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# INEQUALITY, INVESTMENT AND TRADE: THE FAILURE OF SUPPLY SIDE MARKET LIBERALISM

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A major restructuring of advanced capitalist political economies has been underway since the 1970s, particularly in the Anglo-Saxon world. The overall aim has been to overturn earlier models of economic development so as to create a new economic order more compatible with business market freedom and profitability and more in tune with the need for 'competitiveness'. At one level this has involved repudiating the post-war 'Fordist' developmental trajectory that championed redistribution and full employment through instruments such as Keynesian policies and the growth of the welfare state (Lipietz 1992). As J.K. Galbraith (1980) has argued, there has been a 'revolt of the rich' aimed at re-balancing the political and economic scales put out of alignment by the extraordinary conditions of the post-war era of full employment, labour movement empowerment, state expansion and reduced inequality (see Cox 1987; Bell 1996).

Neoliberal polices have figured prominently in the 'revolt'. Notwithstanding certain national variations, writers such as Gourevitch (1986) are broadly correct to point to a pattern of neoliberal policy convergence across the advanced capitalist world, especially in the Anglo-Saxon economies. This has involved financial deregulation, an associated shift away from Keynesianism towards neoliberal policies of 'sound finance' aimed at low inflation and external balance, as well as a new microeconomic emphasis on deregulation and market-led restructuring. Neoliberalism has also promoted a widespread pattern of redistribution of national income from wages to profits; a project aimed

at reversing the distributional outcomes attained under post-war Fordism and one designed, in part, to rekindle what, by the 1970s, had become a clear pattern of flagging business investment.

Deflation is a key instrument in the neoliberal approach to distributional politics. It was used in Australia by the Fraser government to try to weaken the bargaining power of labour and to strengthen the hand of business in distributional struggles. The political and industrial divisiveness of this approach, however, saw the post-1983 Labor government install an alternative corporatist approach to distributional politics under the auspices of the Accord (Stilwell 1986). For the labour movement, Accord-style corporatism offered the possibility of avoiding deflation and high unemployment by instead adopting a growth-oriented strategy in which inflation would be checked through negotiated regulation of aggregate wage outcomes. The Accord also offered various side-payments to buy union cooperation (eg. 'social wage' improvements, superannuation provisions). As it turned out, however, (and despite a brief expansionary phase in 1983-84) the broad thrust of macroeconomic policy since the mid-1980s has been deflationary (mainly because of worsening current account problems and also because of 'sound finance' concerns about inflation)(Bell 1996: chapter 8). Under Labor, the worst effects of deflation, as well as the upward redistribution of market income under the Accord, were offset to a large extent by social wage increases and transfer payments. However, these were funded largely by public asset sales and by running down public sector investment. As Dywer and Larkin (1996) point out, such attempts to counterbalance market outcomes are fiscally unsustainable. The new Coalition government, seemingly hell bent on public sector retrenchment, has less interest than Labor in such non-market compensation.

Critically, however, Labor's corporatist approach to distributional politics was not complemented by the development of any significant capacity for supply-side planning. In particular, and despite a commitment to a comprehensive industry policy in the 1983 Accord agreement, Labor's industry policy remained ad hoc and half-baked (Bell 1991). A few industry plans were developed in cot-case sectors such as steel, automobiles and textiles, clothing and footwear, but overall Labor's

approach reflected the kind of supply-side liberalism that had been apparent under the Fraser government. A central aspect of this approach is the lack of any form of public accountability on the part of business in relation to investment responses. Under Labor, for example, it was expected (hoped) that re-investment on the back of Accord-based redistribution would help improve Australia's trade performance (by boosting exports and/or import competing industries) and thus ease Australia's chronic current account constraint on growth and employment creation. Yet, underlining the structural weakness of labour and government relative to capital, there were no firm commitments or guarantees from capital. Capital's structural position allowed it to remain unaccountable, to stand aloof from the Accord negotiating process and yet gain substantial benefits (Bell 1992). It is this aspect of the wider neoliberal agenda, namely, the idea that appropriate investment responses will occur under a regime of supply-side market liberalism, that is the focus of critical attention in this paper. Evidently, this kind of crude supply-side policy is set to continue under the new Coalition government. It is timely to ask whether such a policy 'works', even by its own restricted economic standards. More precisely, has the post-1970s shift in national income towards business delivered the goods in terms of improved investment and trade performance?

This paper reviews the evidence and the dismal facts are these:

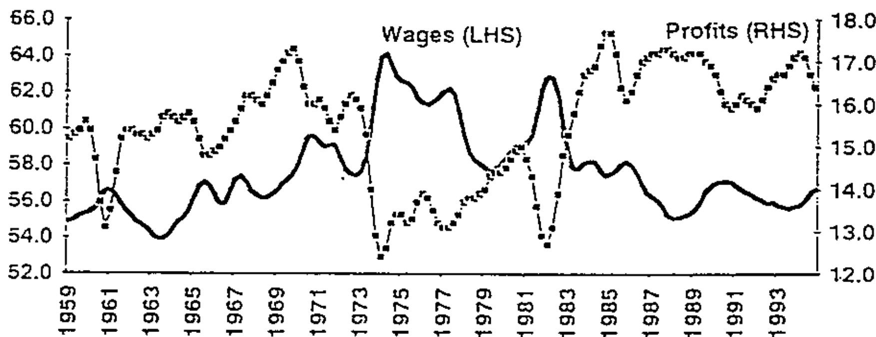
- Profits have been rebuilt at the expense of wage levels and rising economic inequality.
- The expected pay-off in terms of higher investment has not materialised. Overall, private sector investment levels have deteriorated whilst there has been an even more drastic fall-off in public sector investment.
- On the trade front, rapid export growth of manufactures since the late 1980s has been outweighed by a wider pattern of lacklustre trade performance, particularly in terms of the high level of imports flooding into Australia.
- After more than a decade of 'restructuring' aimed at reducing the nation's dependence on low value-added exports, overall trade performance has slipped to a point where Australia is now *more*

dependent on commodities and low value-added exports than it was at the start of the exercise.

## Business Incentives

In many respects, the distribution of income and wealth reflects the distribution of economic and political power. As indicated above, in Australia and in other western countries in the last two decades, wealth holders and powerful business interests have demanded higher returns and an increased share of national income in order to boost 'business confidence' as an incentive for re-investment. As Figure 1 indicates, wage and profit movements since the mid-1970s show a sharp reversal of earlier post-war trends. Between 1974 and 1994 real wages as a share of national income fell by 12 percent whilst profit's share rose by 40 percent. In the last decade executive salaries have also soared (Wynhausen 1995; Eccleston 1995), much to the chagrin of the wage restrained union movement.

**Figure 1: Wages and Profits Share of GDP at Factor Cost (%), 1959-95**




Source: ABS Cat. No. 5206.0

The boosting of profit shares and executive salaries (combined with reductions in top marginal and company tax rates) has meant that the rich have done very well in the last decade or so. On the other hand, high

unemployment has proved to be a persistent problem. Other labour market changes have thinned middle income ranks and generated increasing levels of casual and part-time employment, as well as increasing the share of jobs at the lower end of the income range (Raskell 1993; Gregory 1992; King, Rimmer and Rimmer 1992; Harding 1994; EPAC 1995). Indeed, Gregory (1993) shows that of 1,379,000 jobs created between 1976 and 1990 in Australia, 983,000 (or 71%) were in the lowest income quintile. The overall result of such changes is not only an increasing polarisation of market incomes, but a substantial rise in the share of income going to the highest income earners. These trends in market income have been occurring since at least the mid-1970s. As Table 1 shows, the highest twenty percent of market income recipients increased their income share from 34.2 percent in 1975 to 37.2 percent in 1990, whilst the bottom 20 percent of earners dropped in income share from 8.2 percent to 5.9 percent over the same period.

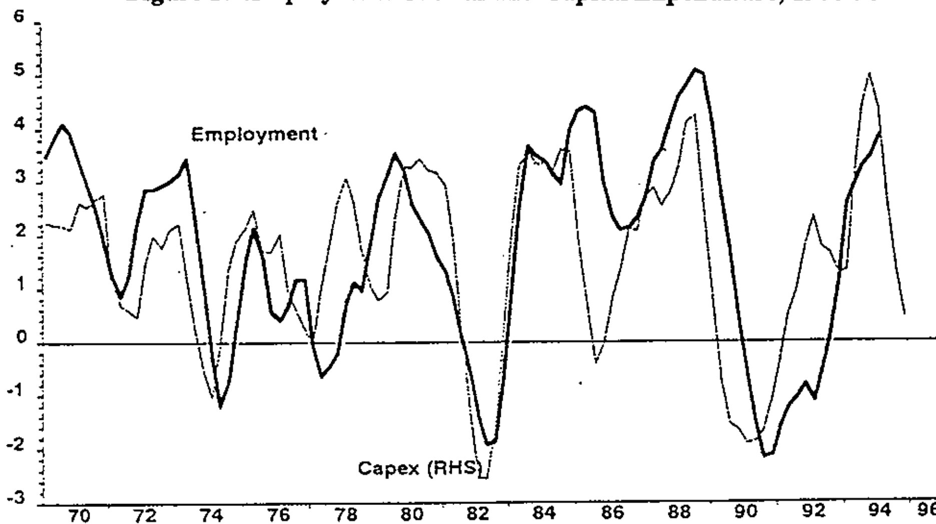
**Table 1: Distribution of Market Income*, 1975-90**

| | All Employees | |
|---|---|---|
| **Year** | **Highest Decile** | **Lowest Decile** |
| 1975 | 34.2 | 8.2 |
| 1979 | 35.4 | 7.7 |
| 1983 | 36.4 | 6.9 |
| 1986 | 36.2 | 6.6 |
| 1990 | 37.3 | 5.9 |

Source: Raskall (1993:41), *excludes non-cash fringe benefits.

The key question is whether these changes in the distribution of income flow through into higher levels of productive investment. That is the neoliberal promise - that the social costs of increased inequality are a necessary condition for achieving improved national economic performance. As Figure 2 shows, the capacity of an economy to generate employment growth is closely linked to investment dynamics.

**Figure 2: Employment Growth and Capital Expenditure, 1970-96**




Source: Datastream

## Investment Dynamics

Examination of the Australian evidence shows that the implicit bargain described above - redistribution towards business in return for reinvestment - has failed to deliver on the promise. The pattern of investment in Australia, both in terms of level and composition, has fallen far short of what is required to effectively revive and restructure the economy.

A brief historical synopsis of the key investment dynamics in the last two decades runs as follows.

First, after a slump in the 1970s, there was a short-lived resources-led investment surge in the early 1980s. Following this, the Accord generated labour movement expectations that wage moderation would lead to reinvestment. This failed to materialise and the lack of an investment response soon constituted a running sore in the politics of the Accord. Reflecting its frustration, the ACTU commissioned a study in

1986 which examined the determinants of investment and which reported that the investment environment, particularly in the wake of financial deregulation, had become less conducive to productive investment and more conducive to financial and speculative placements (National Institute of Economic and Industry Research 1986). For its part, the government also found business's investment behaviour during this period a source of considerable frustration. As former Prime Minister Keating put it:

> In 1983 they [business] said - if you restore competitiveness we'll invest. So we did that. We floated the dollar: 'Oh well, if you get the size of the public sector down we will invest'. So we did that. 'Ah, if you fix the factor shares between profits and wages then we'll get the thing going'. So we did that. And now they're saying: 'Oh, if you get the waterfront and the ports done we'll get going'. I mean a lot of these people wouldn't get going in a barrel of yeast (quoted in Tingle 1994: 237).

Finally, however, a major investment boom occurred in the late 1980s. Keating quickly changed his tone and argued the investment boom would produce a 'massive modernisation of industry' and an eventual turnaround in Australia's trade imbalances (quoted in Dusevic 1989). This proved wildly optimistic. One problem was that the investment which did occur within key areas such as manufacturing was mostly devoted to cost-cutting and to the replacement of worn-out or obsolete plant and equipment following the run-down of the 1970s and early 1980s. Significantly, little expansion of capacity occurred; the growth of capital stock was sluggish, well below the strong capacity expansion of the 1950s and 1960s (Budget Paper No. 1: 1995: 2-38). As one commentator was moved to admit at the tail end of the investment surge in 1989, the fruits of the investment boom may prove to be as 'elusive' as the much hoped for resources boom of the early 1980s: 'the investment has been reactive rather than proactive, a catch-up process not a quantum leap forward' (Hawtrey, quoted in Dusevic 1989a).

By the early 1990s the boom collapsed into the worst recession since the 1930s. Business investment fell to its lowest level relative to GDP since World War II (Clark 1995). Since 1993, there has been some rebuilding of investment but, overall, the investment pattern over the last two

decades has been decidedly 'stop-go' in character. In aggregate, there has been a substantial and alarming fall-off in the trend level of investment. As Table 2 shows, this has occurred in both the private and public sectors, whilst Figure 3 indicates that Australia's investment performance has deteriorated more than the OECD average. It should also be noted that, contrary to neoliberal orthodoxy, there is a strong positive relationship between public sector investment and private sector productivity, profits and investment (Aschauer (1989; Munnell 1992; Easterly and Rebelo 1994). Aschauer's (1989) work in the US, for example, has argued that zealous public sector deficit reduction programs are likely to undermine private investment. He also estimates that 40 per cent of the fall since 1975 in private sector productivity is directly attributable to the declining stock of public capital.

**Table 2: Gross Fixed Capital Expenditure as a % of GDP.**

| | Public | Private | Total |
|---|---|---|---|
| 1960's | 8.2 | 17.4 | 25.6 |
| 1970's | 7.7 | 16.8 | 24.5 |
| 1980's | 6.8 | 17.6 | 24.4 |
| 1990's | 5.0 | 16.0 | 21.0 |
| **Decline** | **39.0** | **8.0** | **18.0** |

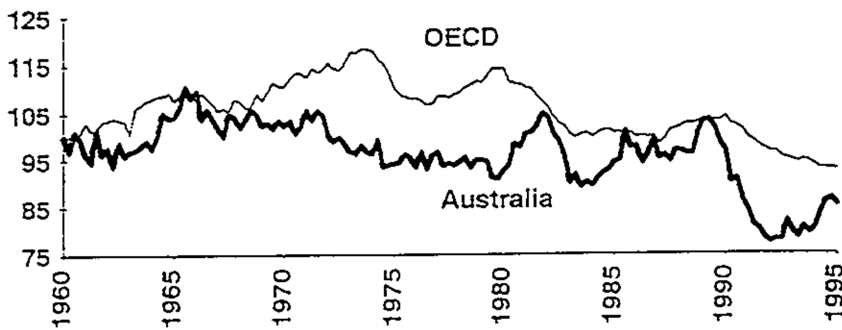
Source: ABS Cat. No. 5206.0

The fall-off in domestic investment has been exacerbated by an off-shore exodus of Australian investors. Total non-official off-shore investment increased thirteen-fold between 1985-86 and 1992-93, amounting to an annual growth rate of 44.4 percent (Mitchell 1994: 23). Moreover, as Figure 4 indicates, Australian superannuation funds have also been active in moving investment out of Australia, with off-shore placements now reaching almost $30 billion.

Beyond the fall-off in the aggregate levels of investment there are also problems with the composition of investment. One problem, as Figure 5 indicates, is the trend decline in plant and equipment investment as a proportion of total private investment (see also Toner 1988). Such trends are serious because equipment investment and innovation are

critical to economic restructuring; they are a key source of productivity growth and competitiveness.

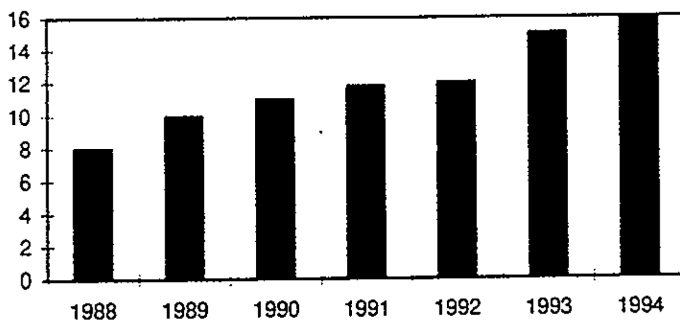
**Figure 3: Capital Expenditure as a % of GDP Indexed to 1960: Australia v. OECD**




Source: Datastream

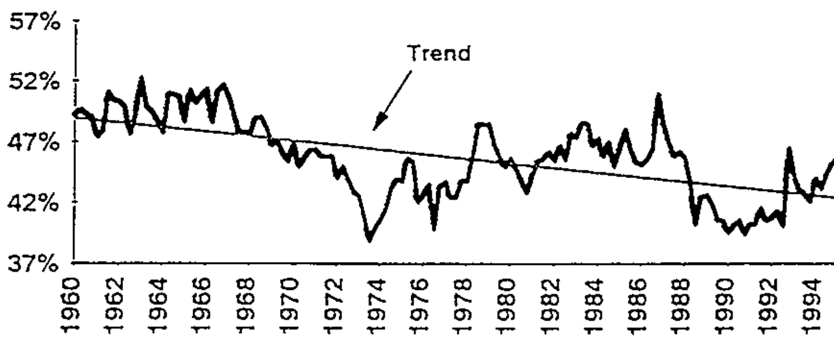
**Figure 4: Proportion of Superannuation Assets Invested Offshore**

**Figure 4: Proportion of Superannuation Fund Assets Invested Offshore (%)**




Source: ABS Cat. No. 5656.0

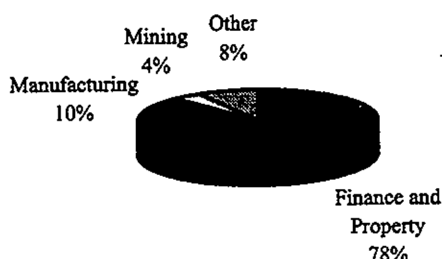
**Figure 5: Private Equipment Investment as % of Total private Capital Expenditure, 1960-94**




Source: ABS Cat. No. 5206.0

The sectoral composition of investment has also been problematic. Reserve Bank researchers have pointed to a substantial skewing of investment towards the financial sector (particularly in the investment boom of the 1980s)(Kent and Scott 1991). This has been reinforced by the pattern of foreign investment which has moved away from earlier pattens of 'productive' investment in manufacturing industry and mining in favour of financial placements. In the period from 1983-84 to 1987-88, 34.5 percent of foreign investment was in finance and property, yet in the period 1987-88 to 1992-93, this figure climbed rapidly to almost 80 percent (see Figure 6)

**Figure 6: Components of Foreign Investment in Australia, 1987-93**




Source: ABS Cat. No. 5306.0

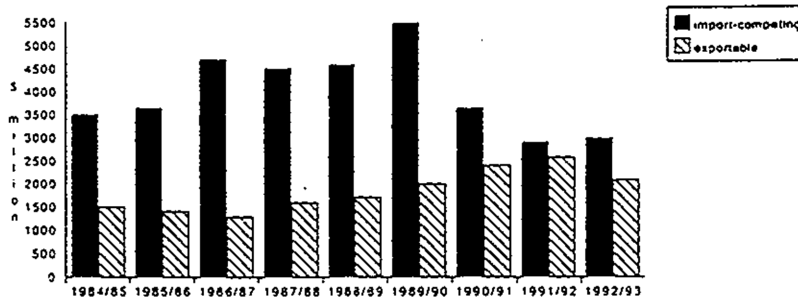
Overall, then, Australia has a major investment problem on its hands. This is also reflected in Australia's declining productivity performance. In the period 1960-73, labour productivity growth averaged 3.4 per cent per annum, but this fell to 2.3 percent in the years 1973-79 and has dropped again to an annual average of only 1.2 percent between 1979-93 (OECD 1995). As Mitchell (1994: 24) writes, 'despite an unprecedented redistribution of national income from wages to profits, a favourable exchange rate, and a compliant union movement, the private sector refused to channel the increased profits into productive investment'.

To restructure the economy and to make any inroads into Australia's unemployment problem, the level of investment will need to be lifted substantially. Sicklen (1994) estimates that aggregate investment will need to increase to 25 percent of GDP to make much impact on unemployment, a task that will entail an historically unprecedented level of re-investment. At present, the signs are that this will not happen. Indeed, the investment growth associated with the current economic recovery has now peaked, with (late 1995) capital expenditure levels unable to take the investment/GDP ratio above 21.9 percent, a level from which it now receding. The economic forecaster BIS-Shrapnel also points to investment weakness as a major reason why the recovery of late 1994 and 1995 is likely to be short-lived as it bumps up against supply-side and capacity constraints. More broadly, BIS-Shrapnel argues that

investment weakness is likely to see Australia unable to escape from chronic balance of payments and debt problems which will continue to derail economic growth into a series of short-term boom-bust cycles (BIS-Shrapnel 1995)

The only bright spot amidst Australia's overall investment slide has been a modest shift in the sectoral composition of investment towards traded goods, and, in particular, towards exportable industries. Consistent with policy trends to internationalise the economy, the share of total investment in traded goods industries increased from 34 to 37 percent of GDP between 1984-85 and 1992-93 (Dwyer and Groeger 1994: 13). The share of investment going to exportable industries (both as a whole and within manufacturing) also rose somewhat (see Figures 7 and 8). The darker side of these developments, however, is that investment in import competing industries has declined since 1989-90. These investment trends are consistent with the overall pattern of manufactures trade over the last decade or so: namely an improvement in exports but a fall-off in import-competing capacity. These matters are considered further below.

**Figure 7: Levels of Real Investment in Exportable and Import Competing Manufacturing Industries, 1984/85 - 1992/93**




Source: Dwyer and Groeger (1994).

**Figure 8: Levels of Real Investment in Exportable and Import Competing Industries, 1984/85 - 1992/93**

Source: Dwyer and Groeger (1994)

## Trade Dynamics

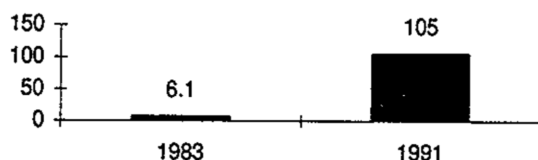
A litmus test of restructuring the Australian economy is the development of high value-added industries and exports, particularly in areas such as elaborately transformed manufactures (ETMs). On this score, the improvement in manufactured exports during the late 1980s and early 1990s was a source for some optimism, particularly for policy makers keen to vindicate neoliberal policies of free trade and market-led restructuring on the supply-side. ETM exports, in particular, grew rapidly and this helped alter Australia's export profile. In 1985, for example, ETM and other manufactures accounted for 20 percent of total commodity exports. By 1993, this position had improved to a point where ETM and other manufactures accounted for almost 30 percent of total commodity exports (Sheehan et al. 1994: 108). Moreover, the ratio of exports to imports slowly improved for both ETMs and manufactures as a whole. Thus, in 1986, ETM exports were running at just 15 percent of total ETM trade but by 1993 exports had moved up to 30 percent. For manufacturing as a whole, exports were running at about 20 percent of total manufacturers trade whilst, by 1993, exports had moved up to about 35 percent. These shifts in export/import ratios appear encouraging but the sheer size of the imports numbers compared with exports means that the relative growth rates of the late 1980s would need to be maintained for several decades in order for the ratio to bring any marked improvement in net trade outcomes. As shown below, this is not happening. Moreover, the manufacturing trade deficit as a proportion of

manufacturing output continues on its relentless trend deterioration and by late 1995 had reached a record 63.3 percent of manufacturing GDP.

Thus, while manufactured exports have expanded, manufactured imports have expanded even more. The growth of manufactured imports have swamped any improvement in manufactured exports, as Figure 9 indicates.

This trend towards a deteriorating trade balance in manufactures is consistent with the above-noted fall-off in investment in import competing industries. It is also reflected in the rising import propensity of the Australian economy (Figure 10), as well as in the tendency for cyclical recoveries to generate more serious current account problems than previously (McCrann 1995). Indeed, as Figure 11 indicates, the economy now seems much more prone to run into current account problems as growth picks up, indicating a progressive tightening of the current account constraint.

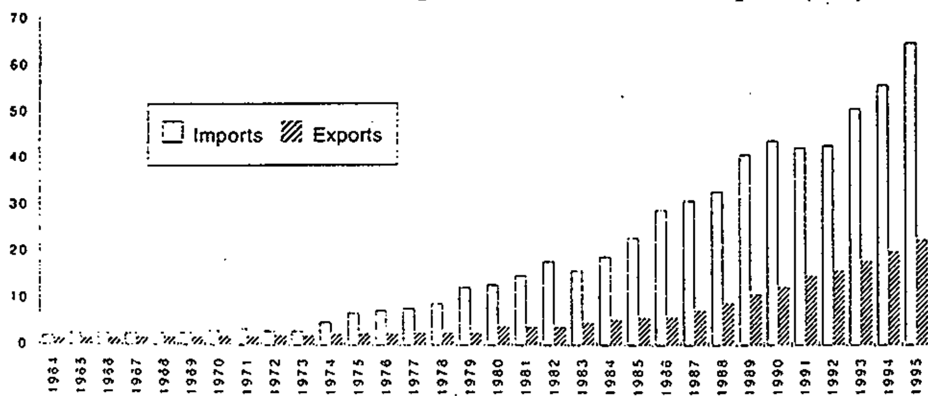
**Figure 11: Increase in Current Account Deficit (% GDP), 1983 and 1991**




Source: ABS 5302.0

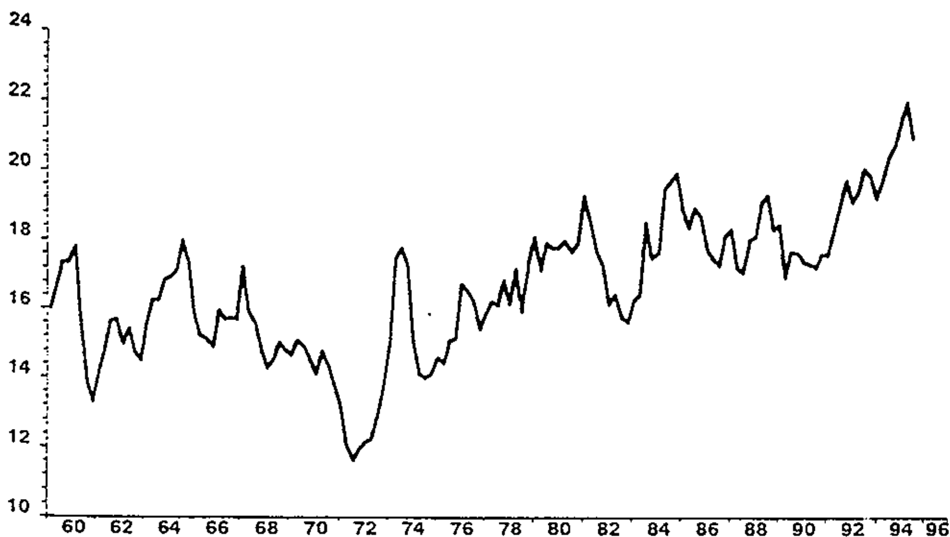
A key issue, then, is that Australia's manufacturing sector seems particularly vulnerable on the import front. Manufactures import penetration increased by 47 percent between 1970 and 1989, a figure 24 percent higher than the OECD average. Many imports no longer compete with any form of local production. Moreover, on the ETM front, despite the improvement in exports, the ETM trade deficit increased from $20 billion in 1985 to almost $37 billion in 1994, as Figure 12 shows.

**Figure 9: Manufactured Imports and Manufactured Exports ($Bn)**



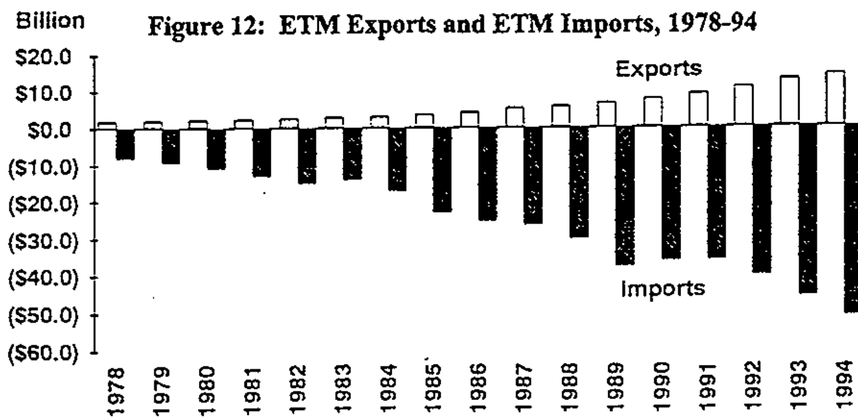

Source: unpublished ABS data.

**Figure 10: Australian Imports as % of GDP**



Source: Datastream

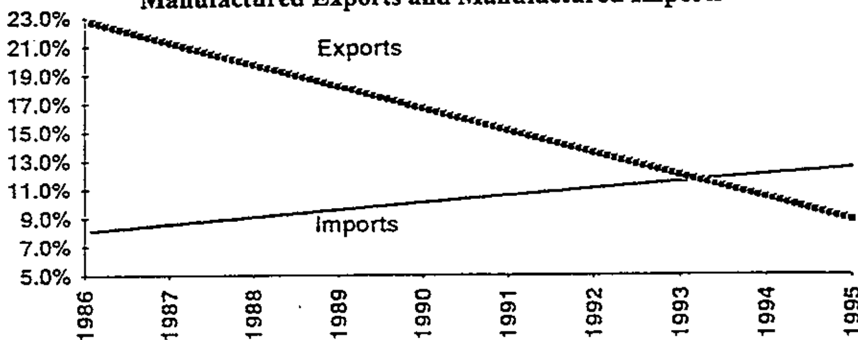
Figure 12: ETM Exports and ETM Imports, 1978-94




Source: Unpublished DFAT data.

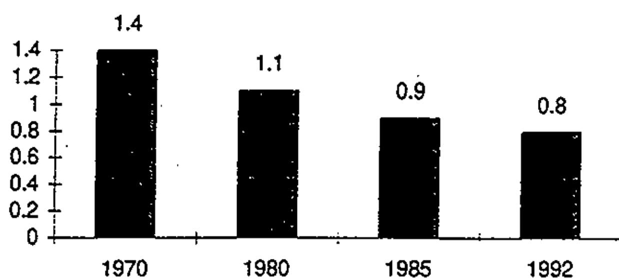
The trade imbalance would be less worrying if the capital goods component of imports were to provide a basis for rebuilding the economy. However, the recent surge of imports on the back of domestic recovery contains a level of capital goods no higher than that of the late 1980s (Ellis 1995). It is also true, as Figure 13 indicates, that the rate of growth of total manufactures exports is tailing off and is now exceeded by the rate of import growth. Australia's presence in international manufactures export markets is also clearly declining, as indicated in Figure 14.

Figure 13: Last 10 Years Trend in Annual Growth Rates: Manufactured Exports and Manufactured Imports




Source: Unpublished ABS data.

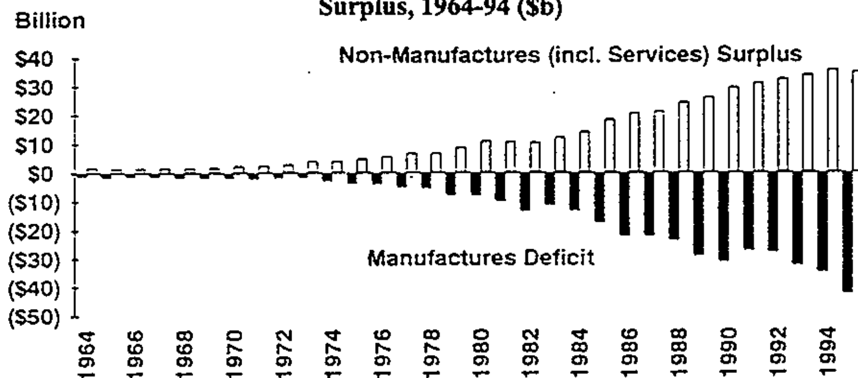
**Figure 14: Australia's Share of Total OECD Manufactured Exports, 1970-92 (%)**




Source: OECD 1994.

Beyond all this, it is apparent from Figure 15 that the manufactures trade deficit is largely being off-set by a non-manufactures trade surplus. This means that Australia is actually becoming *more*, not less, dependent on non-manufactured, largely low value-added exports. This is a trend hardly consistent with economic restructuring (Sicklen 1995).

**Figure 15: Manufactures Trade Deficit and Non-Manufactures Surplus, 1964-94 ($b)**




Source: Unpublished ABS data and ABS Cat. No. 5302.0.

## Conclusion

Australia's balance of payments constraint is a major factor limiting economic growth and employment opportunities. Accordingly, one of the fundamental tasks of economic policy must be to effectively restructure the economy and boost productive investment so that chronic balance of payments problems can be overcome. Although a wide range of factors shape economic outcomes, it is nevertheless clear that Australian government attempts to use supply-side policies premised on a redistribution of income towards business and upper income earners to stimulate investment have failed. This applies to deflationary policies used to help business in distributional contests and, more pointedly, to the continuance of supply-side liberalism under the Accord from 1983 to 1996. This paper has shown that the key assumption embedded in Australian economic policy is misplaced: the assumption being that market incentives (or indeed the incentives engineered under the Accord) will rebuild the economy by stimulating appropriate investment forms. Clearly, a fundamental policy rethink is required. The starting point must be the recognition that incentives for productive investment must be actively and consciously managed, not left to the vagaries of the market.

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