accepted the flawed assumptions of the buy Australian idea, the taxpayer has not received value for money from the body set up to manage the campaign, the Advance Australia Foundation. This can be seen by examining some of the 'objectives' the Foundation set out for the Australian Made campaign:

> *To make the Australian Made certification mark synonymous with innovative, well-designed, quality products and services.*

Most manufacturers have their own brand names and logos and, in some cases, spend large sums on advertising these, in order to persuade consumers to purchase their products. If business believed there were benefits in creating an Australian made certification mark then business organisations had incentives to register such a trademark prior to the federal government's appointment of the Advance Australia Foundation

Since private firms need to be profitable to survive, they are motivated to undertake projects which generate benefits greater than costs. The failure of private firms to fully fund the Buy Australian campaign indicates that its benefits are not likely to exceed its costs.

Further, while this 'objective' focuses on quality, it appears that the certification was granted to firms which merely complied with the Australia made content requirements. Accordingly, the taxpayer funded Australian Made certification mark may be associated with substandard goods. Even so, the Advance Australian Foundation will continue to survive, as it is significantly funded by compulsory taxation rather than satisfied customers. In contrast, if private business organisations financed the Australian made logo, they would survive only if customers willingly paid prices which covered the cost of promoting Australian made. This would be dependent on the certification of products of acceptable quality.

> *To encourage consumers to compare Australian Made products and services and buy Australian Made where they constitute value for money.*

While the 'value for money' rationale in this objective is not disputed – indeed it is applauded – it implies consumers were not doing so prior to the Australian Made campaign, and they need to be taxed to pay for advertisements to encourage them to do so. It is doubtful whether any consumer would deliberately choose to buy poor value for money products. With hindsight it can be said that some purchases were not value for money, but except for Dr Who, nobody can buy with hindsight. At the time of purchase, each consumer decides what is value for money for them personally.[1] Given that consumers will buy the best value for money goods in any case, if the campaign is to have any effect, it will be to persuade Australians to buy Australian when the price is higher, or the quality is lower, or both. The likely effect of this policy contradicts its stated emphasis on value for money.

A government campaign effectively encouraging the purchase of goods that are not value for money is irresponsible A survey by the Australian Institute of Family Studies found that 15 per cent of families claimed to be spending more than they earned. A further 31 per cent just broke even every week (Rodgers 1993). While people on limited incomes

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1 Since each person can alone decide what is value for money for them personally, it is invalid for someone to say that other Australians erred in their assessment of comparative quality. While the critic may disagree with someone else's assessment of value for money, this does not indicate that the purchaser has erred. Instead, the choice is optimal for the purchaser, even though the critic may have an entirely different set of values.

have to be rational in their spending choices, the Buy Australian campaign might make them feel guilty for buying foreign goods, and encourage them to make purchasing decisions contrary to their interests. Various surveys indicate Australians have been persuaded to buy Australian. For example, Coles Supermarkets conducted a survey which indicated that: 'six out of ten shoppers would pay a 10 per cent premium to buy Australian made products' (*Courier Mail*, 1 October 1992). While there are reasons to doubt the reliability of such surveys – it is easy for people to say they would buy dearer Australian products, but it is another thing for them to continually pay more – it is plausible to believe that some people have been persuaded to make spending decisions which are not in their interest. The spending of taxpayers' money on advertisements to encourage people to 'buy Australian Made [products] where they constitute value for money' is not just a waste of taxpayers' money, but could actually harm some of the people it is intended to help.

To give consumers, retailers and manufacturers national pride and purpose.

Undoubtedly some consumers obtain benefits such as nationalistic pride from buying Australian made products. Does this fact then justify government (taxpayer) funding of the Buy Australian campaign? If the benefits of advertising exceed the costs, then the program is worthwhile. Insight into the question whether advertising of 'Buy Australian made' provides net benefits is obtained by examining the behaviour of profit motivated business firms. The supplying of national pride to consumers, retailers and manufacturers, is not something that on economic grounds individual businesses have judged to be beneficial.

The federal government, through the Advance Australia Foundation, says that it 'gives...'. Nothing is further from the truth. Rather than being 'given' national pride, taxpayers in fact pay for the privilege of receiving national pride, since they fund the campaign. They have no choice, since taxation is compulsory. If instead, businesses paid for such advertisements, then consumers would voluntarily decide whether these advertisements were value for money. Consumers would then choose whether or not to buy Australian Made products with the price reflecting the cost of such advertisements. We would then find out whether or not Australians value the benefits of national pride provided by Australian Made advertisements, above their cost.

It could be argued that individual firms do not engage in such advertising because the generality of the message benefits other firms including competitors (a free rider problem), and thus the advertising firm will anticipate that it cannot capture all of the net benefits. However, firms will individually advertise if they expect to obtain net benefits, even if they may not capture all of the possible net benefits. In this case they may have incentives to collectively advertise and internally reallocate net benefits. There exist a number of vehicles for firms to do so including business organisations such as Chambers of Commerce, manufacturer associations, the Business Council of Australia, or a new privately funded body to promote Australian made. The fact firms producing Australian Made products did not, prior to the taxpayer subsidy, individually or collectively pay for such advertisements themselves, tells us these firms do not believe that Australians value the benefits sufficiently to pay higher prices to cover the cost of such advertisements. Since firms demonstrate that Buy Australian made advertising on their part does not pay, then in the absence of externalities, a tax-funded program yields negative net social value.

Perhaps Australian consumers tend to systematically undervalue the quality of Australian made products. Has the historic emphasis on production for the home market created an unjustified reputation that the output of Australian manufacturing is not of international quality? It is plausible that earlier this century, when the opportunity for Australians to sample overseas made products was less than it is today, that Australians believed that Australian made was inferior. However the world today is a much smaller place with huge advances in international transportation. This has enabled increased opportunities for both overseas made products to be imported into Australia and for Australians to travel overseas and sample overseas made products first hand. It is implausible that Australians as a whole are today ignorant of the quality of Australian made relative to overseas made. For the Buy Australian campaign to be justified requires a demonstration of market failure – that Australians are systematically and incorrectly biased against Australian made. The supporters of Buy Australian have not attempted to justify the campaign on this ground.

If firms believed that sufficient consumers would pay for the cost of creating national pride through certifying the Australian Made logo and advertising it, then some businesses would have done so prior to the federal government initiating the campaign. The fact that none did so is significant.

Federal and State Government Funding of the Australian Made Campaign

The federal government has spent some $15m advertising 'Buy Australian'. This constitutes 43 per cent of the total funding of the Australian Made licensing system with the balance from fees paid by licensees. With this gift of $15 million it is not surprising some businesses have jumped on the bandwagon.

Table 2 below shows the number of licensees is significantly affected by the extent that business firms are subsidised by the federal government's 'Buy Australian' advertising. Note the dramatic reductions in the number of licensees in 1988 and 1990 when advertising declined from $2m to $0.8m and from $2.5m to nil respectively.

Table 2

Federal Government Funding of Australian Made

Year ended	$m	Number of licensees
1986	3.7	600
1987	2.0	1210
1988	0.8	974
1989	2.5	1482
1990	nil	1204
1991	2.0	1534
1992	2.0	2020
1993 (Apr)	2.0	2600

Source: Advance Australia Foundation, undated(a):4.

In addition to the federal government subsidisation of Australian businesses, state governments provide assistance through 'the Industrial Supplies Office [ISO], an import replacement organisation with offices in each State, [which] will assist companies wishing to maximise their Australian content. This service is free of charge' (Advance Australia Foundation: undated (b)).

The phrase 'free of charge' means users of the service are, of course, not charged. However, from the viewpoint of taxpayers, the service is not free. The free of charge aspect is promoted by the Advance Australia Foundation as a virtue, but it is unlikely taxpayers share this view.

There are very few things people will not accept, if they are given to them 'free of charge'. Not surprisingly, business has taken advantage of this gift, particularly when it can lead to further funding:

> the department through the National Procurement Development Program (NPDP), a Commonwealth/State/Territory initiative to improve the efficiency and international competitiveness of Australian industry, provided supplementary funding to six companies (QGDBIRD 1992: 31).

The justification given for this government generosity is jobs:

> The ISO operates in Brisbane, Cairns and Townsville and through a new joint ISO/DBIRD office opened during 1991-92 in Gladstone. It assists Queensland firms by advising on industrial capabilities and assisting in import replacement, thereby generating jobs and greater use of locally-produced goods and services (QGDBIRD 1992: 32).

Let us consider the cost of government spending on ISO offices, which is borne by taxpayers. Since government spending is, in the long run, financed by taxation then the spending on ISOs (although creating employment of public servants) results in less private spending and less private sector employment. The result is a substitution of public sector employment for private sector employment. This raises the question of whether this is an efficient allocation of society's scarce resources. If private firms provided the ISO services, then users would have to pay, and only if the service was profitable would it continue. When a private firm provides an unsubsidised service and earns a profit doing so, then we know the value to society of the service exceeds the cost to society of providing the service.[2] When ISO offices give their services away free, then there is an absence of a reliable mechanism to indicate whether users value the service such that the benefits to society exceed their cost. However, given that private firms, prior to the 'free' ISO system, did not provide such services, then it is almost certain users would not pay a sufficient amount to cover the cost of providing ISO-type services. Accordingly, Australians would be better off if government spending on ISO offices was eliminated and taxes correspondingly reduced. The additional private spending would result in the consumption of goods and services which have greater benefits to taxpayers than ISO services.

Analysis of the Funding of Licences

Payment of the licence fee[3] (which since 1986 has covered just over half of the cost of the Australian Made Campaign), is a voluntary choice by private firms. Given the subsidy from the federal government is a large percentage of

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[2] Leftwich (1980) points out that even if private and social costs and benefits do not concur, private provision is the highest optima achievable unless it can be demonstrated that taxpayer funded public supply is an improvement - the onus of proof that this is so lies with the government. No such evidence has been supplied.

[3] It is based on 0.1 per cent of budgeted annual turnover on nominated products only. To qualify to use the Australian Made certification mark, the major component must be of Australian origin and at least 75 per cent of the cost of producing the product must be incurred in Australia. Refer to *Guidelines for Licensing*, Advance Australia Foundation.

the cost of the licensing system, it is not surprising a number of private firms have found it worthwhile to incur the reduced cost of the licence fee. These firms expect there will be an increase in their sales (from the large, taxpayer funded, advertising of Buy Australian), with the profit on increased sales exceeding the cost of the licence fee (net of the taxpayer subsidy).

What do taxpayers obtain from funding the Buy Australia campaign? Firstly they obtain promises that both unemployment and the current account deficit will reduce. These benefits are considered in chapters Two and Four respectively where it is concluded that these promises are not met. Secondly Australians are given national pride. We have seen that it is unlikely that consumers place a high value on national pride when buying goods. This conclusion is supported by the fact that the number of licences significantly declined when subsidised advertising was reduced (refer to Table 2 on p.67). Clearly, ex-licensees found the benefits of the licence, additional sales, were less than the licence fee, or else they would have continued to pay the fee.

Further evidence that firms were sceptical of the campaign's capacity to increase sales is that the Advance Australia Foundation had the opportunity to increase the licence fee, to make up for the 1988 and 1990 reduction/cessation of the federal government advertising subsidy, but did not do so. The increased licence fee could then have been used to continue the Buy Australian advertising. The fact the Advance Australia Foundation did not increase the licence fee tells us the Foundation believed that doing so would have caused an even larger reduction in the number of licensees, than the do nothing alternative it adopted.

The Advance Australia Foundation *Australian Made Research Update* (1993b:2) cites market research which states that 'ninety-six per cent of licensees think it is important to have an Australian Made Campaign operating in Australia'. What are we to make of this revelation? Does it mean that 4 per cent of licensees are not in favour? If so, they contradict themselves by being licensees. It is surprising that only ninety-six per cent are in favour. Given they all have paid licence fees, I would have expected one hundred per cent would be in favour.

Perhaps the licensees are really saying 'it is important to have an Australian Made Campaign operating in Australia' which is subsidised by taxpayers. Given that taxpayers, and not business, pay the cost of television and other advertising, then Australian business benefits at taxpayers' expense from shifts in the buying of imported products to Australian made products. Since the taxpayer funding of the Buy Australian campaign is akin to a donation to Australian business, it is not surprising that Australian business supports the Buy Australian campaign. However, taxpayers suffer from the burden of the subsidy. The subsidisation by taxpayers of products and services which would not survive without the subsidy is a misallocation of society's scarce resources. It is in the best interest of Australians that subsidisation of the licensing system cease, thereby saving taxpayers from further subsidy costs. If taxes are accordingly reduced, then taxpayers benefit from being able to spend that money on goods and services they prefer.

Government Purchasing Policies

In 1994, a House of Representatives Committee investigated whether the government buys Australian made products. The report, *Buying our Future*, recommends that government purchasing procedures be modified. The proposed procedures give preference to Australian manufacturers, and, to the extent more expensive or lower quality local products replace imports, taxpayers will have to fund the additional expenditure.

At present, the Department of Finance regulations state that purchasing officers, when spending public money, must obtain value for money, requiring that: 'the proposed expenditure will make efficient and effective use of the public moneys available for the Commonwealth program implementing these policies' (HRSCIST 1994:47).

The Chairman of the House of Representatives inquiry into government department purchasing policies argues for a buy Australian made policy without referring to the criterion of value for money. Instead jobs and increases in exports are given as the reason:

> Brisbane MP Arch Bevis, who chairs a House of Representatives committee investigating how and what the government buys, said improvements in government purchasing had the potential to boost jobs and the export performance of Australian industry by **giving** firms a domestic base. [emphasis added] (Maher 1994).

Firstly, as we have seen in Chapters Two and Four, Bevis is mistaken if he believes that there will be an overall boost to jobs and export performance. Secondly, if Australian industry was efficient, it would **earn** a domestic base by producing products that were better value for money than imports. Rather than Australian industry earning its customers, Bevis suggests **giving** them government business. This is evident when Bevis talks of assisting local industry:

> Purchasing is, in the post-GATT world, one of the last domains of government intervention to assist local industry that is still available, Mr Bevis said (Maher 1994).

Bevis' recommendation, by ignoring the value for money criterion, will result in taxes increasing to cover the higher cost of lower value Australian made products when they are substituted for better value overseas made products. Currently, the value for money, and open and effective competition, are the first and second purchasing guidelines. However, '[t]he committee recommends that the Purchasing Guidelines be re-written and re-numbered with the industry development guideline becoming guideline number 1 (p.49)'.

The implications of this re-ordering are significant. This is acknowledged by the House of Representatives Committee which states, 'the order in which the three guidelines is presented may influence the importance which purchasers attach to them (p.48).' Clearly, the Committee by placing industry development (buying Australian) as the number one guideline, believes it takes priority over the value for money criterion when spending taxpayers' money. This view is presented throughout the Report, particularly in Chapter 3. For example, the Committee referring to the Department of Defence and Telecom stated 'it is clear that their purchasing culture and practices are far more supportive of competitive ANZ industry (p.24)' and 'in essence the Australian telecommunications supply industry has been built by Telecom's purchasing policy (p.25)'. It is surprising the Committee would cite Telecom as an example of a model purchaser when even limited competition provided by Optus demonstrates how inefficient Telecom has been all these years. When Telecom was a monopoly, it could waste money by establishing and supporting high cost Australian suppliers. Since Optus has provided some competition to Telecom, the result has been that Telecom has shed a large number of excess staff. Given the Committee views Telecom's inefficiency as the model for future government purchasing, then taxpayers will be burdened with a large increase in taxation to fund its proposed buy Australian policy.

Potentially the recommended change in government purchasing priorities could impose enormous costs on taxpayers. If government departments emphasise 'industry development' (buy Australian) over 'value for money' as recommended by the House of Representatives purchasing guidelines, then taxpayers through the compulsory taxation system, will face a significantly increased burden. For example, with government purchases totalling $12 billion p.a. currently, the cost of a 10 percent increase in purchase prices will burden Australians with an additional $1.2 billion in taxes.

Senator Parer, at a 1993 Senate Estimates Committee hearing, said:

> 90 percent of the equipment in his office was foreign made.

> 'In fact it was difficult to find something from Australia, with national representation being relegated to a 1993 diary, sticky tape and labels,' Senator Parer said.
>
> He said he had a ruler from New Zealand, Taiwanese scissors and stapler, Hong Kong staples, Chinese paper clips, American stamp pad, West German glue stick, and British thumb tacks.
>
> Senator Parer told the hearing, which was looking into the activities of the Purchasing Australia division of the Department of Administrative Services, that the situation made a nonsense of the Government's 'Buy Australia' programme (Leary 1993:3).

Senator Parer's comments suggest that having the various overseas made products is undesirable, but if this is so, then why were they purchased? It is not likely, at the time they were purchased, that they were considered poor value. In fact, these items from overseas indicate the benefits from being able to purchase world wide, and choose the best value products from this enormously wide range. In other words, rather than these imports being undesirable, they are an advantage to Australia which was not available to previous generations.

Senator McMullan points out that the real issue is value for money:

> Administrative Services Minister Senator Bob McMullan said that while the Government had a policy of buying Australian products it also had a responsibility to spend money wisely.
>
> He said it was not mandatory for Government Departments to buy Australian goods where taxpayers' money would be saved by buying overseas (Leary 1993:3)

However, federal Labor MP Arch Bevis doubts the competence of Commonwealth purchasing officers:

> Many of these (40,000) purchasers have received very little training and it would be remarkable if many of them have any clear understanding of how to properly calculate value for money (Lynch 1993a:15).

This view is denied by government departments who argue they buy cheaper imports rather than relatively expensive Australian made products:

> The Commonwealth spends \$10 billion a year on goods and services but – despite the Government's 'Buy Australian' Campaign – depart-

ments often forsake local goods for cheaper imports (Lynch 1993b).

The House of Representatives report into government purchasing policies (HRSCIST 1994: xvii) states that: 'the Committee has received a substantial body of evidence from suppliers, industry associations and purchasing institutes supporting the view that government buyers, when applying the value for money guideline, still usually interpret it as meaning buying the cheapest product.' The report argues purchasing officers must use whole of life costing, which recognises that associated costs arise in addition to the initial price. For example, the cost of replacement parts, timely delivery, after sales service, and warranties are relevant. The implication is the best value for money may not be the product with the lowest price, since associated costs over the life of the product may be higher than alternatives. Given the Committee admits that 'whole of life costing, including appropriate cost and benefit identification is often a complex and resource intensive process', then the solution lies in the hands of those who claim whole of life costing would demonstrate their product is the best value for money. Australian suppliers who claim that their product is better value than imports when whole of life costing is employed, can simply rearrange their advantages by reducing the initial price and compensate by increasing the price of other services over the whole of the life of the product. This would ensure that purchasing officers who buy on the basis of the cheapest price would, in fact, be buying the best value product under whole of life principles. This would also avoid the problem of purchasing officers having to estimate costs across the life of the product which is not only a 'complex and resource intensive process', but is fraught with inaccuracies. After all, the supplier has access to the information for whole of life costing and can do so much more effectively and efficiently than government purchasing officers. The fact Australian suppliers have not done so, and instead merely resort to claims at government enquiries that Australian made is, under whole of life costing, better value, indicates there is little substance to their claims.

In a 1986 study of the Australian government's purchasing policy, which provided a 20 per cent preference margin for Australian and New Zealand suppliers, Joson (1986:9) stated: "[b]uy-Local' policy and offsets are both highly potent non-tariff measures of protection. Estimates of the implicit protection of the "Buy Australian" policy have been shown to be more than double the level of protection which is accorded the local industry by all other measures such as tariffs, quotas etc.' Further, the restrictive effects of its purchasing policy is many times greater than tariffs: 'the protection accorded local industry by the government civilian purchases was estimated to be 42.5 per cent while the normal rate of protection available from various other measures eg. tariffs, quotas, etc., was only 17 per cent (p.8).'

A 1989 reform of purchasing policies abolished preference for Australian and New Zealand goods. However, the 1994 report recommends returning to a buy Australian policy. The result will be taxpayers subsidising Australian producers. Taxpayers' living standards will reduce because of the tax increases required to fund the government departments buying Australian rather than lower priced overseas made products.

Winners and Losers

The literature on Australian Made continually refers to aggregates – for example, manufacturers, consumers, Australians. In this spirit, the Australian Made campaign is about Australians taxing themselves to convince themselves it is good for them if they buy Australian. Put this way, it is obviously absurd to talk about Australians in aggregate, yet this is what the literature on Buy Australian does. Clearly, not all Australians benefit from the campaign. Given that prior to the Australian Made campaign most Australians would have purchased goods on the basis of value for money, with the country of origin being largely irrelevant, then the campaign has not benefited them.

Some Australians may have been persuaded by advertisements and switched to Australian Made products because they believe they are 'doing the right thing' for Australia in reducing unemployment. Chapter Two indicates that, unfortunately, they have been misled. The Buy Australian policy has gained some public approval as it appears to favour the employment of Australians at the expense of foreign employment. In fact, it favours Australians employed by firms which supply the domestic market over Australians employed by firms which import goods and Australians employed by firms which export. These not so obvious offsetting effects become difficult to sheet home to those responsible for endorsing the Buy Australian policy. Accordingly, the policy appears to be a must win, or at least a no lose situation, for its supporters.

Even if there is a significant shift from imported products to Australian made, it is not likely that unemployment will be affected significantly. Why then does the federal government, state governments, the Australian Consumers Association, the Australian Council of Trade Unions and Australian business strongly endorse the Buy Australian Made policy?

The present high unemployment levels in Australia place pressure on such groups to be seen to be doing something to solve this problem. No doubt politicians will point out the additional employment that results from the Buy Australian policy as they take credit for the number of new jobs created, but do not accept responsibility for unemployment. Accordingly, they will neglect to mention the offsetting loss of employment resulting from the reduction of both imports and exports.

The winners from the campaign have been politicians, such as the current and immediate past Prime Minister, who have obtained favourable publicity from supporting the Australian Made campaign. Similarly, for unions and the ACTU who have vocally supported the campaign. Other winners include public servants and staff of the Advance Australia Foundation who have gained employment. Advertising agencies have also clearly benefited. Australian business firms have gained to the extent of additional sales for which they did not incur the full cost. Losers are taxpayers, who have obtained poor value for their taxes through subsidising the campaign.

Chapter 6

Buy Australian Only from Australian Owned Companies?

So far, we have looked at the case for buying only Australian made goods and services. Some supporters of buying Australian, however, take the argument a step further. They believe that consumers should only buy from Australian owned companies.

The issue of ownership is considered so important by some Australians that an organisation called The Australian Owned Companies Association Limited has been formed. It produces brochures which provide an extensive list of companies and identifies whether they are Australian or foreign owned. They are opposed to Australians buying from overseas owned firms operating in Australia. Products singled out include Vegemite (American), Bushell's tea (English), Life Savers (Swiss), Coolabah wine (French), Kelloggs' cereals (American), Nanda's pasta (Swiss) and Cadbury's chocolate (English).

This organisation argues in *AusBuy Guide No.3* that buying Australian when it is made by foreign owned firms is unacceptable: 'Every purchase of a fully imported product hurts Australia a lot. Every purchase of an Australian made product from a foreign owned company hurts Australia significantly. The best way to help Australia is to buy Australian made products from Australian owned companies.' The emphasis of this organisation is 'to help you to keep Australia Australian owned.'

Other commentators argue that Australian ownership will be the big issue at the next federal election. Petersen states that 'important as both considerations are [party leadership and the monarchy versus republic issue] they could and probably should be overtaken by a more immediate and frightening question: how much of the national economy do Australians own and who really plays the tune to which politicians, even Heads of State, dance? (1994:9).'

Profits Go Overseas

The Australian Owned Companies Association recommend that Australians buy only from Australian owned companies 'to keep the money' in Australia. However, when foreign shareholders receive Australian dollars, they cannot spend them in their own country. Consequently, they exchange them at banks who buy them because they expect other overseas citizens to want Australian dollars. The dollars return to Australia as payments for Australian products, tourism expenditure, or investment.

Complaints about profits going overseas overlook the considerable benefits of foreign business's presence in Australia. Consider two scenarios – the first a new, foreign owned business commences operations in Australia and the second the sale of an Australian business to overseas owners.

A wide range of Australians benefit from a new business being set up in Australia. Australians who become employed by a foreign owned new business benefit – even if they were previously employed, since by moving they indicate that they prefer their new job to their former job. The position vacated will also benefit a job seeker. Eventually it is likely that an unemployed person will acquire a job, and so the foreign owned business commencing operations in Australia will cause a reduction in Australian unemployment.[1] More jobs will be created by the foreign owned business buying raw materials and services from other businesses operating in Australia. Even more significant than the wages and other payments made to Australians, is the benefit received by Australian consumers of the overseas owned businesses' products or services. Australian consumers benefit because they either prefer such products to the alternatives, or because they are new products not previously available in Australia.

To discriminate against overseas owned firms because profits flow overseas is to ignore the reasons why these firms operate in Australia. They usually have access to overseas technology which enable them to operate at lower cost and thereby sell at lower prices than Australian owned firms. The Australian motor industry is a case in point. Multinational firms are able to bring knowledge and economies of scale which are beyond the reach of an Australian owned firm. The fact that no Australian owned firm has set up business in competition with foreign owned car companies is consistent with the view that Australian owned firms in this industry cannot operate as efficiently.

The profit/dividend component returned to the foreign owners is usually only a few percent of sales, while the wages and other costs such as

1 Assuming a continuation of Australia's existing wage setting framework, then investment creating growth in the economy is the best hope for unemployment to reduce in the 1990s.

electricity, raw materials, etc, paid out to Australians could in total be as high as ninety-nine percent of sales. To focus on the relatively trivial profit/dividend component and argue accordingly that Australians should not buy from overseas owned firms, is to deny benefits to Australians many times larger.

The second scenario involves the purchase by overseas residents of an existing Australian owned business. While this appears to be contrary to Australia's interest because profits and dividends will now go overseas, this is not necessarily so.

Why do people sell assets such as shares, houses, cars, etc? The reason they do so is that they consider the price they obtain for the asset exceeds the present value of future benefits to them. (See Ross et al. 1994 for an explanation of net present value decision making.) In the case of a business, the benefits of owning it are the profits earned. When the owners sell a business, the price the owner receives either equals or exceeds their estimate of the present value of future profits. If the price offered is less than the owners estimate of the present value of future profits, the owner is better off not selling. Accordingly, when an owner sells a business, the owner receives the present value of the future profits, today. As far as the profits are concerned, it does not matter that the business is sold to an overseas owner, since the profits are still available to be spent by the former owner, just as they were when the business was Australian owned. But what about the profits that are now sent to the overseas owners? Surely Australia is worse off? The answer to this question comes from remembering that the overseas owners previously sent to Australia money to buy the business – an amount equal to the present value of the future profits.

Supporters of retaining Australian ownership might argue that the buyer's estimate of the future profits will exceed the current owner's estimate of future profits, either because the owners have it wrong, or because the buyers can bring to the firm assets or skills that will increase its profits. However, owners of any asset, be it a house, car or business have the most knowledge and the greatest incentive to get it right. While some decisions with the benefit of hindsight can be said to be wrong, unfortunately nobody can make decisions this way. If the new owner brings to the firm assets or skills that increase the profit, surely nobody can dispute that the new owner is entitled to the additional profit. Of course the additional profit has nothing to do with the claim that profits which were formerly in Australian hands are now in foreign hands, since the Australian owner was not earning these profits. For the new owner to earn additional profit, Australian consumers must be increasing their purchases (benefiting from the new owners' innovations).

Excess Profits?

Overseas owned firms operating in Australia survive because Australians buy from them in preference to imports or products made by Australian owned firms. To object to buying from an overseas owned firm, (when Australian consumers benefit, Australian employees of these firms benefit, and Australians employed by firms which provide goods and services to them benefit), on the basis that these firms receive a profit is not sensible, unless the amount of profit is so excessive that it outweighs all of these benefits.

In practice, it is unlikely that the profits could be excessive, since if they were, Australian owned firms would be able to enter the market and reduce prices. In many cases the overseas owned firms either do not have competition from Australian owned firms (indicating that Australian owned firms do not consider they can produce at lower prices), or there is competition from Australian owned firms, which ensures that the profits of overseas owned firms are unlikely to be excessive. Further, if the profits earned by overseas owned firms were excessive, then not only would Australian owned firms then compete, but so too would imports. It is not plausible that the profits of overseas owned firms operating in Australia are excessive. More likely they represent a return judged by the market to be appropriate for the risk of the industry.

Australian Ownership

AusBuy Guide No.3 recommends buying from Australian owned rather than foreign owned companies. Concern with the foreign ownership of Australian business is misplaced. It must be realised that the level of foreign ownership of Australian business is consistent with the wishes of Australians, as revealed by their economic behaviour. This is because these businesses are available for purchase but Australians choose not to do so. Many businesses based in Australia have their shares listed on Australian stock exchanges and can be purchased by Australians if they wish. In addition, some are listed on overseas exchanges and can be purchased by Australians. The fact that they are not purchased indicates Australians prefer to spend their money on things other than reducing foreign ownership.

Petersen (1994) provides examples of Australian firms sold to overseas buyers: Billy Tea, Bundaberg Rum, Cottees, Drizabone, Speedo, Rosella, Violet Crumble, Aspro, Minties, Jaffas, Life Savers, Henry Jones/IXL, Arnotts, Stubbies, Sidchrome, and Vegemite. The sale of these businesses was voluntarily undertaken by Australians who considered they were better off selling than retaining ownership. This indicates that rather than foreign ownership being a problem for Australia, it is the foreign owners that may have a problem. Australians who were owners have judged that they are better off selling rather than remaining owners.

While it is evident that the former owners are better off, is Australia better off? When one Australian is better off, then the collective wealth of Australia is thereby greater. Are other Australians affected? Firstly, other Australians benefit from either the consuming or saving of this wealth. If it is saved, it is then available for other Australians to borrow to finance either investment or consumption. Secondly, the new owners clearly believe that they can operate more efficiently and effectively and thereby can increase profit. If so, it is likely that Australian consumers will benefit from reductions in price or improvements in quality from the more efficient firm. Competition from other firms will ensure that these economies are passed on to customers. If the new owner does not do so, then competitors can increase their market share by doing so. Instead of criticising overseas buyers, it is beneficial for Australia to welcome them, whenever they are prepared to pay more for an Australian based business than Australians judge it is worth.

Dependence on Overseas Firms

Choice argues that a benefit of buying from Australian owned firms is that Australians will not become dependent on overseas firms:

> If a company has worldwide operations, it can set up shop in Australia and import goods from its own overseas based firms. Therefore it can set very low import prices for a couple of years until it has driven out any locally owned competitors. Then there's nothing to stop the company from rapidly increasing its prices, and Australian consumers would have no one else to purchase from (1994:8).

Firstly, note *Choice* states that Australians benefit from the overseas firm setting, '... very low import prices for a couple of years.' However, they go on to argue that Australian owned companies will be driven out of business, enabling the overseas owned company to increase prices leaving Australians no option than to pay high prices. In other words, *Choice* is claiming that a monopoly will be created. For a monopoly to exist there have to be effective barriers to entry or else other firms (Australian owned or overseas owned) will be able to enter the market and undercut prices. There is nothing in *Choice*'s example to indicate that the overseas firm has effective barriers to entry. On the contrary, the example suggests that the overseas owned firm can readily 'set up shop' in Australia. The implication of 'high prices' is that the overseas owned company would be earning excess profits. If that were the case, other firms (Australian or overseas owned) would then have incentives to start up businesses to compete with the foreign owned company and undercut its prices.

Also the 'high prices' would provide incentives for overseas firms to export to Australia. *Choice* claims that having driven out locally owned firms 'Australian consumers would have no-one else to purchase from'. If one overseas firm can do this, then so too can other overseas firms. While the number of firms in Australia is relatively small, world wide competition is vast. Contestable market theory (Baumol 1982) argues that the threat of competition is sufficient to stop the overseas owned firm increasing its prices to that of a monopolist. Competition, or the threat of competition from Australian firms, overseas exporters, and overseas firms who potentially could also set up business in Australia, would ensure that *Choice*'s example is unlikely to occur in the real world.

Made Overseas by Australian Owned Firms?

Choice (1994: 8) points out that:

> A growing number of Australian-owned companies are moving their manufacturing activities offshore. While it's true their profits flow back to Australia, the offshore drift causes local factory closures and, as a result, unemployment.

An example is lingerie manufacturer The House of Jenyns:

> Mr Carter is the managing director of the House of Jenyns, Australia's only major lingerie manufacturer which operated as a family-run company for almost a century until it was bought by Triumph in 1971.
>
> Last week Mr Carter told his 400 staff at factories at Wynnum and Ipswich that manufacturing would cease in nine months, with a loss of 317 jobs and the closure of the Ipswich factory, because government taxes and charges had made it impossible to compete with cheaper Asian imports.
>
> He said yesterday that these on-costs represented 30 percent of his total labour bill and the company would import lingerie from its own manufacturers in Asia to its Wynnum outlet in order to match the prices of rival Asian competitors.
>
> The five crippling on-costs are payroll tax, superannuation contributions, workers' compensation premiums and long service and holiday leave loadings (Southorn 1993:5).

We have to ask why do Australian based companies move their production offshore? If they were able to earn normal profits for the risk of the industry, they would remain in Australia. In most cases, the reason for going overseas is that Australian costs are too high in this industry, and the export of lower cost overseas production can thereby sell at lower prices. In the case of the House of Jenyns a major factor is government imposts. If they are concerned about factory closures, advocates of buying Australian should turn their attention to these rather than supporting preferential treatment for Australian companies.

However, where other cost factors are encouraging offshore manufacturing this need not be regarded as a long term problem. While the immediate effect of such a relocation is a closure of a local factory and thereby unemployment, this is not necessarily the long term effect. Australians paying high prices for Australian made benefit from buying overseas made at lower prices, as they thereby have money left over to spend on other goods and services. This will increase Australian employment in other industries. In the long run there is unlikely to be any significant effect on unemployment caused by the relocation overseas. However, there is an increase in Australian living standards, since Australians consume both the product (which was previously made in Australia) plus, as a result of the price reduction, other goods and services.

Increase in Employment?

Choice suggests the following benefit from buying from Australian owned firms:

> Mass support for Australian-owned companies could enhance employment. If consumers stopped buying the products of foreign-owned companies to a point where they stopped producing in Australia, in theory locally owned companies would simply produce more to cope with the overhanging demand. It could be argued companies would have to take on more employees to cope with this extra demand. The counter-argument to this is that the employees of the foreign-owned companies would then have lost their jobs (1994:8).

The main point of *Choice*'s argument is that although the total production of goods and services is unchanged, Australian employment will increase, if Australian owned firms produce them, rather than overseas owned firms doing so.

The chapter on unemployment pointed out that the net effect on unemployment from buying Australian made is likely to be small at best.

However, even if the consequence of buying from locally owned companies rather than foreign owned companies was that Australian unemployment decreased, this result is not necessarily desirable. The major benefit claimed by *Choice* for buying from Australian owned businesses is that they would employ more Australians than overseas owned businesses. If this is so, then rather than being a benefit to Australia, it is a cost. The net increase in Australian employment, as a result of buying from Australian owned firms rather than foreign owned firms, represents a cost of inefficient production. The additional employment required for the same quantity of goods and services being available to Australians means that the cost of production increases and therefore so will prices.

Foreign Investment and Jobs

Critics of foreign investment point out that it has created only a small number of new jobs (e.g. Peterson 1994:9). Of course, it is not the direct intention of foreign investors to create jobs in Australia (though it may well be a consequence). Foreigners are no different to Australians – everyone invests to earn a return. Foreigners invest in Australia when returns are higher than they can earn in their own country or elsewhere. Why do Australians accept this investment? Australian based businesses have a choice of borrowing overseas, borrowing domestically or, of course, not borrowing at all. Businesses borrow because they expect that the benefits will exceed the cost – that the investment will be profitable thereby benefiting their shareholders. Australian based businesses borrowed overseas, in preference to borrowing domestically in the 1980s and 1990s, because interest rates were lower.

Is it valid to argue that the creation of jobs is an essential justification for foreign investment? If the creation of jobs is to be a condition of the Foreign Investment Review Board allowing foreign investment, who is to pay for unprofitable investment which creates jobs? If management were to put jobs ahead of profits, then shareholders would replace such management. If all managers were required by legislation to put jobs ahead of profits, then the foreign investment would cause business to incur costs greater than benefits. This would force business to increase prices and so Australian consumers would pay for the job creation. These jobs are unnecessary jobs since competition currently ensures that business only employs staff when their benefits exceed their costs. If legislation required foreign investment to create unnecessary jobs, then business would not undertake such unprofitable foreign investment.

Under the existing foreign investment guidelines, business undertakes investment that is expected to be profitable thereby benefiting shareholders and consumers. Foreign investment can create jobs, but only jobs that business considers are necessary. To put on staff unnecessarily is to impose costs on business which inevitably will result in higher prices to consumers – a reduction of Australian living standards.

Conclusion

Buying Australian only from Australian owned companies is buying Australian at its most extreme – and most counterproductive. While ostensibly concerned to protect Australia's economic interests, it is a policy than can only result in lower living standards for Australians. Not buying products made by foreign owned companies would deprive consumers of many popular goods and cause many Australians to lose their jobs. Restricting new foreign investment would similarly make victims of consumers and workers. Consumers would be denied the new or better products foreign investors can bring to the Australian market. Workers would lose the opportunity to find jobs or move to a job they prefer. Why Australian consumers and employees should bear such burdens in order to bring benefits to the owners and staff of Australian owned companies producing for the Australian market has never been made clear.

Chapter 7

Conclusion

The buy Australian idea – that consumers should be encouraged or forced to buy goods and services based on their Australian origin – is deeply flawed. It is based on misunderstandings of several important aspects of economic activity, and is highly unlikely to achieve its claimed objectives.

Ultimately, economic policy is concerned with living standards. Buy Australian advocates identify unemployment, the current account and foreign debt as the objectives, but they miss the real issue, which is consumption.

Buy Australian policies are contrary to specialisation, which is the basis of economic progress. It is also contrary to the way Australians conduct their lives. Few Australians attempt to be self-sufficient by producing everything they need. Instead, they specialise and exchange the output of their employment with that of others. Each Australian's standard of living is increased by specialisation. Buy Australian policies are contrary to specialisation as they imply that Australia should become self-sufficient. However, when Australia specialises in producing goods in which it has a comparative advantage and trades with other countries, then Australian living standards become the highest possible.

While the advocates of buy Australian policies are right to think unemployment is a serious problem, they do not fully recognise that employment is a means to the end of producing goods and services. By promoting employment in industries in which Australia lacks a comparative advantage more work may be provided, but at the cost of less production. This is no way to improve living standards.

While supporters of buy Australian policies refer to the current account deficit in alarmist tones, there is little reason to be concerned.

This concern reflects the pre-1983 situation in which Australia on occasion had foreign currency reserve crises. Since the floating of the dollar these crises have become historical curiosities. Australia's exchange rate continually adjusts so that the balance of payments always balances.

Foreign debt is also the subject of concern. The media and AusBuy claim that every Australian taxpayer owes part of this debt. This is not the case. For the private component of the debt, only the individuals and firms that borrowed are liable. For public debt, taxpayers are liable for the annual interest as part of their taxation commitments, but that is the extent of their liability.

Despite the fact that there is no problem with the current account deficit, the federal government made its reduction their number one target in the 1980s. It employed fiscal policy, monetary policy and buy Australian policies to reduce the current account deficit. The result of the federal government's monetary policy – pushing interest rates up to some of the world's highest in 1988-89 – was the worst recession in Australia since the Great Depression.

Even if the aims of buy Australian policies had been sound, the policies are ill-suited to achieving them. The defenders of buy Australian policies claim that they create jobs. While a switch to Australian made goods will increase employment by Australian producers, this does not mean unemployment will decrease. By decreasing imports there will be fewer Australians employed in importing. Further, there will be a loss of employment in exporting industries as the drop in imports causes an appreciation of the Australian dollar. Also, to the extent that Australian consumers substitute higher priced Australian products for imports, they will have less to spend, which will cause a reduction in employment. Overall, it is unlikely that buying Australian will cause any significant change in Australia's total unemployment.

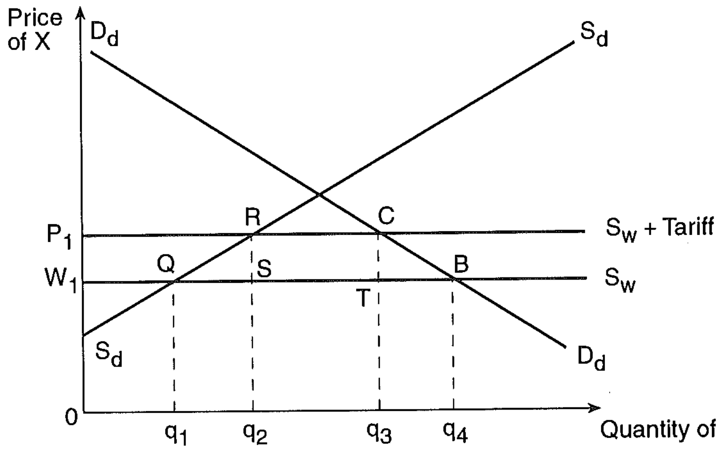
Nor will buying Australian reduce the current account deficit. The reduction in imports, by causing an appreciation in the Australian dollar, will reduce exports with the current account deficit being unchanged. For the current account deficit to change the capital account surplus has to change by an equal and offsetting amount. The capital account records overseas finance used to fund both the government's deficit and the difference between investment in Australia and savings by Australians. Substituting Australian made products for imports has no effect on the capital account surplus and consequently no effect on the current account deficit.

Buy Australian policies have been misconceived from the beginning. The only beneficiaries have been Australian firms producing for the domestic market and politicians wanting to be seen to 'do something' about unemployment. The losers have been consumers and taxpayers. Changes in government purchasing policies will see taxpayers losing yet again.

Buy Australian? Yes, if buying Australian represents the best value for money. The living standards of Australians are the highest possible when Australians buy the best value products, irrespective of whether they are made overseas or made in Australia.

Appendix 1

The resource misallocation effects of the imposition of a tariff [1]



In the above diagram, S_W is the world supply price of a good X, which is infinitely elastic at price OW_1. D_dD_d and S_dS_d are the domestic demand and supply curves respectively. Prior to the imposition of the tariff and the Buy Australian campaign, Australians buy $0q_4$, of which domestic producers supply $0q_1$ and quantity q_1q_4 is imported. If a tariff of W_1P_1 is imposed then the world supply curve shifts to S_W + tariff. At the new domestic price

[1] This section is indebted to Challen et al. (1985:368-9).

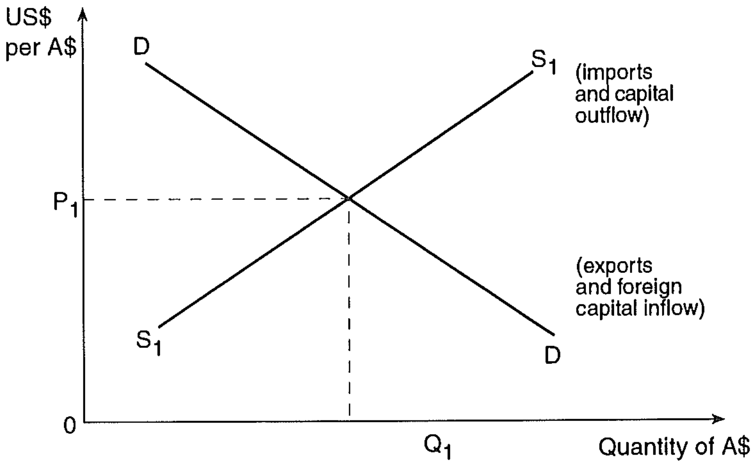
OP_1, Australians buy a smaller quantity in total Oq_3. However, a larger quantity Oq_2 is produced domestically and imports fall to q_2q_3. At the tariff induced price of OP_1 Australians reduce the quantity they consume by q_3q_4.[2]

2 The tariff and the Buy Australian policy both impose costs on Australians in the form of resource misallocation which is represented by the areas of triangle QRS and triangle CTB. These areas are called the deadweight loss of the tariff. The consumption loss, represented by triangle CTB, arises because Australians are prevented by the tariff from buying X at the world price OW_1. The production loss, which is the extra cost of domestic production over the cost of imports, is represented by QRS. It arises because the quantity q_1q_2 is produced domestically as a result of the imposition of the tariff. In addition, part of government tariff revenue will be diverted to the employment of customs officials for enforcement purposes. The deadweight loss from the tariff is increased by the socially unproductive use of resources for enforcement purposes.

Appendix 2

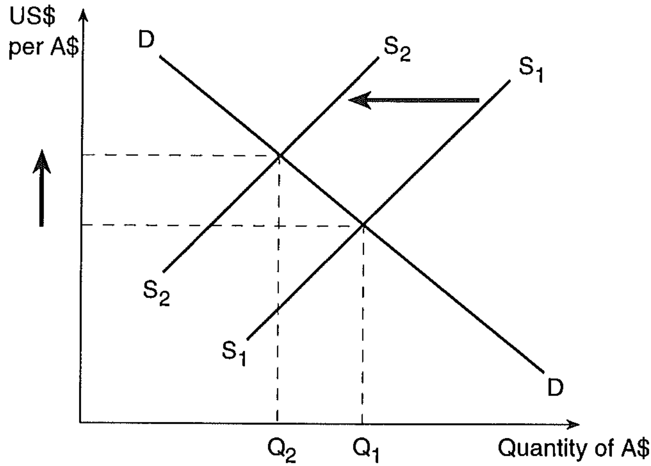
Determination of the Australian Dollar Exchange Rate

The figure below illustrates the usual analysis of the foreign exchange market for Australian dollars, showing the demand for, and supply of, Australian dollars graphed against the exchange rate.



On the vertical axis is plotted the amount of US dollars required to purchase Australian dollars. The amount of demand for Australian dollars increases with a lower (devalued) Australian dollar exchange rate. That is, Americans have to give up fewer US dollars to obtain an Australian dollar and consequently Australian goods (exports) become cheaper to Americans. Likewise the supply of Australian dollars for the purchase of imports decreases with a lower exchange rate (imports are now more expensive) and increases with a higher exchange rate. In addition to export receipts, capital inflow affects the demand for Australian dollars.

If there was a shift by Australians away from imports in favour of Australian made, what is the effect on the exchange rate? The supply curve of Australian dollars for imports would reduce (shift to the left) as shown in the diagram below.



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