Australian Economic Growth: A Structural Perspective (A Preliminary Report)

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Abstract
In this paper we argue that Australia's current economic problems are not just the result of our being at the bottom of the cycle, but rather reflect a longer term decline. The reasons for this decline are located in structural problems relating to the decline of the industrial sector and the increasing unreliability of the export sector. We view industry as the core sector which generates technology and growth. Within the industrial sector, capital goods producing industries are the 'hot bed' (so to speak) of structure change and technical progress. Australia has let these industries decline. As a result, traditional remedies in the form of either demand management policies or 'waiting for the world recovery' will not be enough. In fact, recent economic policies, rather than being a panacea, have exacerbated the problem.

1. Introduction
It is widely asserted that structural change is necessary before the Australian economy can enjoy sustained economic growth at a satisfactory level. In

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this paper, we examine the question of why structure is important, before looking at the general structural constraints which impinge on the Australian economy, concentrating on the inadequate development of the capital goods sector. Finally we consider the ways in which the Labor Government's policies have influenced the structure of the Australian economy. It is our argument that these policies have had a inhibiting effect on the economy, as they have adversely influenced investment decisions, so increasing Australia's reliance on international forces.

2. Traditional Views

Most analysis of Australia's economic growth has focussed on supply side factors. In particular, analysis has concentrated on issues associated with allocative efficiency such as the role of price signals on productivity and thrift. It has often been argued that growth has been hampered by low savings and by policy induced market imperfections- tariffs in the product market and the effects of arbitration in reducing the flexibility of the labour market.[1] Gruen, in an important article on Australia's economic performance (Gruen (1986)), clearly blames our low growth rate on these later factors. He accepts that Australia has had relatively low productivity growth, but argues that this is the result of immigration. This is a difficult position to sustain given that he also acknowledges our low per capita investment over the same period (p.185). Similarly the EPAC growth papers emphasis allocative efficiency. However, as has been noted by Aspromourgos and White (1990):

> At the deepest theoretical level, EPAC's treatment of efficiency in relation to growth may be construed as a corollary of its lack of interest in the problem of the relation between demand and productive capacity. (p.18)

It is the argument of this paper that it is this latter factor which explains Australia's poor performance; and that underlying structural problems, associated with the failure to develop a capital goods sector, explain Australia's relatively low growth performance.

3. Historical Overview

Historically, it has been a characteristic of the left to focus on issues of structure. The economy is conceived in terms of sectors which can generate growth and accumulation and can, endogenously create new technologies which then affect the rest of the economy. At times this approach was very reductionist, in the sense that it identified only very specific branches of industry such as steel and so called heavy industries as the main engines of growth. Yet, it had some sound basis, at least conceptually, in the sense that it had a clear view of the hierarchical structure of production. Perhaps too much constrained in its own reductionist approach and becoming aware that it was no longer workable, the labour movement in the last ten years in Europe (except Scandinavia and Germany) and Australia all too quickly accepted the tenets of monetarism and post industrialism, abandoning the notion of structure all together. The years of the crises for the labour movement were also the years in which labour lost its structural perspective.

For Australia, as well as for the labour movement, it is important to return to a structural perspective. In our view, the starting point requires an analysis of the break down of the system of regulatory forces which governed the Australian economy until the early 1970s, i.e. until the end of full employment. More specifically, is it true that during the 1950s and 1960s Australia could sustain full employment and high GDP per head as well as serving domestic demand through domestically produced output? In other words, is it the case that during this time, Australia had a substantially larger industrial base than it has today. So the question becomes, what were the structural features of accumulation in Australia? In particular, which were the sectors which pushed accumulation of physical capital and which were the sectors which were towed by it?

As has been well documented, it has been the primary goods sectors, especially wool, wheat and coal which have provided the main basis for expansion, while the manufacturing sectors have played a secondary role. Unfortunately, these foundations have not significantly changed, so that, with the long term decline in agricultural terms of trade, Australia's potential for capital accumulation has been significantly eroded.

Historically Australian economic growth showed unique weaknesses for a high per capita income economy. Growth rates are only meaningful in comparative terms. Maddison (1989) has measured long term growth from the middle of the last century to 1987 and what emerges is that the growth rate of per capita GDP in Australia has been, in the 1900-1987 period, 1.4% per annum on average, which is equivalent to the British growth rate, the lowest of the 16 OECD countries be examined. The turning point in the case of Australia was the Depression which followed the First World War (1914-1920), highlighting the high cost of the war for Australia. This, combined with the Great Depression brought for Australia a 1900-1950 growth rate of GDP per capita of 0.8% as compared to an equivalent OECD average of 1.3%, and the British average of 0.8%. If we look at the post war, 1950-1987 period, Australian GDP growth rate at 2.1% per capita was slightly below the British 2.2%. However in the post war period Australian growth per capita was slightly above that of Canada 2% and USA 1.9%.

An important question then is why has the growth rate hovered around this relatively low rate? The clue must lie in the nature of long term investment. Can we say that, for example that, like post world war USA, there were stagnationist factors at work? There should not have been, due to immigration plus policies to sustain growth such as large capital schemes like the Snowy Mountain Scheme. Instead, should we look at the structure of industry? Has investment caused endemic unused capacity due to actions by large multinationals, so that sectors were born on an oligopolistic basis? A highly monopolized/concentrated sector need not necessarily be subject to unused capacity, if the surplus is used for capital accumulation (investment) or exports as was the case in the early phase of post war growth in Japan and current phase of growth in South Korea. Concentration was used, in such instances, to obtain economies of scale, and high domestic profits were used to subsidize exports, to allow exports to penetrate foreign markets. This contrasts with multinational investment in Australia which was not dynamic, the domestic market generated levels of demand way below that of the expertise and technical level of those firms. The multinationals' aim was never to use Australia as an export base, but rather production was aimed exclusively at the small domestic market, so there was never any intention to generate economies of scale. Rather than being part of an overall production strategy by these companies, multinational investment in Australia was merely an attempt to exploit quasi rents resulting from domestic tariffs. The tariffs were unable to engender a local capital goods industry, of specialized machine tooling. All of this occurred within a period of fixed exchange rates, so that there were none of the problems caused by exchange rate volatility of the 1980s, so the potential was there to build a strong local capital goods industry. Especially since, at that time, Australia had reached a higher stage of development than its Asian neighbours and so had potential export markets. The conditions for sustained economic development were never taken advantage of, in the Australian economy in the post Korean War (1953-1973) period, despite the fact that the period was characterized by full employment. Australian per capita growth rates at the time were similar to that of UK. The low full employment growth rate can be explained by the maintenance of the importance of the primary goods sector in the structure of the economy. Initially this was related to our ties to the United Kingdom, which was the main importer of our goods until the mid 1960s. This role was then taken over by Japan.[2] At the same time there was a switch from rural exports as the main category of exports to minerals.[3] Notwithstanding the fact that the Asian expansion absorbed some of our surpluses, this left our exports in a weak position, at ever unstable and deteriorating trend terms of trade.[4]

When the full employment period broke down with the collapse of the Breton Woods system, and therefore the collapse of the fixed parity system, Australia was in a double bind over the future of exchange rate movements. Whatever the direction of exchange rate changes, there would be net negative effects on the domestic economy. The movement of exchange rates cannot be explained by equilibrium theory, as it is the result of disequilibrium movements in capital. Given that peculiar nature of Australia's imports and exports, exchange rate movements are unlikely to lead to improvements in the balance of trade. As most of our exports are primary commodities, they adjust more to changes in world income than to prices, so that they are relatively price inelastic. Imports are mainly intermediate and final manufacturing goods. Demand for these is income elastic, but will display asymmetry with respect to price elasticity. Due to the limited nature of import competing domestic industries, there is a low supply elasticity of import replacement. As a result, a real exchange rate depreciation would hit the industrial base by causing increased cost of imported capital goods, without bringing forth domestic substitutes. So the likely impact would be inflationary. A revaluation, on the other hand, would have a more ambiguous effect on the industrial base. It would hit the industrial base by increasing imports of consumer manufactured goods, whose demand is relatively price elastic for reductions in price, while at the same time it would reduce the costs of imported inputs.[5] In either case it is likely that the industrial base will be squeezed. This is because the industrial base is too weak to regenerate itself. Instead of becoming stronger during the 1950-1973 period, the structure of the local economy became less adaptable as it still relied heavily on a declining primary sector. So, it absorbed passively the negative effects of exchange rate changes. This may be contrasted with Sweden and Finland who actively used exchange rate policies to restructure the economy, eg. by combining devaluation with retraining programmes and investment programmes to retrain and reequip economy for the new condition, so making the economy more flexible.

Given these questions, we would like to start by focusing on the manner in which the full employment phase was brought to an end. It is true that unemployment started growing in the late 1960s in all OECD countries. On this basis we have the following typology. Some countries, such as Sweden, accepted the cost of the international crisis without creating mass unemployment and later undertook restructuring without substantial increases in unemployment. Sweden was able to achieve this due to its advanced machine tool industry which allowed the core of the economy to survive. Japan reacted to the crisis by slowing down its growth rate and expanding its exports, while at the same time increasing its degree of specialization and sophistication in its production of capital goods, and introducing specific import constraints. The same can be said about Germany, with the important difference that they did not eschew mass unemployment. However, this mass unemployment was felt most by the "guest workers", who, in effect, constitute a disenfranchised group within the population, and who became the catalyst for the frustrations created by the dangers of unemployment.

An intermediate situation occurred in France and Italy where some sectors were made efficient while others were retrenched, with little concern about unemployment. Nevertheless, even in these cases, the structure of the economy was not allowed to deteriorate too much. That is, the capacity of the economy to accumulate was not reduced, so net investment in productive capacity was maintained. As a result, the potential exists, in the face of a change in the balance of political power towards labour, for the economic machinery being sufficiently strong to *allow* the economic transition to alternative policies.

Finally, there is a fourth case of countries under-going severe deindustrialization, especially the USA and Great Britain. The former is still the largest single capitalist unit in the world economy and its analysis would require a separate discussion. Australia followed the path of Britain, with two important differences. Firstly it has much less industrial capacity than Britain, making it more difficult to reverse the trend. Secondly, the importance of financial capital in Britain has led to a conflict between financial and industrial capital which has hastened the decline of the latter.

Australia was hit by the changes of the seventies on two fronts: firstly the initial increase in the price of raw materials raised the cost of production causing a cost push inflation, as was the case in all other industrialised countries. This took place in an environment characterised by extreme competition in manufacturing products coming from South East Asia and Japanese economic areas where development was showing much greater scale economies than anywhere else in the world. Secondly, since Australia's position in the world economy was determined by primary products, their increase in price crowded out the manufacturing sector eventually leading to a Gregory effect by the late 1970s and early 1980s. From a rational perspective increases in raw material prices and in the exchange rate should have helped modernize the economy as capital goods became relatively cheaper. Australia could have built a sophisticated and specialized industrial structure. However, due to the Gregory effect the increase in raw material prices had the opposite impact via an over-valued exchange rate leading to serious contractions in the manufacturing sector rather than to expansion. This further led to speculative gains in the raw materials sector, and a standard recession in the industrial sectors.

That there has been no transition to a more sophisticated manufacturing export base, and no fundamental change from Australia's traditional reliance on raw material and commodities exports is well documented. In addition, there are indications of a long term decline, of at least 20 years, in our terms of trade, which are likely to continue for some time.[6] Given the fact that the potential for the development of a sophisticated manufacturing base is waning, and given the fact that SE Asia has become a pole for capitalist development in its own right which implies the creation of large productive capacities and sectors, it will be very difficult to restart the industrial development of Australia. It is far easier for a country like Switzerland to find a place in an international division of labour alongside South Korea as it produces engines, turbines etc. That is, it has industrial structure typical of a very advanced country, whereas Australia will play typically the role of perimeter producer at the periphery of an industrial pole.

Overall, what we see is the tremendous importance of international forces for Australia's growth.[7] This is reinforced by historical evidence which shows a strong correlation between world economic activity and Australia's growth. It is our contention that demand factors originating from overseas have provided the main restraints to domestic growth. In particular, the structure of the domestic economy limits its ability to respond to increased aggregate demand without either domestic bottle-necks or balance of trade constraints. These constraints are reinforced by the nature of our exports and imports.

4. Structural Problems Under Labor

Against this background, we can evaluate the policies of the Labor Government since 1983. Instead of being concerned with long term questions of the structure of the Australian economy, the Labor government has been more concerned with short run problems relating to maintaining steady macroeconomic performance so as to ensure electoral victory. In particular their policies have led an over-valued exchange rate, so as to ease inflationary pressure. This, coupled with the effects of financial and exchange rate deregulation, in turn reinforced short and long run balance of payments problems. The net effect of this is to augment long run pressures which tend to reduce the size of the industrial sector. To combat these, especially the effects on the balance of payments, the government has attempted to reduce the level of domestic demand. The main instrument for this has been high interest rates, which also serves to maintain a high exchange rate. This has been reinforced by deregulation of both the exchange rate and of financial markets. The cumulative effect of these is to make any long term investment less attractive, and make the market more myopic. This has manifested itself in a decline in private fixed investment expenditure (except in building and construction), and a shift towards the acquisition of financial assets.[8] The deregulation of the exchange rate has led to greater volatility, and this has had serious implications for investment. Great variability in the exchange rate discourages long term investment for a number of reasons:

1. variability in the price of imported inputs leads to variability in costs
2. variability in price of imported substitutes, makes is difficult to predict future demand
3. variability in the exchange rate itself encourages investment in short term, liquid projects as this increases the ability of business to take advantage of exchange rate fluctuations, or to bail out if it looks like the currency is sinking
4. variability in export prices discourages investment in export industries.

On top of this the deregulation of financial markets and the high interest rates have led to a strong bias towards investment in financial assets and to an increase in the number of mergers and takeovers as substitutes for investment in industry.

One of the main arms of government policy was The Accord, which essentially enabled the reduction of real wages, in return for a trade off for higher growth and employment. However, this did not lead to a strengthening of industry. Despite the fact that there was a substantial increase in corporate profitability during the 1980s, for all the reasons we have discussed, real fixed capital expenditure investment did not increase.[9] As a result, the gains from The Accord were short term, in terms of employment during the 1980s, with no implications for long term growth, employment or structure.

This has been reinforced by the level playing fields view, which has led to reduced government involvement on the rationale that it would allow market forces free play. However, all this has done is to reinforce the power and monopoly elements that already exist. Level playing fields only advan-

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tage those who already have power. The emphasis on "market forces" and (so-called) "level playing fields" are ideological rather than aimed at any real benefit to efficiency. "Market forces" are the sum total of different balance of powers, they do not themselves guide things but are the outcome of processes which are at the level of decision making. So these forces are the sum total of the relation of the market and the state, and are often the result of previous intervention. This is shown very well by the experience of many of the countries of East Asian (particularly Japan and South Korea) where the development of capitalism has been the result of deliberate interventionism. In no way do their capitalist successes correspond to the blue print of a free market.

In Australia the deindustrialization gave power (social and economic) to those sectors, like finance, which are relatively free from the industrial base, and which have been motivated by the characteristics of the free markets ie. short term interests. The issue of world markets will become a battle of productive capacities, fortresses of productive capacities. In Australia there has been a prevalence of those groups which call for a total hands-off policy, ignoring the implications for the domestic economy. For example, such policies will lead to further worsening of raw materials terms of trade, as strong countries like US impose their conditions on Asia, as they are forced, increasingly, to rely on the export of primary goods.[10] Australia cannot compete as an equal in such an arena.

This approach should be rejected, as indicated by the failure of the market orientated policies. Such policies as devaluation and deregulation have been tried and shown not to work.

As we have argued, the result of these policies has been an effective deindustrialization of the economy, a winding down of the manufacturing sector; which has been reinforced by the resource boom. The result of this has been that, for any given level of demand, our balance of payments are in a worse position than they would otherwise have been. This can be illustrated by an examination of import penetration, defined as "the ratio of the real value of imports to real sales to the domestic market" (Bureau of Industry Economics, 1989, p. xv). The figures reveal a definite upward trend in both real and nominal import penetration during the 1980s. From the late 1960s until the early 1980s, real import penetration before duty was around 20%, and after duty around 22%, while nominal import penetration after duty was about 18% until the mid 1970s, and around 23% for the rest of the 1970s. All of these rose in the 1980s. Real pre-duty import penetration was around 24%, post-duty import penetration around 26% and nominal post-duty import penetration around 28.5% from the mid 1980s on. (Bureau of Industry Economics, 1989, Appendix 3) While this data should be interpreted cautiously, it lends support to the view that there has been a greater than trend increase in reliance on imports during the Labor years.

This has led to a vicious circle, where the deterioration in the balance of payments has led to the government applying contractionary policy to dampen demand. However, the main instrument for this contraction has been the interest rate, which merely accelerates the problem by reducing long term investment, and, at the same time inducing capital inflows to keep the exchange rate artificially high.

What is needed are policies specifically designed to promote industry, especially import competing and export industries, that is, to encourage some sort of switching of resources to the manufacturing tradeable sector of the economy. Here we should distinguish between the traditional tradeable sector of the Australian economy, the rural sector, and the possibility of encouraging manufacturing tradeables. It is to the latter of these that we believe policy should be specifically aimed. In Australia's case, it has been shown that the response of structure to changes in price is extremely weak,[12] so that other forces will be needed to induce structural change.

6. Conclusion

The above analysis raises some important questions and issues. Firstly, it is an attempt to raise awareness of the dangers stemming from the weakening of the productive base, as well as the problems inherent in relying on traditional sectors. At the same time it is an argument against dismissing Australia's current problems as being due to our being at the bottom of a cycle. Rather, it identifies the current situation as resulting from longer run structural problems. We stress the fundamental weaknesses to the economy resulting from deindustrialisation,[12] coupled with the increasingly dominant role of financial capital. From the structural approach we can deduce the movement of capitalist groups towards finance; leading towards a euthanasia of the industrialists. This creates major problems as it eliminates the possibility of an accord between industry and labor. This was precisely the philosophy behind the Accord; however, the very policies of Hawke's government helped create the environment in which financial capital took centre stage, thereby rendering The Accord impotent.

Therefore, given increasing importance of financial capital, and the weakening of the industrial sector, reindustrialization will be an uphill battle.

Notes

1. For an alternate view of the flexibility of Australia's labour market see Withers (1987) and Nevile (1990)
2. See Foster and Stewart (1991) p.11
3. Ibid p.10
4. See Gruen (1986) FitzGerald and Urban (1989) and Abelson (1989)
5. See Pope (1981)
6. See references for footnote 4
7. See McLean (1989)
8. The evidence for these empirical observations can be found in Stegman (1990)
9. See Stegman (1990).
10. Ermini and Halevi (1989) argue that the US, which is now the biggest debtor nation in the world, will only be able to address its trade deficit problems by an aggressive export policy. They further argue that, because of the loss of technological edge in manufacturing, such a policy "can only rest on raw materials and agricultural products". (see pp.10-11)
11. See Dixon (1989)
12. We have taken the importance of the industrial sector as the main vehicle for growth as granted. See, also, Eatwell (1982) and Rowthorn (1989).

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