SHANN MEMORIAL LECTURE

CHANGE IN THE AUSTRALIAN ECONOMY:
WHAT IT MEANS FOR AUSTRALIANS...
...AND WHAT IT MEANS FOR AUSTRALIAN ECONOMISTS

by

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THE SHANN MEMORIAL LECTURE – 5 SEPTEMBER 2002 

Dr Don Stammer 

As an undergraduate student in economics in the 1950s – the late 1950s, I should add – I was required to read several chapters from Edward Shann’s book An Economic History of Australia. In preparing tonight’s lecture I took the nostalgic trip of revisiting the chapters I had studied in my youth – and happily went on to read the whole book. The themes that come out relate to the practical application of economic theory in an economy experiencing change.

I am honoured to have been invited to deliver the Shann Lecture for 2002. In this evening’s lecture, I propose to focus on the theme of change. I will highlight some key changes in the Australian economy over the decades – almost five of them – during which I have been a student of economics and I will seek to draw out the implications of these changes for Australians and, more particularly, for Australian economists.

THE ECONOMY IS MUCH LARGER – AND WE ARE BETTER OFF 

The most obvious change in the Australian economy over my working life is the extent to which the Australian economy has expanded.

![Real GDP graph](chart.png)
A couple of details of this growth might also be of interest:

- Economists always talk about goods and services – but it is services that now dominate our spending. Australians spend more on services than on goods and over time, services will constitute an even larger part of the economy. And there is nothing wrong with that.
- Second, a favoured forecast from half a century ago – that most of us would take the large part of the benefits of economic growth in the form of increased leisure – has turned out to be largely incorrect. Many Australians chose to work long hours – indeed, in terms of hours worked, Australia is second only to South Korea among OECD counties.

My first chart was a reminder that, as a nation, our material standard of living is much higher than in earlier years: over the four decades shown on the graph, real GDP increased fourfold, while the population increased by about 60%. As a result, Australians can achieve a much higher level of material comfort than in earlier years and we enjoy greatly increased choice as to how we live our lives. And those benefits, in my view, are substantial.

Every few years, a fashion develops that is critical of economic growth – and is critical also of economists who see merit in economic growth. The alleged concerns, which will be familiar to this audience, include claims that: GDP is a misleading measure of our wellbeing; economic growth breeds materialism; growth destroys attractive features of existing life styles; growth brings or requires globalisation; growth costs the environment; and growth benefits just a few at the expense of the many.

These arguments can be – and have been - readily rebutted. Yes, economic growth involves costs and it creates and requires change. Certainly, benefits are not distributed equally. And, yes, there
is more to life than is currently included in official measures of gross domestic product. But growth also gives us many benefits – including better lifestyles, wider choices in how we live and a greater opportunity to address problems such as poverty and stress on the environment.

SOME DECADES HAVE BEEN BETTER THAN OTHERS

Growth in the Australian economy might have been impressive over the decades, but our economic performance has been uneven by decades.

Over much of the 1970s and 1980s, the Australian economy was a troubled economy. Inflation was high over both decades, growth was below potential and the economy was rocked by three severe recessions. The good news is that since the early 1990s, the Australian economy has returned to low inflation and stronger growth. Indeed, over the last dozen or so years, Australia has shared the top ranking for economic performance with Ireland and China – and think of the odds that trifecta would have attracted in 1990!

In my view, five factors are important in explaining the improved performance of the Australia economy since the early 1990s:

- **First**, monetary and fiscal policies have been better managed. The settings of these policies were dreadful over much of the 1970s and 1980s. The overall setting in economic policy was too easy. And monetary and fiscal policies were out of balance, with the budget deficit uncomfortably large – leading to a huge build up in the level of government debt outstanding - and monetary policy having to carry too much of the load of economic stabilisation.

- **Second**, monetary policy faced another problem over those years: it was overloaded. In my days as a central banker over the 1970s, monetary policy had seven or eight largely independent goals - price stability, full employment, a fixed exchange rate, the level of interest rates, the rate of increase in the money supply, the level of bank lending and allocation of credit across individual industries. When any one instrument of economic policy is trying to do so many things, it is inevitable that it will fail to deliver on what is most important. Since the early 1990s, monetary policy in Australia has been mainly directed at delivering and maintaining low inflation. And with the budget largely balanced or in surplus the load that monetary policy has to carry is much reduced.

I should add that monetary policy now has more powerful effects on the economy than in earlier years. Through the 1950s and 1960s, there was a great deal of pessimism about monetary policy. I recall being told as an undergraduate that changes in interest rates did not affect spending of business or households. Whatever the merits of those arguments in those days, there is no doubt of the potency of monetary policy in today’s Australia. Indeed, with the huge build up of variable rate debt in this country, even small changes in interest rates now have a big effect on cash flows of households and businesses in this country – monetary policy is awesomely powerful in Australia.
- Third, the sequence of government deficits over the 1970s and most of the 1980s did terrible things to the level of national saving in Australia. In my view, a country is like a company - it needs to build up its saving and its balance sheet in the good years if it is to cope with the crises, shocks and downturns that are inevitable from time to time. But under the influence of a generation of economists who, following the simplifications of Keynesian ideas, were too convinced of the ability of governments to maintain full employment through fine tuning their economies, governments came to run budget deficits year after year after year.

Indeed, my generation of undergraduate students in economists was encouraged to treat saving as "a leakage from the income flow". It was a natural further step for us to believe that saving was an undesirable form of economic behaviour. In turn, this intellectual climate contributed, I believe, to Australia's poor record in national saving.

Our national saving has recovered a little in recent years from its low point in the early 1990s – and this increase in saving is contributing to the strength and stability of the Australian economy. But I believe we need to increase national saving further if we are to achieve appropriate levels of capital formation in the public and private sectors and if we are to cut back on our heavy dependence on capital inflow.

- The fourth favourable influence on the economy has been the float of the Australian dollar. These days, when there is an international crisis – such as the recession that began in 1997 in our Asian trading partners – the main impact is felt on the Australian dollar. With the Australian dollar acting as a shock absorber at the time of an international crisis, less adjustment has to be felt on our economy or our interest rates.
- The fifth - and major - reason for the improved performance of the Australian economy lies in the series of economic reforms over the past twenty years which have made the economy more flexible and adaptable. I include such reforms as financial deregulation, national competition policy, the reductions in tariffs, the corporatisation and privatisation of many public utilities, the disciplines applied to government finances, and the progress made in moving away from the old rigid centralised control over wages and work practices. The economy is better able to cope with shocks and efficiency gains are impressive.

EFFICIENCY GAINS

The various structural reforms – each of which was much criticised at the time by vested interest groups and by many commentators - took time to have their desired effects. And they created pain on the way. One way of seeing the benefits from the structural reforms in the economy is to look at the recent performance of productivity growth.

<table>
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<tr>
<th>Labour Productivity</th>
<th>(non-farm output per hours worked)</th>
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<tr>
<td>Index</td>
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Australia's strong productivity performance over the 1990s is evident in my chart. And it has come, I believe more from the boost to what economists call X-efficiency rather than from the one-off or static benefits of resources being used in more efficient ways. In my years as a central banker and, even more, in my years in business, I have become convinced that the dynamic gains to efficiency from competition substantially exceed the static gains to efficiency from moving resources to their more efficient uses, though I would not wish to ignore or to decry these latter gains.
In turn, the gains to efficiency and the strong growth in productivity that accompany the improved efficiency have raised real incomes, contained inflation and improved our international competitiveness.

I should add that increases in productivity add to the economic pie – and thus must make someone better off. The benefits of higher productivity must be shared between one or some combination of the following groups:

- **employees** – through higher wages (or shorter hours of work);
- **consumers** (in Australia or overseas) – through prices being lower than otherwise they would have been;
- **shareholders** – through higher profits; and/or
- **governments** – via additional tax revenues.

The trick, of course, is that the additional benefits that flow from the efficiency gains must in total equal the increase in benefits created by the efficient gains, no more and no less. Too often in Australia's past, we wanted the benefits from efficiency gains to add up to much more than the total gains to be distributed. As economists, we still have a lot to learn in understanding how the slices of the increased economic pie are cut up and distributed. It seems, however, that the battle over income shares is less divisive and less destabilising than in the past, including over the formative years of the Australian economy written up by Professor Shann.

**THE SCOURGE OF INFLATION**

The 1970s and the 1980s were decades of high inflation, with price increases averaging more than eight per cent a year – or a debilitating three-fold increase in prices over twenty years.
In my view, the economic and social costs of that sustained period of high inflation were much greater than economists had expected. (In the early 1970s, one branch of economics had even suggested that the only costs of sustained inflation would be the “welfare losses” resulting from the distortion to the optimal holding of cash because no interest is paid on Holdings of banknotes and coins).

I would like to remind you of the costs Australia experienced from the rapid inflation of the 1970s and 1980s - in part to inform younger people, who have not experienced high inflation, of the damage it inflicts:

- Inflation contributes to a sense of unfairness - the belief that we are being ripped off.
- High inflation, by adding to uncertainty and by raising discount rates, reduces planning horizons and encourages short-termism.
- Rapid inflation creates all sorts of distortions to accounting standards and to the tax system - because accounting standards and the tax system both assume price stability.
- Inflation encourages excessive borrowing and speculation - and it discourages saving.
- Most importantly, high inflation promotes inefficiency. A market economy works because of the information that is contained in relative prices - and a market economy works best when people and businesses can clearly see changes in relative prices and respond to them. But an environment of high inflation makes it hard for people to determine whether the changes they see in relative prices reflect genuine shortages or abundances - or whether those changes in relative prices that are just a part of the leads and lags in the process of inflation. Inflation gums up the workings of relative prices.

My generation needs to pass on to the next generation an awareness of the evils of inflation and, in that way, contribute to Australia not again experiencing another bout of sustained inflation.

THERE IS STILL A CYCLE IN THE ECONOMY – BUT IT IS MILDERS

Over the last decade, the growth rate of the Australian economy has moved up a gear – and Australia is again a low inflation economy. But there is still a cycle in the economy, albeit milder than those experienced over the late nineteenth century, the inter-war period and the 1970s and 1980s. My next graph illustrates how the economic cycle in Australia has narrowed over the past two decades – in my view because of the better shape of monetary and fiscal policies, the structural changes that Australia has been through and the floating of the Australian dollar.
In turn, the milder cycle has reduced the commercial risks that face households and businesses. For instance, and as my next chart shows, the cyclical swings in interest rates are much more subdued than in earlier years. And the cycle in our share market is greatly damped—relative both to our past and to the recent experience of other countries. There was a time when I asked my students in Finance 101 to explain why Australia had the most volatile—or high beta—market of the major share markets around the world. That question would now have to be reworded as to why Australia has the least volatile share market of the major share markets.
But let us not claim we are in a new era in which the cycle in the economy has been abolished. Claims of a "new era" or "new paradigm" are made too often. Indeed the most frequently held conference in the history of economics is one under some variant of the title "Is the Business Cycle Obsolete?" The fact that economists keep asking the question answers the question.

Over my life time, the alleged demise of the business cycle has, successively, been attributed to each of: economic planning, Keynesian economics, money supply targeting, deregulation, and globalisation and technology. My experience is that when claims of an alleged new era are at their peak, a turn in the business cycle is usually close at hand. Think of the United States and the frequently-made claims over the late 1990s of a new era in which the economic cycle was no more! The business cycle lives on for one very simple reason – being human, we are all affected by the optimism or pessimism of other people:

- When the general mood is buoyant, we tend to spend more ... and we borrow ... and we invest without the caution that normally applies (recall, for instance the fashion in the United States during the dot.com boom to value companies on the basis of their share prices relative to the company's revenues rather than its profits or cash flows). Excessive optimism for a time feeds on itself.

- And when the mood of optimism – still worse, a mood of euphoria – finally collapses, it is the end of the world as we know it ... we spend too little ... and borrowings are repaid or written off ... and we don't invest even in quality assets that are selling too cheaply. For a time, pessimism feeds on itself.

Tonight’s audience of economists does not need to be reminded that the cycle lives on. But I make two predictions. One is that we will continue to see cycles that are mild relative to the exceptionally wide cycles that we experienced over the 1970s and 1980s. And, second, when Australia's next recession arrives – perhaps in six or seven years – it will catch many people by surprise. At that time, younger Australians will be excused for being caught unawares – after all, someone aged 30 in say 2009 would have been 11 when Australia last was in recession in 1990. But there is no excuse for older Australians being caught by surprise by the onset of the next recession. Older Australians have no excuse for forgetting that the cycle lives on – and that this means, from time to time, that we experience recession.
EMPLOYMENT AND UNEMPLOYMENT

My next slide illustrates changes in the unemployment rate in Australia over the last forty years. And this, I must say, is an informative graph in several ways.

![Graph showing the unemployment rate in Australia over the last forty years.](image)

The impact on unemployment from the recessions of 1961, 1974, 1981 and 1990 is easy to see. For many years and in many countries, recessions have affected unemployment in two ways. First, there was the immediate rise in unemployment caused by the slump in demand. Second, the unemployment rate would then remain at higher levels after the recession.

But in Australia, this latter experience seems to be changing. The rate of unemployment has not continued to ratchet up to permanently higher levels. In my view, this welcome reversal of the long sequence of step-wise increases in the unemployment rate reflects the series of moves to allow greater flexibility in the labour market – changes initiated by the Labor Government in the 1980s with the phasing out of centralised wage increases and the introduction of multi-skilling and changes which were carried a lot further by the Coalition Government.

It is also clear, I believe, that the dominant causes of unemployment in Australia have changed over time:

- Over much of the 1950s and 1960s, unemployment was mostly frictional except during and immediately after a recession when the main cause of unemployment was inadequate demand.
- In the 1970s, the substantial increases in unemployment mainly resulted from the sharp jump in labour costs associated with the unprecedented increase in real wages.
Over the last dozen or so years – a period when the economy has expanded by about 50% - three other influences have contributed to unemployment. One has the growing mismatch of skills – the reduced demand for unskilled workers while technology was changing rapidly. The second has been growing region imbalances at a time of rapid change. The third influence is the high effective rates of tax that now apply when people on unemployment benefits move on to paid work. Those effective marginal rates of tax are usually 70% and when costs of travelling to work are included, the effective rates of tax are even higher.

Even though the unemployment rate has fallen from eleven per cent to six per cent, we often hear the statement “unemployment is unacceptably high”. That is, I believe, a misleading set of words. Unemployment is high because we fail to accept the policies that would reduce it. As a former head of the Commonwealth Treasury said, in one of the two best one-liners yet expressed on the Australian economy, “we get the unemployment rate we choose”. (I’ll mention the other of the two aphorisms later).

The reduction in the unemployment rate over the past decade is impressive. But we need to go further. If Australia maintains and extends recent efforts to make labour markets more flexible, and if we can reduce the high effective rates of tax that people face when they go from social security to paid work, we could expect to see the unemployment rate fall below five per cent over the next couple of years. Indeed, we could see our unemployment rate fall below the unemployment rate in Japan, something that would have been unthinkable a decade or two ago. The message is, of course, that we are benefiting from implementing some of the necessary changes in our economy while Japan is paying a high price for its political paralysis and its unwillingness to deliver change.

POVERTY, INCOME AND WEALTH

As I said earlier, as a nation we are prosperous beyond the hopes and dreams of earlier generations. But it is often argued that Australia has done too little to achieve an equitable - or even a fair - distribution of the enlarged income and the wealth created by economic growth. These are difficult areas to summarise, but let me share the lessons from my experience.

First, it is nonsense to argue, as some welfare groups have done, that “nearly one in eight” Australians live in poverty and that poverty is becoming more widespread. In one recent study (by the Smith Family and the National Centre for Social and Economic Modelling), poverty was defined to include anyone receiving less than half of the average level of income. (The average level of income was taken to be the arithmetic mean level of income). Even though the real incomes of poor people increased over the 1990s – by an average of $38 a week according to this study – the poor were said to become worse off (as well as more numerous) because above average incomes had increased proportionately more rapidly than low incomes had risen.

But when the more appropriate definition of “relative poverty” is adopted – an income of less than half of the median income – the proportion of people living in poverty falls to one in twelve. And this figure hardly changed in the 1990s. The number of people living in relative poverty would be even smaller if assessments were based on levels of spending rather than income, or if
allowance were made for temporary misfortune or were allowance made for support such as Medicare. Absolute poverty is extremely rare in Australia today because of sustained economic growth and social security. Relative poverty is a problem but not on the scale that we are sometimes told.

In my view, discussions on poverty and the distributions of income and wealth need to take account of these major points:

- Increasingly, the major challenge is to assist families that have been trapped in poverty over several generations because of lack of one or more of education, work-skills and work ethic. There is no alternative to targeted assistance for these groups.

- The Federal Government spends $70 billion a year on social security – the equivalent of $17,500 a year for four million poor people. There are still too many opportunities for the Australian middle classes to receive social security benefits which ought to be directed only to the needy.

- Poor people face unreasonably high effective taxes – the combined effects of tax and of loss of social security benefits – when they take paid work. As I have mentioned earlier, the tax rates are often 70% and in some cases higher. There is, I believe, a lot to be said for a system of tax credits to reduce the worst features of the poverty trap that for some Australian families has become an inter-generational poverty and welfare trap.

EXTERNAL TRADE

Australia’s external trade is a topic that fascinated Professor Shann. He saw Australia as a great trading nation, but also one that experienced wide swings and occasional crises in its foreign trade. These were the results of volatility in the demand for our primary products shifted. His book contains a vivid account of the sharp changes in Australia’s trade experienced between the prosperity of the 1880s and the depression of the 1890s. And his final chapter on the costs that tariffs impose should have been compulsory reading for our federal politicians over the 1950s and 1960s as they trod the path of import quotas and high tariffs.

As was the case in Shann’s time, Australia still runs a deficit in the current account of the balance of payments - we regularly import more goods and services than we export. I suspect, though that the proximate causes of this deficit have changed:

- At times in our past, the current account deficit reflected our lack of competitiveness – costs of producing things in this country were high relative to those abroad.

- But today the main cause of the current account deficit is to be found in our poor saving record – that is, in the saving-investment imbalance. When a country saves less than it spends on capital investment, it has to draw on the savings of the rest of the world – and those savings are brought in from abroad to finance a transfer of real goods and services which of course constitutes the current account deficit. (Here is a challenge to a young economist: explain to your neighbour in non-technical language that amount by which our capital formation exceeds the amount we save is exactly and necessarily equal to the current account deficit).
But other than our continuing to run a current account deficit, Australia’s external trade has changed profoundly since Professor Shann’s days:

- A majority of our exports is now shipped to Asia, while the United States is the main supplier of our imports.
- Trade in services has grown rapidly.
- Exports of manufactures now make up more than a fifth of total exports. Exports of motor vehicles and their components now greatly exceed exports of wool.
- Thanks to the diversification of exports, our terms of trade are not as cyclical as they used to be. (It is a little known fact that because of the swings in prices of computer chips and IT products, Singapore now has a wider cycle in its terms of trade than Australia does).
- Over the 1950s to the 1980s, Australia’s external trade was very low as a share of the total economy – indeed, the ratios of exports and imports of goods and services were at levels that would have been seen as unthinkably low in Shann’s days. The reason, of course, is that Australia turned protectionist, imposing import quotas and then high tariffs on a wide range of imports. We deliberately reduced imports – and thus we inadvertently reduced exports - as proportions of the overall economy.
- As my chart shows, exports and imports have risen sharply as shares of the total economy over the last dozen or so years. Notice, particularly, the increase in both imports and exports over the early 1990s, following the then Government’s move – and a brave one as it was announced during a severe recession – to cut tariff protection.

| Exports & Imports of Goods & Services  
| (% of GDP) |
|---|---|
| % GDP | % GDP |
| 24 | -23.5 |
| 23 | -22.5 |
| 22 | -21.5 |
| 21 | -20.5 |
| 20 | -19.5 |
| 19 | -18.5 |
| 18 | -17.5 |
| 17 | -16.5 |
| 16 | -15.5 |
| 15 | -14.5 |

Let me elaborate on this last point. We have known for a long time – because it was in the standard textbooks - that while tariffs protect some import-competing industries they do so at the cost of exports. That is because tariffs add to costs and they keep the exchange rate higher than it would otherwise have been. And we always knew that tariffs disadvantage regions such as
would otherwise have been. And we always knew that tariffs disadvantage regions such as Western Australia which are export-oriented and which had to pay higher prices for goods manufactured from business located within the tariff wall in the eastern states.

Surprise! Surprise! As Australian tariffs have reduced, we have seen the following consequences:

- The Australian dollar has weakened – helping to make Australia more competitive on international markets. (It is important to note, too, that unlike earlier episodes of weakness in the Australian dollar, the recent declines in Australia’s exchange rate have not boosted inflation. This time, the improved competitiveness is lasting).

- Both imports and exports have increased more rapidly than the economy has grown. Our fellow Australians are, for obvious reasons, more aware of the increase in imports – but exports have grown rapidly since the major cuts in tariffs.

- Australia now exports goods such as motor vehicles which used to be a notoriously uncompetitive industry in this country.

- There has been particularly rapid growth in exports such as wine and ships that used not to feature in our export mix.

- States such as Western Australia, which were forced by the tariff to pay higher prices for a wide range of consumer goods and industrial products, have benefited.

**WHAT CHANGE MEANS FOR AUSTRALIANS...**

I like to describe myself as someone who has been around for 28.5% of Australia’s European settlement. That is a lot of years and a lot of change. It is now time now to bring out some implications.

Over the 1950s, 1960s and 1970s, Australia was not good at coping with change. More recently, we have become better at taking the necessary tough decisions and, indeed, we are currently managing change better than most countries. Therein lie important benefits – a higher material standard of living, a wider choice of lifestyles and a great ability to confront problems such as poverty.

But the structural adjustments that have helped us to adjust to and benefit from the processes of change do not come without pain. And it is abundantly clear that the benefits and the costs of adjusting to change are unevenly spread across the community. The important points are that we need to adjust to change; that there are benefits – particularly longer-term ones – from adjusting to change; that there is a larger economic pie from which to provide appropriate compensation and assistance to those adversely affected by change; and that part of that large economic pie should for a time be used to offer assistance to those disadvantaged.

The worst thing we could do as a nation is to display reform fatigue. Both major political parties, when in government, have undertaken some necessary and important reforms. For my money,
the boldest and most commendable moves by the Labor Government were the floating of the exchange rate in 1983 and the move to cut tariffs in 1991 and the boldest and most commendable moves by the Coalition Government were a tough budget in 1996 and the courage to oversee reform of Australia’s wharves.

I worry that the big political parties are beginning to lose enthusiasm for further reform. And I would not look to the small parties of either the left or the right to give either leadership or support to the processes of adjusting to change. Indeed, on economic policy matters, the small parties of the left and the right broadly agree on the one set of policies that would in my view hold back the necessary adjustments to change - and in the process leave us poorer.

As individual Australians, we also need to recognise what change means for us. As I have mentioned several times, we are on average more prosperous and have greater choice in what we do. There is now little absolute poverty. And change is reducing the disadvantages of Australia’s “tyranny of distance”. Of course there are adjustments to make. For example, there is no longer job security in the sense of a job for life. Instead, job security now means having the skills, flexibility and presentability to find another job when one is lost. But change – and our adjustment to it – also provides a level of income and wealth that enables us much greater choice in how we live and in what we do.

...AND WHAT CHANGE MEANS FOR AUSTRALIAN ECONOMISTS

For Australian economists, the processes of change also have interesting and profound consequences.

There was once a time when economics was seen as the dismal science. Economists were expected to be gloomy people, who told only of forthcoming gloom (perhaps because, like Malthus, they expected that population growth would inevitably outstrip food supplies) or to be always reminding others of the opportunity cost of doing anything (that is, if we used our resources in one way, we could not use those resources for something else).

But in the early postwar years, economics became the most glamorous of the social sciences. That was because economists were seen – by themselves and by the broader community – as having solved the problems of unemployment and the economic cycle. Alas, economists claimed too much. Unemployment rose over the 1970s and 1980s and the economic cycle widened - in large part because of the consequences of the economic policies that economists of that time had championed.

Economists of the 1940s to the 1980s claimed too much for discretionary monetary and fiscal policies. The main purpose of monetary policy should be – as it is today - to maintain price stability. And the main functions of fiscal policy should be to determine the split of total spending between government and private sectors to ensure that a good safety net is in place – and to contribute to national saving.
Economists will do well, too, to allow that, in normal circumstances, stable settings in monetary and fiscal policies contribute to stability in the overall economy. And economists must not forget the evil effects of inflation.

Economists can, I believe, take some satisfaction from the gains to national prosperity that have flowed, over time, from such major changes to the economic framework as the floating of the Australian dollar, the cuts in tariffs, competition policy, and the moves to a more flexible labour market. (I guess I am saying that microeconomics has more credit points than macroeconomics).

But more attention needs to be given to ways of reducing unemployment – by way of labour market reforms and changes to social security. And we need to give more effort to policies which compensate groups that are initially hurt by structural change. I also believe that we need a better understanding of how the benefits from gains in productivity are distributed across employees, consumers, shareholders and the government.

I should add that, over the years, the profession of economists – or is the collection noun an assumption of economists? – has itself changed. If I were an undergraduate student in economics today, I would be keen to combine accounting and finance skills with my study of economics. A good economist is someone who knows how to take account of the future – and in thinking about the future an understanding of net present value analysis/discounted cash flow analysis is essential.

My dominant worry about the economics profession it is that economists sometimes spend too much time in the cul-de-sacs of abstract theory and not enough of their time and energy going over the important fundamentals of the discipline. And what are those important fundamentals? From my experience, they are:

- relative prices are important – and we need an environment in which relative prices are responsive, are seen and can be responded to;

- inflation is costly;

- national saving is mostly a good thing;

- monetary and fiscal policies, while important, need to be implemented with a steady hand and do not provide ready-made solutions to the problems of unemployment;

- priorities are important, including in government spending on social security;

- and Australia cannot afford reform fatigue.

On this last-mentioned point, let me repeat a particularly apposite comment on the Australian economy. The Economist in the late 1980s observed that, if you look at history around the world, Australia has proven itself to be one of the great managers of adversity ... and the worst manager of prosperity. We've shown over more recent years a commendable capacity to manage prosperity. But complacency and hubris – as well as inflexibility in the face of necessary change – have at various times undone the good records of other economies, including Japan, Germany and the United States, over the past fifteen years. Those experiences contain lessons for the Australian community, and particularly the Australian economics profession.
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<td>Lee, M. Tcha, M.</td>
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