The Politics of Economic Change in Australia in the 1980s and 1990s

After-dinner address by Paul Kelly[1]

In December 1993 the Federal treasurer, John Dawkins, announced he was leaving politics after his budget received a tough public reception and a mauling in the Senate. At his farewell drinks, as described by journalist, Laura Tingle, Dawkins called himself a politician of the 1980s 'when you acted first and explained yourself later'. It was a melodramatic view. Yet Dawkins had a point. The power of the 1980s story gains fresh lustre from the progress of the 1990s and its contribution to this success.

The conference proceedings today were arduous so let me begin this address with the sort of grand simplifications appropriate for a journalist. The 1980s saw the globalisation of the Australian economy; the 1990s saw this globalisation being contested in a new political struggle between globalists and anti-globalists; and the coming decade will determine which side wins the ascendancy in this struggle. An assumption running through my comments is that political and economic cycles are just as likely to be in conflict as they are in harmony.

I want to put three main propositions in these remarks. First, that a series of unique events no longer in place, made possible the 1980s reforms and triggered a transformation in Australia's economy. Second, that the domestic keys to our 1990s success are because economic decision-makers managed to retain the best from the 1980s policy but also discard the worst. Third, that a new political framework to underwrite a more neo-liberal and open economy has not been constructed in the 1990s, leaving the prospect of an uncertain future for Australia's economy in a globalised world.

1. The Foundations of the 1980s Reforms

With the benefit of a decade's hindsight, what was that remarkable combination of factors that made possible the 1980s reforms? Let me try to identify what could be called the foundations of the 1980s reformism.

First, there was a fairly pervasive sense of national stagnation and decline symbolised by the early 1980s recession. Australia's annual average GDP growth during the Fraser era was 2 per cent – disappointing in terms of both our historical performance and international comparisons. Our high unemployment level, which hovered around 9 per cent in the recession, was seen as evidence of failure within the

1. I would like to thank those people with whom I spoke in preparing these remarks, none of whom are responsible for the content of the speech. There are two people I want to thank in particular, whose assistance and ideas I have drawn upon, HSBC Chief Economist, Dr John Edwards and Director of Access Economics, Dr Ed Shann.

economic system and a defect that had to be fixed. The notion that Australia had to engage in a global catch-up was a useful driver for new policy.

Second, there was a new Labor Government determined to bring a new approach. The Hawke-Keating Government was free from both party dogma which had ruined the Whitlam Government and the old-fashioned economic orthodoxy which had destroyed the Fraser Government. Hawke and Keating were not just interested in finding a new approach; they believed that a new approach was essential.

Third, there was a set of economic ideas waiting for Labor to seize upon. These ideas, which had currency in agencies such as the Treasury, the Reserve Bank and the Industries Assistance Commission, had won some support in Federal parliament and more in the quality media – freer trade, smaller government, deregulation of markets, lower tax rates within a fairer system, a more flexible labour market, low inflation, an attack on economic rent seekers and a more market-orientated economy. The components of this new direction evolved at different times for different reasons but it was increasingly seen, overall, as essential for Australia's adaptation to a more integrated global economy. These policies needed a fresh government prepared to defy vested economic interests. Such a government would win much support for its boldness.

These ideas came from the top down. The public wanted change – but it was not protesting in the streets for a floating dollar, free trade and low inflation. The intellectual momentum for the 1980s reforms was elite-driven.

Fourth, the Hawke and Keating Governments had a formal social contract with the trade union movement. The Accord represented a choice by the union movement to switch from an industrial to a political strategy; to give priority to an economic growth strategy with the ALP rather than to achieve a lift in the wages share by industrial might. The Accord conceded one of Treasury's own convictions – that wage restraint was central to job creation. For the Accord partners, wage restraint would make a credit squeeze unnecessary. It was an anti-inflation instrument to deliver a growth cycle and it achieved this purpose for most of the 1980s. It meant that the unions and the industrial left, potential critics of the market reforms of the Hawke and Keating Governments, had been converted instead into stakeholders in their policies. But it had other effects as well.

Fifth, the Accord meant Labor's reformism would be based upon gradualism and a search for consensus. The 1983 National Economic Summit was a remarkable and successful effort to engender a new chemistry. The unilateral nature of the float tended to disguise Labor's support for outcomes that were more negotiated than imposed. This was clearly reflected in its macroeconomic policy of fighting inflation and unemployment simultaneously.

There are many cynics about Hawke's consensus but my own judgement is that this wasn't an empty slogan, but reflected much of the policy formulation approach, though it was often a point of tension between Hawke and Keating given their temperamental differences. The float, by definition, was a 'big bang' reform yet Hawke-Keating reformism overall shunned the 'big bang' technique. The tax debate of 1985 and the incremental approach to labour market changes are classic proofs of search for consent in preference to ‘big bang’ reformism. This meant that reform was multi-faceted, that it didn’t depend on one ‘all or nothing’ policy and that the government had the political insurance of fighting with policies on a wide front.

Sixth, for the Hawke Government, social and economic equity was vital in the transition to economic liberalism. Equity was integral to the Accord, to Labor’s own constituency and as a tactic in selling a market-based economic agenda. But equity was vital in another sense – it was part of the reform agenda itself, an aim in its own right. That real wages were being cut in the cause of job creation only reinforced this element. Labor introduced a more targeted welfare system, an assets test on the pension, arbitrated superannuation, a family allowance supplement for poor families, a restoration of Medicare, a loan scheme for tertiary education and tax changes where lower marginal rates were traded-off against an extension of the direct tax base to include capital gains and fringe benefits. Research by Professor Ann Harding suggests that government policy in terms of the tax-transfer system during this period was highly effective in nullifying most of the income inequity arising from a more market-orientated economic system. The Hawke Government had to prove to its cabinet, caucus, factions and trade union partners that equity was a real concern. It was a function of the social contract.

Seven, John Howard is right to argue that in the 1980s the Opposition supported many of the Government’s reform directions. In fact, the Opposition often attacked the Government for not advancing further and faster. This was a remarkable and unusual advantage for a reforming government. For example, the Coalition supported financial deregulation, low tariffs, a broadly based indirect tax (most of the time) and microeconomic reform. It attacked the Government at various points for its failure to be bolder and for buckling before the vested interests on its own side, notably the trade unions who, via the Accord, had a unique access to decision-making. The Coalition criticised the Government for its failure to free-up the labour market, its reluctance to privatise more quickly and for too lax a fiscal policy. Far from complaining that Labor was engaged in rip and tear reformism – the classic 1990s oppositionist perspective – the Coalition’s typical claim was that Labor was too timid. This gave Hawke and Keating great political flexibility and the chance to occupy the middle ground. It also helped to entrench the reform policies.

Eight, the Government had only minor troubles in winning Senate support for its reform agenda despite the 1987 double dissolution over the Australia card. The Senate balance of power was held by the ALP and the Democrats. But Labor was able to prevail either because of Coalition support or by winning Democrat backing. The Senate never became a major threat to the reform agenda.

Nine, a more subjective and contentious judgement is that the Hawke Government was effective in putting and winning the intellectual case for new economic ideas and in selling the new economic direction as part of a national vision. These judgements are subjective but I would nominate the quality of political salesmanship as an element in the carriage of 1980s reformism. For a considerable time Treasurer Keating was highly successful in winning intellectual backing for his approach from the media, the markets and opinion-makers.

There are, no doubt, other underlying factors which I have overlooked but I suggest that these nine points capture most of the principal forces at work. After I wrote them down, however, I reached an interesting conclusion – that virtually none of them obtains in the 1990s. There are elements that flow from one decade to another but the core political qualities that distinguished the 1980s have been supplanted in the 1990s. These decades are very different in their political character.

For example, in the 1990s there is probably not an urgent sense of the need for national catch-up; after the cathartic 1990s recession there was, surprisingly, no new economic model; the ideas of the 1980s have been refined but they have clearly been retained. In the 1990s there is no formal social contract; equity is less important as a reform goal and, despite the rhetoric, does not seem to be a priority policy goal in its own right; the major government-sponsored change is a ‘big bang’ tax reform on which the life of the government depends rather than a more broadly based reformism; the Opposition has vigorously opposed much of the Government’s agenda; the Senate has been a far more significant obstacle than in the previous decade; and, finally, my own assessment is that John Howard has not won the intellectual case in the 1990s for economic liberalism and, in respect of some of his interventionist and more populist policies, he has weakened that case.

I would now like to make a tenth and final point about the 1980s, which is very much a judgement in retrospect. It is also self-evident – at the time the people didn’t comprehend the full consequences, positive and negative, of the reform agenda. This sense of public discovery hit home only in the 1990s.

2. The Impact of the 1990s Recession

For all its glories the 1980s ended in failure, a monetary policy failure – a deep recession provoked by interest rates of 18 per cent resulting in unemployment above 11 per cent. Once again, the character of the coming decade was forged by recession. This time the legacy of the recession was ambivalent, complex and apparent only in retrospect.

First, the reform policies of the 1980s were not lost or abandoned. Given the depth of the downturn this was remarkable. One reason is that the Labor Government surmounted its historic nemesis – facing a severe recession it didn’t fall apart like the Scullin Government or crumble with the initial recessionary impact as did the Whitlam Government. Taking a long view of Australian history, this is a significant event which has been underestimated. The 1990s Labor Government refused to repudiate its own past and Prime Minister Keating refused to apologise for the recession. The Prime Minister declined the invitation to reverse the protection reductions of the 1980s, despite pressure from senior ministers and the ACTU. Keating, therefore, was locked into a strange hybrid position as PM – he campaigned as the leader best able to lead the nation out of recession yet he refused to abandon his ownership claims on the 1980s reform structure. He went to the 1993 election as a counter-cyclical activist who upheld the 1980s status quo. Hardly a winning position.

The 1993 election is the pivotal point of the decade. The choice was quite stark. This is when the Australian people signalled their preferences. They rejected the position of 'big bang' reformism proposed by Dr John Hewson, former economics professor and former Reserve Bank official. Hewson saw the recession as the chance to win on a radical mandate and take the policies of the 1980s to a rapid conclusion. Hewson had declared: 'If we can't win with the GST then we don't deserve to govern'. An unconventional approach.

Hewson's rapid conclusion was called *Fightback!* – a GST, a major cut in the size of government, amendment of the *Reserve Bank Act* to strengthen independence and introduce a 0–2 per cent exclusive inflation objective, faster cuts in protection, a devolution of wage fixation to an enterprise level and large-scale privatisation. Hewson called his program 'a generational change in politics and attitudes'. It was truly courageous but very dogmatic. In the hands of a skilled practitioner it could have been marketed but Hewson was more economist than politician. It is important to note that Fightback was not geared to beating the recession; it was strictly a structural reform agenda to increase the speed of economic change. But Australians were not prepared to issue such a high-speed political licence.

The 1993 election was a vote against another bout of economic reform. It terminated this position in federal politics. It was a vote for economic progress to be coupled with more stability. It signalled a break from the 1980s. The GST was the issue but there were many messages – the people began to re-claim the economic agenda and to terminate the imposition of 'top-down' economic reformism. The election meant that any economic change in the 1990s would be contested and that gradualism would be the likely path.

The defeat of Hewson reflected other sentiments – that people were wary of elites purporting to have the answers and that public opinion might have turned against certain types of economic change.

There was another bigger message implicit in the 1993 result – that economics wasn't enough to sustain political success. In later years this would translate into the need to explain how economic reform would lead to a better society and a better life. The politician who best grasped this new mood was John Howard. After the 1993 election the Coalition marched back to the middle ground. The radical Dr Hewson surrendered to the safer Mr Howard. Howard re-invented his political persona for the 1990s just as Keating had earlier re-invented himself. Howard declared that leadership was about 'listening' to the people. He rejected a GST, accepted Medicare, became a 'greenie' with a strong pro-environment stance, pledged that nobody would have their wages cut in his IR reforms and boosted middle class welfare. Howard's 1996 election success was not based on any substantive economic reform agenda. Howard's proposals were very modest. After his 1996 defeat, Keating correctly said that Howard had won 'a big majority on a narrow mandate'.

While the recession had tamed political reformism it had also delivered a decisive policy plus – a low-inflation economy. It was monetary policy that caused the recession and it was monetary policy that was transformed by the recession. There were several steps in that story which unfolded within the Bank – the conclusion that monetary policy should target inflation not the balance of payments; that this should be done without legislative amendment; the announcement by Bernie Fraser in 1993 of the 2–3 per cent target; the gradual acceptance of the Bank's position by both sides of politics; and the formalisation of the policy in 1996. This meant that the RBA conducted monetary policy on an independent basis. It is a remarkable story in economic policy construction matched only by the success of the policy over the next seven years.

It meant the 1990s expansion was different from the 1980s expansion. It was based upon low inflation which offered the potential for greater longevity than the 1980s growth phase.

The monetary policy model devised within the Reserve Bank and embraced by the politicians was far more moderate than the option offered by Dr Hewson in 1993. It was the defeat of the Coalition in 1993 that allowed the present policy to evolve and to be accepted by a Coalition Government in 1996. It should be noted, however, that the model has not really been tested because the economic results have been satisfactory. The truth about this model is that it rests, not in law, but in a political compact.

It is a shared agreement between the politicians and the Bank. How did the RBA win its practical independence? Because it seized an opportunity and the politicians saw advantages in condoning such a system. Its permanence should not be assumed.

The second feature of the 1990s expansion was high productivity, a function of the 1980s pro-market reforms and the modest labour market changes introduced by the ALP and Coalition Governments, culminating in the formal acceptance of enterprise bargaining by the Accord partners and the extension of enterprise bargaining under Peter Reith. One of the deceptive issues for analysts is how much the shift to enterprise bargaining contributed to the 1990s productivity performance and how great the potential remains for further labour market deregulation to generate more productivity benefits. The outlook in year 2000 for more labour market reform was somewhat pessimistic because of ALP-Democrat resistance.

3. The Howard Government

I want to consider the Howard Government under four headings – economic strategy, tax policy, management of the anti-change backlash and salesmanship.

The primary economic strength of the Howard Government resides in the 1990s reappraisal of fiscal and monetary policy. In its first budget the Government put in place a fiscal consolidation with the aim of achieving an underlying balance on average over the economic cycle. The budget was returned to surplus in 1997/98. This set up the medium-term economic strategy – a fiscal policy to boost national savings and combat the current account deficit and a monetary policy to target inflation. This is a significant departure from the 1980s construct. As Treasury Secretary Ted Evans has explained, these approaches reinforce each other but 'a breakdown in the performance of one policy inevitably compromises the other'.

The Howard Government has also signalled the political limitations to fiscal consolidation – it does not intend to accumulate surpluses but to utilise them. The first drawdown from the projected surplus was devoted to the 1998 taxation package and the selling of the GST; the second drawdown will be announced next year in the context of the Coalition's 2001 re-election campaign. Australian politics has entered a new phase – the debate about how to spend the surpluses. The politicians enjoy this process very much. The economic question is whether this is premature given the size of the current account deficit and need for fiscal insurance against a future downturn. Significantly, the new 'surplus politics' seems to be enthusiastically bipartisan although the 2001 election will be the test of this.

Howard's economic reform agenda has been modest with one major exception – the tax package. How should this package be seen? I believe there are several answers to this question. I think it should be seen as representing the major commitment of Howard's career going back to his time as Treasurer. His initial submission for tax reform was defeated by the Fraser cabinet in early 1981. It has been a personal and career-long crusade.

Second, it should be seen as an objective deep within the psyche of the Liberal Party. Of the six elections between 1984 and 1998 the Liberals ran on major tax reform on four occasions; 1984, 1987, 1993 and 1998, with three of these four packages involving a new indirect tax and three of these four election platforms being dominated by the tax issue. When John Howard got into trouble in his first term he reached instinctively for his top drawer and another tax package.

Third, the design of Howard's package – notably the huge drawdown from the surplus to make nearly everybody a winner – reveals how the cost of reform has risen between the 1980s and 1990s. The political reality is that Howard felt that a 1980s type tax debate involving winners and losers was untenable; he felt that everybody (excluding the tax cheats) had to be made a winner and he tried to do this. Given Howard's narrow re-election in 1998 it is hard to argue with his assessment.

Fourth, although he won the 1998 election on tax, Howard was almost undone in the Senate. It was only the decision taken by new Democrats leader, Meg Lees, to strike a deal that saved Howard from the humiliation of not just losing his tax package but having his prime ministership seriously undermined.

Fifth, given this issue was always going to put the Government's survival on the line, the question is whether the economic benefit justified the political price. My colleague Alan Wood has argued that in Howard's first term there would have been a greater economic dividend from making IR reform, not tax, the central issue. That is, if you are going to risk survival then fight on the right grounds. But Howard had no interest in such a notion. Howard made it clear to Peter Reith at the time that he wanted a negotiated settlement on the Coalition's industrial reforms, not a double dissolution bill. He chose to make tax, not the labour market, the issue of his prime ministership. Why?

I believe the real answer to this question is that John Howard has never seen tax reform in narrow economic terms. He has always been interested both in its appeal as an election winner and in lower marginal rates for the middle class as an ideological re-positioning of Australian society.

The next feature I want to assess in Howard's approach, overall, is his effort to ameliorate the backlash against economic change and globalisation driven typically by the notion that its dividends have been unfairly distributed.

Howard has relied on three techniques here. First, keeping a social safety net in place for the underprivileged. He has declared the social safety net to be sacrosanct. Second, by vetoing or limiting a range of economic reforms in the cause of championing the 'battler', for example, quarantining competition policy, preventing bank mergers, freezing protection cuts in manufacturing industry, seeking tax and industrial reforms in which there are 'no losers', pledging special deals for groups of displaced workers such as at National Textiles, cutting immigration and giving the program a sharper focus. Howard's initial instinct to appease the One Nation party reflected a populist strand within his political character and a political calculation. Third, Howard has retained key elements of the Labor social policy orthodoxy – Medicare being the prime example.

My interpretation of Howard's real position on equity is that he accepts that a market economy means there will be a greater spread of income and a greater concentration of wealth and that the key to sustaining support for this outcome is a combination of a firm social safety net and a more aspirational political culture. While Howard stresses fairness in his rhetoric many of his policies, notably his tax cuts, are pitched towards rewarding and encouraging middle-class effort and achievement. The Prime Minister, using the cover of egalitarian rhetoric, seems to be moving Australia's political culture more towards the aspirational end of the spectrum to complement the market-based economy.

My final point about Howard is implicit in this analysis. It relates to the realm of ideas and it is highly subjective – that Howard has not sold the intellectual case for economic liberalism and that support for this philosophy has waned during his prime ministership.

4. The Future

Let me offer some speculations about the future.

First, both sides of Australian politics, having been involved in the introduction of economic liberalism, now have a stake in its future. Australia seems to have struck a bipartisan deal across the two major parties on the open economy.

This is the message repeatedly conveyed by Opposition Leader, Kim Beazley, in his recent speeches: 'We all now largely agree on the "old" agenda: the need for fiscal discipline, an independent monetary policy, deregulation of financial markets, the floating of the dollar, low inflation and a more open economy'.

It would be easy and a mistake to take such assurances for granted. In fact, this is a very substantial cross-party agreement. It is noteworthy that Beazley opposes the decision of the trade union movement to shift from a free to a fair trade position. The bipartisanship does not extend to all institutions in our political life with much of the media and the trade unions strongly critical of the open economy. This puts very real pressure on the political class.

Second, there remains, however, an intense party conflict over the microeconomic reform agenda. This has plagued the Howard Government, it will continue into the future, and its resolution can be expected to influence Australia's economic performance. There will be a litany of issues, small and large, the sale of Telstra, competition policy, reform of major utilities, transport, telecommunications and media policy. The most important area devoid of consensus remains the labour market. The best chance for worthwhile labour market reform is under a Coalition Government. But this has been undermined by the Senate, by falling unemployment (which removes the pressure for further action) and by public fear that a more flexible system might only intensify job insecurity. It is hard to see how these roadblocks will be surmounted. It needs a change of heart by the Senate, or a successful double dissolution on industrial reform, or a downturn to act as a circuit-breaker – and none of these looks imminent. The likely future is for a 'muddle through' scenario on industrial reform. It is hard to see what other option is available for Peter Reith. If the Howard Government cannot make further progress the likely judgement will be that the nation missed a chance to capture another wave of productivity gains.

There are two important tests here. Can the trade unions engineer a reversal from enterprise to industry bargaining? Probably not. And, to what extent would a new ALP Government try to re-regulate the industrial system? This would represent a new and retrograde step. The answer is not clear – though Kim Beazley intends to strengthen the IRC, bolster the legal position of the trade unions, undermine workplace agreements and negate much of the secondary boycott law. Enterprise bargaining would be retained. The message, overall, is that Australia's gradual reform of the labour market is likely to remain gradual at best or be partially reversed at worst. The current declared intention of the Clark Government in New Zealand to re-regulate the labour market is relevant here.

The issue today is not radical versus gradual change; it is gradual change against drift.

Third, a great dilemma for the future is that the new economic model is seen to have delivered more prosperity and greater inequality. How will this conundrum be resolved in the political system? Can it be modified or will this tension prove to be too great? I have argued strongly elsewhere that economic and social policy need to be better integrated in order to sustain electoral support for market-based economics.

But the evidence from the late 1990s is that the test humans apply to determine their happiness is not whether they are better-off but how they compare with others. Relativities, not absolutes, are what counts in a period when everyone is prospering. This reflects a facet of human nature and it is a warning sign. *The Australian*'s recent Newspoll recorded an overwhelming preference 70 to 28 per cent for reducing inequality by lowering economic growth. I think that most people would not want to see their own standards lowered. But the point remains – our political culture displays signs of deep hostility towards the current economic model on distribution of benefit grounds. This is concerning when the tax-transfer system, according to Ann Harding's analysis, actually worked well for the period from the early 1980s to the mid 1990s. What happens when it doesn't work well?

There is a literature in the US about the consequences of these new divisions – it is about not just an underclass but an overclass. What happens to a society when its decision-makers live a totally separate existence to the majority typified by protected suburbs, private transport, private schools, private health cover, domestic staff, unlimited travel, exclusive networks and inter-generational wealth transfers? It is a new feudalism.

In a deregulated economy, the old Australian equity mechanisms of protection, centralised wage fixation and supply-side controls don't apply any more. Access to health and education will be crucial for equity. But new policy responses will be needed to give people a sense of ownership in their new economic system. That is what the emerging literature about stakeholding is all about.

The basic issue here is what do people mean by the term equity? Do they mean more equal outcomes and denying incentive to achievers? Do they merely mean equality of opportunity? Do they oppose a society with a firm social safety net that rewards merit and work? Are they seeking a return to government intervention unaware that it was government intervention in the name of equity that failed Australia before? Does the ALP suffer the misapprehension that a responsible macro-policy and a freeze on micro-reform can ever work?

Fourth, there are powerful limits to the future of economic reform. The first obvious limit arises from the completion of much of the agenda – the float, free trade, and deregulation. The macroeconomy can only be opened to the world once. But there are also limits which arise from within Australia's political system.

No future government is likely to control the Senate under our current arrangements. That means the balance of power will rest with minor parties or independents. There is a fair chance these groups will represent anti-globalisation agendas which span both the right and left of politics. The Senate may emerge with a new historic role: the parliamentary check on globalisation. The Senate was designed explicitly to defend special interests (those of the smaller states) and that design can be utilised to protect vested interests against deregulation, competition and globalisation.

There is evidence that the public is keen to have a strong house of review. This is the persuasive interpretation from the striking Senate vote at the 1998 election. The Howard Coalition which won the election polled only 37.7 per cent in the Senate, the Coalition's worst result ever. It suggests a deliberate choice by many voters to ensure a different political balance in the Senate.

The limits to economic reform are also generated by the scientific poll-driven approach to decisions. The scientific method helps politicians to win votes but doesn't help good policy. Polling is used to identify, target and exploit groups resistant to change. It creates more timid politicians and lifts the hurdle for reformers. The effect can be insidious: the creation of new but phoney poll-driven policy options. I agree that polls can help reformers but they are typically used to exploit the downside of change. The polls are linked to a deeper change in recent political culture – the victory of tactics over strategy. This is seen more clearly in political reporting which is now overwhelming about tactics. It is not unusual to see a major issue reported from Canberra totally in terms of tactics without any reference to whether it is good or bad policy.

There are other subtle but influential forces that limit reform which warrant mention. One is the culture of prosperity. The longer the 1990s expansion has run the more support for economic reform has declined. This relationship, unfortunately, is an inverse one. I believe that John Howard and Kim Beazley have both put far more emphasis than is necessary on winning votes via the downside of globalisation. Of course, the story is not all bad and the comparison with New Zealand is useful here. New Zealand has now retreated into political gridlock, so shocked by the scope of its economic reforms that it changed its political system, embraced a new voting system and guaranteed weak coalition governments as far into the future as anybody can see.

It seems to me, however, that support for economic liberalism is eroding at both the intellectual and moral level. The media is far more sceptical than it was in the 1980s, the climate of opinion within the universities is hostile, the churches are critical and the artistic community is antagonistic. Both the left and right wings of the political spectrum have turned against economic reform such that the best way to envisage our political spectrum is as a straight line that has been bent and turned into a circle where both arms are resisting the centre.

I know that vision is not a popular word with Liberal politicians but vision is essential in explaining how the liberal economy is beneficial. Jeff Kennett, an aggressive reformer, was often applauded yet the final judgement upon him will probably be that he failed to persuade.

If there was one book I would have liked John Howard to have read it is Michael Novak's *The Spirit of Democratic Capitalism*, the moral case for capitalism and the market economy. This idea is virtually non-existent in our political culture and discourse. The notion that there is a moral case for a market economy sounds like a joke in this country. And this is the problem. There are signs of a new anti-globalisation momentum resting upon the premise that it has a moral authority. There are some developing country leaders now angry at the rise of so-called 'fair' trade – being pushed in the streets of the first world by disaffected rich kids – the effect of which is to keep the poor in their place and ensure that they stay poor. Yet this hypocrisy now parades as morality in sections of our society. I suspect there is much support in Australia for the view that a market-based economy is a necessary evil and not a net social gain.

The natural question people now ask is: how does a more efficient economy benefit my life and our society. To misquote Bill Clinton from the 1992 campaign, 'It's the society, stupid'. The Newspoll I reported earlier showed that only 31 per cent of people think that life is getting better. Now, this is not just an economic question, particularly if you're getting a divorce or your kids are taking drugs. The point though, is that once a degree of prosperity is achieved, quality of life becomes decoupled from economic growth. The task for economic reformers is to explain how their policies will lead to a better society, not just a better economy. If they can't, they will lose the struggle.

My fifth point about the future is more optimistic. It concerns the forces that will keep driving economic reform. This lies in the irresistible self-reinforcing nature of the reforms. Each change has a ripple effect in the economy promoting even more change. This has been the story ever since the float. The supply-side consequence of low inflation operates on each firm. It means that business is forced to focus on costs, productivity and supply-side efficiencies – it can't just jack up prices to hold profit. This suggests that, providing the political system can avoid any formal retreat, the economic model has its own momentum for change.

This is sound as far as it goes – but the political system needs to do more than just avoid a retreat. It needs to keep moving forward. The chief ground for optimism here is that politicians have an overwhelming interest in an economy that works, that generates activity, investment, growth and jobs. This is the best guarantee there is that, while the reform pendulum will move back and forwards, over the long haul the politicians will stick with the job of economic change. The liberal economy will have support while it delivers and while it appears to be the best way. That will also be the best way for politicians to win elections.

Sixth, a future dilemma is how far the neo-liberal economy takes government out of the equation. There is no danger of this happening yet but it is a question for the future. How many policy levers are left? There was a time 20 years ago when treasurers could adjust the exchange rate, shift protection levels, manipulate interest rates, change fiscal policy to control demand and influence the Full Bench on wage outcomes. What can they do now? I vividly remember Treasurer Keating's deep pre-occupation with the levers of economic policy, a word rarely used these days.

This reflects the transfer of power from the Treasury to the Reserve Bank. It is explicit in the inflation-targeting policy and implicit in a medium-term fiscal policy with balance over the cycle. The surrender of policy arms to the market or independent institutions such as the Reserve Bank is the great feature of the current economic model. It also represents in the transition from the 1980s to the 1990s a shift to a supply-side strategy from a demand-side strategy.

It is important to remember, however, that it is only governments that have democratic legitimacy and that governments live or die according to their economic results. The issue is whether a contradiction will emerge between the market-based economic model and the expectations invested in elected governments. The Australian economic model at year 2000 is an impressive instrument during a growth cycle. But how will it handle substantial economic fluctuations that demand a response from government? When an embattled future treasurer asks 'what can I do?' an answer will need to be found to the question.

Seventh, it is imperative in every sense that the current growth cycle run as long as possible. The great test will be the unpredictable impact of the next recession. The danger is that it will mobilise the pervasive backlash against globalisation and the open economy into a more formidable political force. If every recession creates a new political momentum from the ashes of its failure, then what will be the legacy of the next recession? This question cannot be answered but the substantial gulf between the elites and the majority of the community on the merits of the current economic model constitute a warning sign. Our integration into the global economy has a long way to run and so does the potential for its political rejection.

Eighth and last, an unanswered question is how well has Australia really done and whether or not we have misjudged our strength. This requires distinguishing between our own efforts and our good fortune. Our economy is chained to the US economy via financial markets. We have gained from US growth, good management by the US Federal Reserve, the US sharemarket and our local depreciation. This is not to argue that Australia's own efforts have not been important. Our success during the Asian financial crisis has been a turning point. But a potentially bigger test is what happens to Australia when it is exposed to some new external shocks. What happens when the US downturn finally arrives? What happens if Chairman Greenspan makes a mistake? Or if the multilateral trade system gets into serious trouble? Or if we face a serious regional crisis that runs for years?

The immediate issue is whether the Coalition's re-election strategy which involves a further rundown of the surplus is consistent with external pressures on Australia such as a slowdown in US growth. I suspect that at the end of the 1990s our leaders suffer a touch of hubris and our public a sense of complacency. The single greatest lesson today is that the margin for error is reduced – the consequences for a nation of economic mistakes are greater than ever (witness Asia) just as the benefits from getting the economy right are greater.