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**IMPORT REPLACEMENT:
AN OPTION FOR ECONOMIC RECOVERY**



Queensland Economic Policy Research Unit

PREFACE

The Queensland Economic Policy Research Unit is pleased to publish this Research Report which follows up on the issues raised in Research Report 931. The matter of policy options for economic recovery is extremely important as the Australian economy continues its sluggish movement out of recession. Ben Rees, who was an instigator of, and contributor to, the March Conference held under the auspices of the Queensland Economic Policy Research Unit, is well placed to contribute to this discussion. He is a graduate in economics from the University of Queensland and from the University of New England and a primary producer. He brings to this Report both a strong analytical background and a sense of urgency for what is required to regain economic prosperity.

IMPORT REPLACEMENT: AN OPTION FOR ECONOMIC RECOVERY

Ben Rees

SECTION I INTRODUCTION

The economic impact of lost aggregate demand in Australia through rising import penetration and debt service payments has received little serious analysis. Spokesmen across the community industry, media politics and academia continue to support sustainable recovery through microeconomic reform and deregulation of the Australian economy. It is believed that the creation of an internationally competitive export driven production base will capitalise upon our comparative advantages thereby creating long term sustainable economic activity, employment and rising living standards. The reality that Australia has been in almost continual economic decline and economic uncertainty for almost two decades does not appear to generate any sense of urgency or need for appraisal of economic direction, philosophy, and policy options.

There has emerged an aura of defeatism in the economic agenda accepting failure of economic management and rationalising historically high and unacceptable levels of unemployment as inevitable in the short and medium terms. Solutions over the long term are offered to explain the intractable economic dislocation currently producing unemployment in the order of 11 percent of the labour force in Australia, and another group of underemployed, generally accepted, of equal magnitude to the percentage unemployed. Inherent in the long term solution hypothesis is the Law of Mathematical Probabilities in which the probability of a given event occurring over the long term is certainty. The problem for the unemployed and the underemployed, marginal businesses and bankrupt entrepreneurs is that "the long term" is a meaningless phrase. Moreover, the "long term solutionists" cannot explain the expected duration of sustainable economic recovery when it finally emerges over "the long term" and why it will be more "sustainable" than any other period over the history of the trade cycle recorded in economic literature.

What is certain however is the recorded growth in expenditure flows required to purchase rising import levels and for service payments on external debt. Between 1978/79 and 1991/92 import penetration grew by 5.8 percent of real GDP measured in 1984/85 prices whilst service payments peaked at 4.5 percent of nominal GDP in 1990/91.¹ The obvious question for analysis and discussion should be concerned with quantifying the economic loss to the Australian economy of growth in expenditure flows offshore in the order of 9 percent – 10 percent of GDP. In other words what would be the flow on advantages to economic activity in the Australian economy if a substantial proportion of this growth in offshore expenditure flow could be redirected to the domestic production base. An attempt to provide an indicative answer to this question is undertaken here using the general aggregate demand multiplier.²

The theoretical framework for the analysis is provided by Alexander's Absorption Model of balance of payments theory.³ The structure of this model is developed from the Keynesian aggregate income identity as follows:

$$Y = C + I + G + X - M \quad (1)$$

Therefore $X - M = Y - [C + I + G] \quad (2)$

and $B = Y - A \quad (3)$

$$B = X - M = \text{trade balance}$$

$$A = [C + I + G] = \text{domestic absorption expenditure.}$$

If the trade balance B is negative, then domestic absorption expenditure is greater than domestic production and the country is living beyond its income.⁴ Policy options for correcting the problem differ depending upon the level of economic activity existing in the economy. For example, if the economy is operating at full employment output there is a need to pursue a different economic strategy to that which would be required if the economy is

1 Refer attached Tables.

2 Dudley Jackson, *The Australian Economy*, Macmillan Press, 1989, p. 650.

3 Salvatore Schiavo-Campo, *International Economics*, Winthrop Publishers, 1978, p. 281.

4 Salvatore Schiavo-Campo, *op. cit.*, p. 282.

operating below full employment. The different policy options are described as expenditure reducing and expenditure switching policies.⁵

Expenditure reducing policies are the solution if the economy is operating at full employment output. At full employment output there is no opportunity to expand export output or import replacement activity as all resources are fully employed. An improvement in the trade balance is beyond policy capacity. A political solution might suggest a restructuring of the economy to a more export oriented production base, but, the net result would be illusory as the import replacement sector and domestic sectors must contract as resources are reallocated to the export sector.

The only rational option for a negative trade balance (given it is required to balance) is to raise national savings. A policy driven boost to national savings can be achieved through restrictive fiscal policies which would entail taxation adjustments, expenditure reduction in the public sector or a mix of both.⁶ Restrictive financial policies are also an option for expenditure reduction policies and indeed such a policy stance is generally considered to require financial policies.⁷ Inflation induced by government policies can also raise national savings.⁸

There is of course no reason why a government would not elect to employ both monetary and fiscal policies to contract domestic absorption. Indeed, the policy approach of the Australian Government since the mid 1980s would fit the general structure of the Absorption Model's expenditure reduction strategy. Moreover, the debate over the 1993/94 Budget revolved around maintenance of the Treasurer's deficit reduction strategy which is consistent with fiscal constraint.

Expenditure switching is a technique or policy strategy which seeks to switch current expenditure flowing to foreign destinations across to stimulate domestic economic activity promoting economic growth and employment. It is the recommended policy strategy under the Absorption Model of balance of payments theory for an economy operating below full

⁵ B.J. Cohen, "Balance of Payments Policy", *Penguin Modern Economics*, 1973, p. 104.

⁶ Salvatore Schiavo-Campo, *op. cit.*, p. 281.

⁷ B.J. Cohen, *op. cit.*, p. 104.

⁸ Salvatore Schiavo-Campo, *op. cit.*

employment output to correct a trade deficit through expanding domestic production. The economy is regarded as living beyond its current income; but, below its potential income. Policy instruments range across currency variations, trade intervention instruments, capital flow intervention.⁹

Because of the direction of economic philosophy in Australia over the 1980s with its commitment to an international level playing field and its involvement in the Cairns Group of Free Traders, expenditure switching policies in general were untenable to policy makers. The comment by the NFF that "All major political parties now are firmly committed to progressive reductions of assistance"¹⁰ demonstrates the difficulty in advocating expenditure switching policies to address the economic malaise confounding the "economic experts and their long term sustainable recovery.

One policy option is advocated by the export sector and indeed is supported by the Australian Democrats in their "Getting to Work" manifesto.

"The gains from a devaluation are enormous. Each one percent fall in the Australian dollar boosts rural export income by \$130m. Tourism will also be more competitive."¹¹

Devaluation as a solution to Australia's economic difficulties is a questionable concept. Consider the following currency devaluation analysis.

Selected Values of \$US per \$AUD and TWI

	\$US	TWI	Unemployment Rate	Current Account Deficit GDP %
June 1977/78	1.1475	86.2	6.3%	-3.3%
1992/93	0.6722	49.5	11%	-3.8%

Source: RBA Bulletins, December 1985 and August 1993.

Depreciation % -41.4% -42.6% Deterioration = 74.6% Deterioration = 15.2%

⁹ B.J. Cohen, *op. cit.*, p. 104.

¹⁰ N.F.F., "New Horizons", Chapter 17, *Tariffs and Industry Assistance*, p. 126.

¹¹ The Australian Democrats, "Getting to Work", *Exchange Rate*, p. 11, July 1992.

As the table demonstrates since June 1977/78 empirical data confirms a substantial depreciation of the Australian currency in terms of the \$US and the TWI between 1977/78 to 1992/93. However unemployment has deteriorated by 74.6% and BOP by 15.2%. It could be argued that the general expenditure switching characteristics of a currency depreciation falls foul of the fallacy of disguised politics.¹² More selective price adjustments available through trade interventionist instruments might have been more successful than the general price adjustments which flow from currency depreciation.

With currency depreciation there is always a danger of the phenomena known as factor reversal.¹³ There is usually a first-round improvement to the balance of trade following a currency devaluation which increases national income. However, given the relationship between imports and national income in an open economy – the marginal propensity to import – the increased income flowing from the initial devaluation will increase the level of import penetration. What is implied by the factor reversal phenomena is that as long as the balance of payments deficit persists, then there must be continued currency depreciation to restore equilibrium in the balance of payments.¹⁴

SECTION II THE AUSTRALIAN ECONOMY IN MOTION

Selected Correlation Statistics Australian Economy 1978/79 – 1991/92

	r	External Sector	r	Employment/Unemployment	r
INC%/INC%GDP	0.91	INC%GDP/INC%M	0.68	INC%BFI/INC%Employment	0.74
INC%BFI/INC%GDP	0.72	INC%LINC%M	0.85	INC%GDP/INC% Employment	0.7
INC%GDP/Rediscount Rate	0.72	INC%C/INC%M	0.7	INC%Employment/Rediscount Rate	0.73
Rediscount Rate/90 Day BBT+1	0.9	INC%X/INC% Employment	-0.1		
INC%BFI/Rediscount Rate	0.72	INC%X/INC%I	-0.2	INC%X/Unemployment	-0.17
INC%C/INC%GDP	0.64			INC%X/INC% Employment	-0.1
				INC%C/INC% Employment	0.54

12 B.J. Cohen, *op. cit.*, p. 103.

13 Salvatore Schiavo-Campo, *International Economics, op. cit.*, p. 283.

14 Refer footnote 11 – Salvatore Schiavo-Campo, *op. cit.*, p. 283.

- Notes: (1) Calculations based upon RBA December Bulletins (various), GDP = 1984/85 Prices INC%I = Rate of Change in investment across Dwelling, BFI and Inventories.
- (2) INC% = Increment Percentage
 I = Investment Expenditure
 C = Consumption
 M = Imports
 X = Export
 BFI = Business Fixed Investment

Whilst correlation analysis above is limited by the parameters of such a methodology, the resultant indications are that the Australian economy is a very different "being" to that hypothesised by neoclassical general equilibrium modelling. Such a criticism is not new. Kaldor had this to say about general equilibrium theory in 1975:

"it gives a misleading impression of the nature and manner of operation of economic forces".¹⁵

The economic debate in Australia has been driven by "dry economics" for almost two decades since the statement by the then Treasurer in the last Whitlam Government:

"We are no longer operating in that simple Keynesian world in which some reduction in unemployment could, apparently, always be purchased at the cost of some more inflation."¹⁶

This was one of the first identified policy shifts of direction which heralded the emergence of the economic philosophy to become known as economic rationalism.¹⁷ In reality however, economic rationalism is neoclassical general equilibrium theory¹⁸ "remarketed".

Perusal of the correlation data suggests that the aggregate demand income-expenditure concept of Keynes offers a more plausible explanation of the real world than the global view of aggregate demand hypothesised under general equilibrium which a given volume of monetary demand assumes that exchange is driven by relative utilities and prices of goods.¹⁹ Moreover, under flexible prices and wages, all output which can be produced in the economy will automatically find markets.²⁰ Underwriting the notion that supply creates

15 Nicholas Kaldor, "What is Wrong with Economic Theory", *Quarterly Journal of Economics*, Vol. LXXXIX, No. 3, August 1975, p. 347.

16 "From Whitlam to Fraser", Chapter 2, *The Economy*, Barry Hughes, Patence & Head, 1979, p. 29.

17 *From Whitlam to Fraser, op. cit.*, p. 29.

18 Refer Rees and McGovern, *Microeconomic Reform*, Problem or Solutions, Conference of Economists, Gold Coast, September 1992.

19 Hansen, *A Guide to Keynes*, McGraw Hill, 1953, p. 26.

20 Hansen, *op. cit.*, p. 26.

demand under flexible prices and wages are the neoclassical theories of the Law of Diminishing Returns and the Theory of Marginal Productivity which of course drive the economic agenda in Australia demanding deregulation of the economy through microeconomic reform.²¹

Empirically, evidence from the correlation table identifies investment as the vital variable in the Australian economy promoting economic growth ($r = 0.91$). Within the overall definition of investment, the most important component appears to be Business Fixed investment (BFI) with a growth correlation relationship 0.72. Consumption expenditure is important for promoting growth; but is a less intense variable than investment with $INC\%C/INC\%GDP$ $r = 0.64$.

In terms of the major economic and social problem for Australia: unemployment, there are some surprising results which challenge popular rhetoric and "expert" economic commentators. Economic growth emerges as the important requirement for employment expansion ($r = 0.7$). This is no surprise, nor is the influence of $INC\%BFI$ on employment at 0.74. However, the rate of change in dwellings is not as strong a variable as popular opinion would have the community believe at 0.48.

Perhaps the most damaging statistic for "dry economic" theorists and followers of free trade is the impact of the rate of change in exports on both employment and unemployment of -0.1 and -0.17 respectively. From the export statistics it is difficult to justify the almost hysterical demands for export expansion for national salvation. The impact of exports on employment and unemployment statistically is of little consequence.

From the macroeconomic management perspective, the most important statistic is the statistic $INC\%GDP/Rediscount$ Rate 0.72 in period $T+1$. The implication of this statistic is that the Rediscount rate is adjusted in sympathy with economic growth in the following period. Given the importance of economic growth for employment expansion, the contractionary policy stance response to increasing economic activity is difficult to explain. However, on the evidence from statistical data analysing the external sectors, it is evident empirically that imports move in sympathy with economic growth $INC\%GDP/INC\%M$ 0.68.

²¹ Rees and McGovern, *op cit*.

More importantly, the rate of change in investment is an important factor in import demand $INC\%I/INC\%M$ 0.85 and at the same time there is also a positive relationship between the rate of change in consumption expenditure and import movement (0.7). Very clearly, empirical evidence suggests that economic growth drives the demand for imports which are more strongly influenced by investment expenditure but also driven by consumption expenditure.

The Government's policy response to economic growth can be explained theoretically within the framework of the Absorption Model of balance of payments: $B = Y - A$. With B continuously negative over the period 1978/79 to 1991/92 [period under review], the policy options were either expenditure reduction or expenditure switching. Correlation data suggests expenditure reduction was pursued as the solution to a balance of payments deficit. Expenditure reduction as the preferred option is confirmed also by analysis of Budget outcomes over the period as they moved from a record deficit equal to 4.1% of GDP in 1983/84 to be in surplus from 1987/88 to 1990/91.

In the face of historically high unemployment levels which peaked at 11% of the labour force in 1992/93, it is difficult to justify the policy stance of expenditure reduction. Theoretically it was an incorrect policy choice. The tragedy for the Australian community in terms of lost economic output and damaged social fabric is without doubt the most severe since the Great Depression of 1930. It was allowed to develop as an economic dislocation of major significance because political philosophies portrayed as economic philosophies became confused and indistinguishable to even some of the most highly trained economic minds in the country.

"It is not possible, for instance, to make use of economic analysis to vindicate, with any pretence of generality, liberal presumptions in favour of freer trade, more competition, smaller public debt, or faster economic growth. Indeed such presumptions cannot be satisfactorily vindicated even by reference to fairly restricted premises about what matters. And if such presumptions continue to be held by a great number of economists, they are held purely on political grounds." (Mishan)²²

22 E.J. Mishan, *The Costs of Economic Growth*, Penguin Books, 1973, p. 11.

SECTION III **IMPORT REPLACEMENT: THE FLOW ON EFFECTS**

Table 1

Openness of the Australian Economy

Year	X Exports/GDP%	M Imports/GDP%	(X+M)/GDP%	Net Income Payment GDP%
1978/79	14.8	16	30.8	-
1979/80	15.6	15.7	31.3	2
1980/81	14.3	16.6	30.9	1.8
1981/82	14.2	18.1	32.3	1.8
1982/83	14.7	16.7	31.4	1.4
1983/84	14.9	16.6	31.5	2.2
1984/85	16.3	18.3	34.6	2.8
1985/86	16.3	17.8	34.2	2.9
1986/87	17.6	16.9	34.5	3
1987/88	18.2	17.8	36	3.2
1988/89	17.5	21.2	38.7	3.7
1989/90	18.3	21.7	39.9	4.3
1990/91	20.5	20.9	41.4	4.5
1991/92	22.4	21.8	44.2	3.9

- Source:
- (1) Calculations based upon RBA Bulletins, December 1988-1992, Tables L5, G5.
 - (2) Net Income Payments/GDP calculated from RBA Bulletin data, December 1988-92, Tables L5, H7, H8.
 - (3) Openness expressed in real GDP values, Net Income is nominal value.

The growth in import penetration between 1978/79 and 1991/92 is 5.8% of real GDP. Net income payments on external debt have also shown substantial growth in GDP percentage terms. The intention here is to examine the alternative policy option under the Absorption Model of Balance of Payments Theory of expenditure switching to calculate an indicative value of lost economic activity which could be theoretically generated if a substantial proportion of the offshore expenditure flow was switched across to stimulate the domestic economy. The general aggregate demand multiplier will be the basis of calculating flow on effects from successful application of expenditure switching policies.

The general aggregate demand multiplier is given by

$$\text{AGGREGATE DEMAND MULTIPLIER} = \frac{1}{[1 - \text{MARGINAL PROPENSITY TO CONSUME}] [1 - \text{MARGINAL PROPENSITY IMPORT}]}$$

Table 2
Marginal Propensity to Consume

Year	C	INCC	GDP	INCGDP	MPC
1978/79	107393		181488		
1979/80	109897	2504	184966	3478	0.72
1980/81	113590	3693	191040	6074	0.61
1981/82	119208	5618	197333	6293	0.89
1982/83	120707	1499	194188	3148	0.48
1983/84	123807	3100	205796	11608	0.27
1984/85	128216	4409	216177	10381	0.42
1985/86	132764	4548	224816	8639	0.53
1986/87	133780	1016	230229	5413	0.19
1987/88	139223	5443	240501	10272	0.53
1988/89	144229	5006	250555	10054	0.5
1989/90	150637	6408	257709	7154	0.9
1990/91	151198	561	256429	-1280	-0.44
1991/92	154850	3652	256942	513	7.12

- Notes: (1) Data from RBA December Bulletins 1988, 1989, 1990, 1992, 1992. Table G5 [1984/85 prices].
 (2) MPC calculated to nearest two decimal places.
 (3) Average MPC 1979/80 - 1990/91 = 0.39
 Average MPC 1979/80 - 1991/92 = 0.9

Table 3
Marginal Propensity to Import

Year	M	INCM	GDP	INCGDP	MPM
1978/79	29099		181488		
1979/80	29006	-93	184966	3478	-0.03
1980/81	31695	2689	191044	6074	0.44
1981/82	35539	3844	197333	6293	0.61
1982/83	32503	-3036	194188	-3148	0.96
1983/84	34189	1686	205796	11608	0.15
1984/85	39505	5316	216177	10381	0.51
1985/86	40082	577	224816	8639	0.07
1986/87	38942	-1140	230229	5413	-0.21
1987/88	42825	3883	240501	10272	0.38
1988/89	53037	10212	250555	10054	1.02
1989/90	55799	2762	257709	7154	0.39
1990/91	53510	-2289	256429	-1280	1.79
1991/92	55964	2454	256942	513	4.78

- Notes: (1) Data from RBA Bulletin quoted MPC.
 (2) MPM calculated to two decimal places.
 Average MPM 1979/80 - 1990/91 = 0.51
 Average MPM 1979/80 - 1991/92 = 0.84

For an overview of multiplier effects, the average values of both the marginal propensity to consume and marginal propensity to import will be used. Data from particular years provides interesting information for academic consideration. However, given the exercise of this section to provide an indicative general overview of lost economic activity, it is more appropriate to use average data. Furthermore, because of the extreme values for the year 1991/92, the average values for both variables will be taken from 1979/80 to 1990/91.

The marginal calculations for both imports and consumption provide interesting questions for policy makers in Australia. In 1990/91, as the recession gathered momentum, the rate of growth in consumption expenditure contracted in both absolute value and M.P.C. The data for 1991/92 tends to indicate that a small increment in income measured in real GDP value led to a release of consumption and import demand which exceeded income growth.

The marginal data for imports is of particular concern. Over both 1990/91 and 1991/92, the growth in import demand ran ahead of growth in income. At a time when unemployment levels were 8.4% and 10.4% respectively, it would seem misguided to argue for continued expenditure reduction policy direction with marginal import expenditure substantially above marginal income coupled with unacceptable unemployment levels. It should not be any great surprise that unemployment rose to 11.3% in November and December of 1992 to average 11% over the financial year 1992/93. If ever there existed doubt over the suitability of expenditure switching policies, they should have been dispelled given the data on the marginal propensity to import over 1990/91 and 1991/92. The community has every reason to question the credibility of all groups who support expenditure reduction policies as an integral strategy for economic recovery in Australia.

SECTION IV THE AGGREGATE DEMAND MULTIPLIER

$$A.D.M. = \frac{1}{[1-MPC][1-MPM]}$$

Average values 1979/80 - 1990/91: MPC = 0.39
MPM = 0.51

$$ADM = \frac{1}{[1-0.39][1-0.51]}$$

$$= \frac{1}{[0.61][0.49]}$$

$$= 3.35$$

Given that the aggregate demand multiplier has an indicative value of 3.35, then the expenditure flowing offshore to purchase imports and service external debt denies the Australian economy of a substantial opportunity to expand aggregate output and hence promote employment growth thereby addressing the problem of unemployment.

The growth in import penetration of 5.8% between 1978/79 and 1991/92, means that the lost economic activity to the domestic economy is 5.8% x 3.35 or 19.4% expansion of GDP. More importantly, the 5.8% of real GDP now flowing offshore to purchase imports translates to the loss of approximately 500,000 jobs²³ which is the opportunity cost of the increased import penetration. It can be inferred therefore that expenditure switching policies designed to switch that level of expenditure flow offshore across to stimulate domestic economic activity would impact substantially upon our unemployment and underemployment problems i.e. it could generate an excess of a million jobs by expansion of the private sector as opposed to a public expenditure alternative.

The other serious offshore expenditure flow is the growth in service payment on external debt peaking at 4.5% of GDP in 1990/91. If we assume an average service payment commitment in the order of 3% of GDP and given that 40% is repayable in \$A, then there is substantial opportunity through debt repatriation to further expand employment in Australia.²⁴ The calculation for GDP stimulus would be in the range of $[0.4 \times 3]3.35$ or an expansion of 4.8% additional GDP.

In terms of lost domestic aggregate demand, the loss through the growth in import penetration of 5.8% GDP and the potential to repatriate offshore debt of 1.2%, the flow on loss of economic activity is in the order of $[5.8 + 1.2]3.35$ or 23.5% real GDP. No nation can continue to lose such a volume of potential output because of a political commitment to an economic philosophy with its origins late 18th and early 19th century economic theories.

23 Ben Rees, "Alternative Strategy for Recovery", paper presented to Pork Producers Association, USQ, March 1993.

24 Ben Rees, *ibid.*

The free trade response to this type of argument is likely to raise the spectre of trade retaliation by our trading partners. The first point that should be realised is that this paper is not advocating the development of Fortress Australia. What is being canvassed is that there exists to most reasonably minded people a level of import penetration which is optimum for raising living standards and generating wealth. Import penetration beyond this optimum level clearly carries with it opportunity costs measured in terms of unemployment for Australians through exporting employment offshore – the ultimate export industry.

The second point that should be understood is that there exists a comprehensive list of countries which impose non-tariff barriers on Australian exports and the non-tariff measures involved.²⁵ The list of non-tariff barriers is left to the initiative of the reader; but below is the list of countries which apply non-tariff barriers to Australian exports.

Thailand	Austria	Denmark	India	Philippines
UK	Benelux	EEC	Indonesia	Portugal
USA	Korea	Finland	Ireland	Singapore
Yugoslavia	Malaysia	Germany	Italy Japan	Sweden
	Canada		Greece	NigeriaSweden
	Colombia	Hong Kong	Norway	Switzerland

Source: Independent Parliamentary Inquiry into Tariffs and Industry Development: Final Report, April 1993.

It would seem that a more appropriate question is who does not engage in trade intervention against Australia? But more importantly, it is hard to understand that it is only Australia which is subjected to non tariff trade intervention measures by the international market place.

"Nothing is more basic to conservative economic thought than the benign preeminence of the market. The market is neither benign nor pre-eminent."
J.K. Galbraith²⁶

SECTION V CONCLUSION

Analysis of macroeconomic policy within the framework of the Absorption Model of balance of payments theory indicates that economic policy over the 1980s sought to correct a balance of payments imbalance by expenditure reduction policies. The appropriate strategy

²⁵ Senator Sid Spindler, "Independent Parliamentary Inquiry into Tariffs and Industry Development", April 1993, pp. 7-9.

²⁶ J.K. Galbraith, *Money. Whence it Came, Where it Went*, Penguin Books, 1976, p. 288.

should have been expenditure switching policies because the economy was operating at below full employment output. The only rational explanation is that the neoclassical dogma of free international trade and deregulation of the domestic economy blinded people who should have known better to the inadequacy of expenditure reduction policies.

Australia's high profile internationally as leader of the Cairns Free Trade Group and champion of trade liberalisation under the Uruguay Round of GATT effectively locked the Australian Government into the expenditure reduction path. However, import replacement available under expenditure switching policies has the potential to provide substantial relief to the major issues of concern confronting the Australian people i.e. employment, unemployment, economic security and prosperity.

The value of the aggregate demand multiplier calculated for real GDP data indicates that a reduction of expenditure flows on import purchases and debt service payments has the potential to make substantial inroads into the major economic concerns of the Australian people. Expenditure switching policies structured to switch the 5.8% GDP import penetration growth and potentially 1.2% GDP of debt service payments across to stimulate domestic economic activity carries the potential to raise real GDP by around 23%. This opportunity to correct the economic malaise confronting the Australian economy should not be dismissed out of hand because of entrenched ideology from the nineteenth century. We are, after all, approaching the 21st century.

The problem with the indicative use of the aggregate demand multiplier is that it ignores the problem of income distribution. It implicitly assumes that the increased economic activity automatically flows equally to all Australians. This need not necessarily follow.

The distribution of income in an economy is important for maintaining economic stability over time. If a maldistribution of income develops, then the concentration of wealth and income in the hands of a decreasing proportion of the population can have detrimental consequences for economic activity and stability. For example it can slow down the income flow within the economy as fewer people command the pool of savings, profits and high incomes. Indeed, such a maldistribution can compound the structure of the national income

flow between the domestic and external sectors as high income beneficiaries are more likely to prefer imports to domestic products.

The farm sector in America was the sick sector of the economy all through the 1920s and each year saw more farmers fail.²⁷ How familiar to Australians is this scenario over the 1980s and early 1990s. Farm leaders frequently accept publicly departure of farmers from the land "an inevitable result of most structural adjustment in agriculture is the departure from the industry of some farmers."²⁸ It is generally accepted that the rural sector in Australia in the early 1990s is characterised by rural poverty and indeed some industry sectors are recipients of food parcels from urban groups sympathetic to the plight of rural Australia.

The level of unemployed reaching over one million Australians unemployed (non-seasonally adjusted) with a further group of similar but unquantified magnitude in itself implies a serious maldistribution of income in Australia. Add to this the normal underprivileged groups of pensioners, single parents and the disabled, there is sufficient empirical evidence to argue that income maldistribution is a serious economic and social problem in Australia in the 1990s.

Whilst an expenditure switching policy stance can offer prospects for substantial economic recovery for the Australian domestic economy, it will create problems for income distribution. Under the neoclassical push for deregulation and free international trade the established institutional structure which distributed income in Australia was dismantled i.e. rural marketing boards, centralised wage fixing system, and industry assistance through the Tariff Board. The deregulators have not offered any alternative structure for income distribution except implicit belief in the principles of Theory of Marginal Productivity and the Law of Diminishing Returns operating in "competitive markets" and some vague references to low taxation rates augmented by transfer payments.

A most pressing question of economic significance for the labour market deregulators to answer is therefore: under labour market deregulation and enterprise bargaining, what happens to income distribution in Australia and what is its significance for economic

²⁷ Robert L. Heilbroner, *The Making of Economic Society*, 4th edition, Prentice Hall, 1972, p. 143.

²⁸ NFF, "New Horizons", *Rural Adjustment*, 1993, p. 122.

stability? They should not be allowed to hide behind the dogma of increased productivity assertions because that simply assumes infallibility of the Law of Diminishing Returns and Theory of Marginal Productivity in a world indicated by statistical analysis to be very different to their beloved general equilibrium theory.

Increased Government intervention in the domestic economy is the logical answer to the problem of income distribution through transfer payments, infrastructure expenditure in areas of hard core unemployment, and other "incentive" based assistance to industry. Increased Government expenditure would be possible given successful expenditure switching policies. The indicated expansion of GDP by approximately 23% would provide an additional tax revenue equal to 5.2% of GDP plus expenditure savings in social welfare payments to the unemployed.²⁹ The revenue gains in that year under successful expenditure switching boost to the economy would have been \$20b plus savings from unemployment expenditure. The Budget outcome would have been in substantial surplus as opposed to a deficit position of \$9.3b.

Policy developed upon sensible expenditure switching principles carries with it the promise of substantial gains to the Australian economy and its people. It is time that the "blinkered" ideological era of the 1980s was put behind the nation. We can no longer turn a blind eye to the development of a substantial group of people who represent a permanent underclass in society in which generational unemployment becomes its expected heritage. The recent electoral results from Canada and New Zealand indicate that other nations have had the courage to dismiss ideologically driven administrators classifying them as yesterday's people. The Australian people have no choice but to follow these examples.

29 Calculations from RBA Bulletin, August 1993, Tables E1 and G5.
 $\frac{\text{Total Tax Revenue}}{\text{GDP}} = 22.8\%$

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