

Comparing Australian Macroeconomic Management: Labor versus Coalition

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Abstract

This paper attempts to assess the relative performance of the Australian Labor Party (ALP) and the Coalition governments in their management of the Australian macroeconomy. Given the problem of defining an appropriate counterfactual, we make comparisons using a number of different methods. Firstly we compare the averages of the key macroeconomic variables for the period of each government and then compare changes over the tenure of each government. Secondly, we use the method of 'difference in differences'; that is, we compare the performance of the Australian economy with the US economy. This allows us to control for any features of the world economy that may be driving all the economies. A crude comparison suggests that the Labor party performed better on inflation and the real rate of interest while the Coalition performed better on growth and unemployment. However, there is no clear cut answer.

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1. Introduction

An interesting question that we should like to answer is whether a particular political party is better at managing the Australian economy. This is important for economists and political scientists, but perhaps more importantly for the voters who are deciding on which party to vote for in the General Elections. For example in the last Federal elections the Coalition attacked the Labor Party for mismanaging the economy, in particular for leading to high interest rates, high unemployment, and budget deficits. This paper is an attempt to see whether we can use data to provide some light on this issue. To anticipate our conclusions we find that since it is difficult to know how the economy would have behaved if certain policies had *not* been introduced, it is difficult to provide clear-cut answers. In studying economic history there is always the problem of deciding the counterfactual: how would the economy have behaved if a different set of policies or events had occurred.

The Australian economy has seen an unprecedented period of uninterrupted growth since 1992, surviving the Asian crisis of 1997, the stock market collapse of 1999, and the war in Iraq. Some politicians and journalists argue that this surprising good run for the Australian economy is a result of the skilful economic policies of the Coalition Government elected in 1996 after a long period under Labor (1983-1996). The ALP won government in March 1983 with the election of Bob Hawke's Government and continued in power with a new leader, Prime Minister Paul Keating, until March 1996. The Coalition Government won back power in March 1996 under Prime Minister John Howard who has been re-elected three times since then, most recently in October 2004. This paper attempts to assess the relative performance of the Australian Labor Party (ALP) and the Coalition governments in their management of the Australian macroeconomy.

The paper examines the behaviour of the major macroeconomic variables; growth rate of gross domestic product (GDP), unemployment rate, inflation, real rate of interest, and the current account deficit. It is common in macroeconomics to focus on the economy in terms of inflation, unemployment, and the growth rate of GDP as objectives/targets of economic policy. Different authors and politicians place different weights on these objectives. Generally we would expect a conservative economist or politician to assign a larger weight to inflation and a relatively low weight to unemployment. Central Banks, generally run by conservative governors, typically consider inflation as a serious evil that must be vanquished at almost any cost, although most estimates of the costs of inflation put them at less than half a percentage point of GDP, while the costs of

unemployment are usually estimated to be higher than five percentage points of GDP (Junankar and Kapuscinski 1992). The focus on GDP as an indicator of welfare has been questioned by several authors (Hamilton 2003). However, most economists would prefer an economy that was growing more rather than less rapidly. Typically, these economists do not put a negative value on pollution or a positive value (a cost) on the loss of natural resources.

The focus on current account deficits as a cost to society has been questioned by economists such as Max Corden (1991), John Pitchford (1990), and by British politician Nigel Lawson in the 1980s. However, there is a view that large current account deficits lead to increased interest rates ('contamination effect') and hence a distortion of saving and investment decisions. In the earlier period of our study the Reserve Bank of Australia (RBA) and the Government often changed policy variables if the current account deficits became too large, as they were concerned about a run on the Australian dollar. In some cases they raised interest rates in an attempt to slow down the economy to improve the current account deficits – Paul Keating's 'recession we had to have'. [Michael Keating (2004) in a recent book provides an interesting account of the policy debates during the Labor Government.]

In recent times, governments seem to have accepted the Corden-Pitchford arguments that the current account deficit should not be a target of economic policy, (see below). Although macroeconomists do not think of the rate of interest as a target but simply as an instrument of policy, the real rate of interest is the resultant of the nominal interest rate (an instrument) and the inflation rate (a target). Since, in the 2004 Australian federal election, much emphasis was placed on the high interest rates that would result if the ALP were to be elected (and hence the higher mortgage repayments that would follow), we have decided to study the behaviour of this macroeconomic variable. As such the interest rate and the current account deficit should therefore be viewed differently from inflation, unemployment and growth rates in the discussion below.

Although important, we are not studying the impact on income distribution or equity of policies to tackle inflation, unemployment or growth. Typically, policies used to tackle inflation are high interest rates, high taxes and low government expenditure, all of which raise unemployment, usually affecting lower paid workers and increasing inequality. Policies for stimulating growth often have adverse short-term consequences for lower paid workers (structural adjustment) and hence may also lead to increased inequality. Labour market deregulation frequently weakens the power of trade unions, again with increased inequality the likely result.

2. Method

Before we provide some criteria for assessing the relative performance of the two parties in managing the economy, we discuss the possible role that a government may have in influencing the performance of an economy. In general a government has three main instruments – fiscal policy, monetary policy and international policy – that it can use to influence the goals of economic policy – mainly growth, employment and inflation. Fiscal policy includes changing tax levels or structures and government expenditures on capital or consumption goods and various welfare payments. Monetary policy once targeted the money supply, but that has now been superseded by interest rate manipulation. International policies are aimed at foreign investment, tariffs, import quotas and quarantine regulations. Finally, a government can, merely by its existence, affect that intangible called ‘confidence’ without making any changes to its policy instruments; that is, consumers or producers may believe that a particular government is going to be better at managing the economy. Or it may influence confidence by ‘open mouth operations’, simply talking up the economy (Blanchard and Sheen 2004).

There are competing views about whether government policy can influence the behaviour of the real economy (e.g. real GDP, employment and unemployment). Keynesians (such as the late James Tobin) believe that government counter-cyclical policies can stabilise the macroeconomy (although there are difficulties due to lags between policy changes and their impact on the economy). New Classical economists (for example Robert E. Lucas and Thomas Sargent) believe that government policy has no impact on the real economy unless the policies are unanticipated. They theorise that people have ‘rational expectations’ and therefore correctly anticipate government policy, thus rendering governments impotent. Most macroeconomists are likely to fall somewhere between these two positions. A neoclassical middle view is that a government can influence the economy in the short run but cannot affect the ‘natural rate’ of (un)employment or the ‘natural rate’ of output (GDP) (Blanchard and Sheen 2004). In neoclassical or New Classical models, the inflation rate is a monetary phenomenon influenced by the rate of growth of the money supply that is determined by the RBA.

In the long run, instruments of government policy could include changes to the industrial relations system, to competition policy and in the provision of education (investment in human capital), improvements in research and development, and reforms to health and safety in the workplace. Changes in any of these areas are likely to have an impact on the economy in the

longer run, perhaps in decades rather than years. Hence, given the delayed nature of the impacts of such policies it is difficult to link any benefits to a particular policy change or to the particular government that introduced the change.

One of the major difficulties in making a comparison between the impacts of different governments on the macroeconomy is that we do not really know how the economy would have behaved in the absence of the changes in policy. To put it in the terms that economists use, we do not have an obvious 'counterfactual'.¹ Ideally what we require is to 're-run' history and replace the ALP Government with the Coalition Government in the period 1983-1996 and the Coalition Government with the ALP from 1996 to date. Obviously that is not feasible. If we had an econometric model of the economy that was accepted as a good representation of reality, we could carry out notional experiments by modelling policies that Coalition or Labor governments had introduced and comparing the outcomes as alternatives. However, this simulation method would rely on good econometric models that are only approximations to the way the real world actually works. Alternatively, we could estimate a model of the macroeconomy (either as a set of interdependent equations, or equation by equation) and test to see if there were a structural break after a change in government. Most extant models of the macroeconomy do not allow for political business cycles.

This paper examines the actual outcomes of the macroeconomic variables under the two governments and tries to make any necessary adjustments to 'control' for 'interfering' effects. However, any comparison that we make has to allow for the fact that the Australian economy is a very small player in the world of giants like the US, Japan and the European Union. With increasing globalisation (associated with increased speculative capital flows),² any changes in these large economies have a significant impact on the Australian economy. Australia is like a small yacht tossed around by the wash of large ships. In recent years the dramatic growth rates of the Chinese economy have provided a massive stimulus to both the world economy and, in particular, to the Australian economy. But globalisation has made it more difficult for the government of a small open economy like Australia's to determine its own economic fate. The several links we have with the world economy via free movements of capital, flexible exchange rates, international trade, world treaty obligations (e.g. GATT and its successor, the WTO), all contribute to Australian governments losing control over the economy.

To return to the issue of comparisons of management between the two different governments, we have to make assumptions about how the

economy would have behaved had there been no policy changes introduced by either government. So, what is the counterfactual? The procedure we follow here is to assume that the Australian economy would have followed a path similar to some of the OECD economies. In particular, we use the method of 'difference in differences' (Heckman *et al.* 1999, pp. 1894 ff.), that is, we compare the performance of the Australian and US economies. Hence, if the Australian economy did relatively better than the US economy during the term of office of (say) the ALP compared to the Coalition period, then we could argue that the policies of the ALP led to the superior performance.

In this paper we follow two alternative procedures (both of them have their own limitations). *Firstly*, we compare the averages of the key macroeconomic variables for the period of the ALP Government with the period of the Coalition Government. We also compare *changes* occurring in the period when the new government took office in 1996 until it is either replaced or the current period ends. *Secondly*, we compare the performance of the Australian economy with that of the US over the period of the Labor and Coalition governments.³ This allows us to control for any features of the world economy that may be driving all the economies. In the penultimate section of this paper we will discuss some of the limitations of these methods but if they all provide a similar answer, then we believe that there is a stronger case to be made for supporting that conclusion.

Before we provide empirical evidence on the relative success of one government compared to the other, we should remember that since the Coalition Government came into power it has essentially argued that the RBA should be given the task of managing the economy with interest rate policies and the Government should abstain from using fiscal demand management to stabilise the economy.⁴ In other words, if the evidence suggests that the Australian economy performed better under the Coalition Government, then the implication is that the Coalition policy of taking its hands off the economic tiller and letting the RBA manage interest rates is a better policy. However, this means that the RBA should receive the prize, not the Coalition Government!

In making comparisons between the performance of the Labor and Coalition governments, we need to remember the international context. The Labor Government came into power in 1983 when most of the major economies were coming out of a recession. Then, in the early nineties, the OECD economies were hit by another recession. Some commentators have emphasised Keating's oft-quoted statement, 'the recession we had to have', as if the ALP were responsible for that recession. We need to note that even the US economy was going into a recession at about the

same time: Keating may have been a powerful prime minister but even he could not create a recession in the US. In other words, changes in the behaviour of the Australian economy may be due to favourable or unfavourable international movements rather than to good or bad policy management by the government.

Another problem in making comparisons between the performance of the ALP and Coalition governments is that any policy introduced by a government usually takes between six and 12 months before it affects the economy (e.g. the inflation rate, the unemployment rate, the current account deficit). More importantly, the effects of policies introduced by a government to increase competitiveness (for example by creating the Australian Competition and Consumer Commission [ACCC], by lowering tariffs or by industrial relations reforms) would not be immediate; it would be some time before improvements in growth would show up in the data. Similarly, policies to increase government investment in education, research and development would require several years before improving the growth rate of the economy. These lags between the introduction of new policies and their impact on the economy suggest that we should be cautious about correlating changes in growth with changes in the policies introduced by a particular government. This also applies to comparisons of inflation rates, current account deficits and unemployment, although the lags are probably not as long as they are for economic growth.

To summarise, we need to answer the following questions:

- Is there a significant difference in the behaviour of the macroeconomy between the two periods?
- If there are significant differences, were they due to the policies introduced by the two governments or rather to world-wide factors?
- Which government, the ALP or the Coalition, did the better job of managing the economy?

3. Background

When the Labor Government came to power in March 1983, the economy was in a depressed state with an unemployment rate of 9.9 per cent and a growth rate of -2.7 per cent. Inflation had been running at high levels and stood at 11.4 per cent (IMF 2004a). The economy was hit by another world recession in the early nineties with unemployment peaking in December 1992 at 10.8 per cent. However, when the Coalition Government took power in March of 1996, the economy was coming out of a recession with unemployment rates declining to 7.9 per cent and a growth rate of five per cent increasing after the recession of the early nineties. Inflation

when the Coalition took office was a modest 2.2 per cent. Similarly, the world economy in 1983 was recovering from a recession while in 1996 the world economy had been through an unprecedented period of prosperity. Finally, the Coalition Government has been in charge of the economy when the terms of trade have been improving continuously (IMF 2004a).

Given these 'initial conditions' we would expect to see that most macroeconomic variables would be 'worse' for the Labor Government compared to the prosperous times of the Coalition Government.

Although this is not the place to detail the policies introduced by the ALP and Coalition governments, it is possible to explore the major differences. The ALP Government made significant changes when it deregulated the financial markets, floated the dollar and introduced various measures to free-up international trade. It began the process of deregulating the labour market by introducing enterprise bargaining in 1993. The Keating Government tightened up the unemployment benefit system and introduced various labour market programs.

Soon after coming to power in 1983, The Hawke Government introduced an incomes policy (the Accord) that went through various phases but was still in place when Labor lost to the Coalition in 1996. In general, the ALP deregulated the economy by lowering tariffs and increasing competition (it set up the The Australian Competition and Consumer Commission); it reformed the social security system and began the system of 'reciprocal obligation' in the provision of unemployment benefits ('mutual obligation' under the Coalition government). In addition, it embarked on a series of privatisations of government assets (e.g. Qantas in 1992 and the partial privatisation of the Commonwealth Bank in 1991 followed by its complete privatisation by the Coalition in 1996).

Recent reports by the IMF (2004 a, 2004 b) discuss the wide range of reforms introduced by the Hawke/Keating Government from the mid-1980s:

- trade liberalisation in the mid-1980s;
- privatisation and corporatisation in the late 1980s;
- the National Competition Policy implemented in 1995; and
- industrial relations reforms, a result of the introduction of enterprise bargaining.

All these measures, it argues, helped to boost economic growth. 'Improvement in Australia's growth performance began with the progressive opening of the economy' (IMF 2004 b, pp. 28 ff).

Reforms enacted by the Coalition Government involved:

- the introduction, soon after coming to power in 1996, of a form of independent central bank by giving the RBA the task of controlling inflation (RBA 1996);
- a major change in the provision of unemployment benefits and provision of services to the unemployed by privatising the services provided by the government to the unemployed via Job Network and Centrelink;⁵
- Australian Workplace Agreements and the further decentralisation of wage bargaining, with only the lower paid covered by the Industrial Relations Commission;
- privatising various public sector agencies (partial privatisation of Telstra in 1996 and 1997; the completion of the privatisation of the Commonwealth Bank in 1996);
- the introduction of the goods and services tax (GST); and
- balancing the budget over the cycle (preferably achieving budget surpluses) and turning around the previous government budget deficits by strict control over expenditures helped by a rapidly growing economy; this is a major plank of the Coalition's new policies.

Figures 1 through 5 provide an interesting backdrop to our analysis in the next section.⁶ In all the figures there is a vertical line drawn at the time the Coalition Government came into power in March 1996. In general the Australian economy moves in a pattern similar to the larger world economies. The time series graphs of the main macroeconomic indicators show that the Australian performance, although appearing to be more volatile, tracks that of the US fairly closely. An exception seems to be the ratio of the current account deficits to GDP. In general we would not expect the Australian current account deficits to be driven by the American economy so that this comparison should be treated differently from that of other variables.

Figure 1a shows that the Australian and US annual growth rates track each other very closely, although Australian growth rates were very low when the ALP Government took office in March 1983. Because the G7 figures are an average of seven economies (Canada, France, Germany, Italy, Japan, the UK and the US), the time path is much smoother but these economies also seem to behave in much the same way as the Australian economy, Figure 1b.

Figure 2a shows that unemployment rates seem to follow a similar path in both Australia and the US, although the recession of the early nineties was more severe in Australia. Since about 2000, the unemployment rate in the US has been increasing while in Australia it has either declined or remained steady. The commodity price boom has helped the Australian economy relative to the US economy. Figure 2b reveals that the G7 unemployment rate is similar to Australia's.

Figures 3a and 3b show that the annual inflation rates in Australia are much more volatile than those in the US. Perhaps being a small, open economy we are more susceptible to international shocks. Australian inflation rates seem much higher in the 1980s compared to the US and the G7, but then fall significantly in the early 1990s.

Figures 4a and 4b show that Australian current account deficits (as a percentage of GDP) have been consistently worse than that of the US and the G7, except for a period of two years from the third quarter of 2000 to the second quarter of 2002 when the US deficit overtook the Australian level. Australian current account deficits are more volatile than those of either the US or the G7 economies.

Figures 5a and 5b show that Australian real interest rates (defined as the nominal interest rate less the annual inflation rate)⁷ were usually higher than those of the US and the G7.

Overall, there are many similarities between the behaviour of the Australian economy and the US and G7 economies.

Figure 1a Annual Growth Rates, Australia and the US

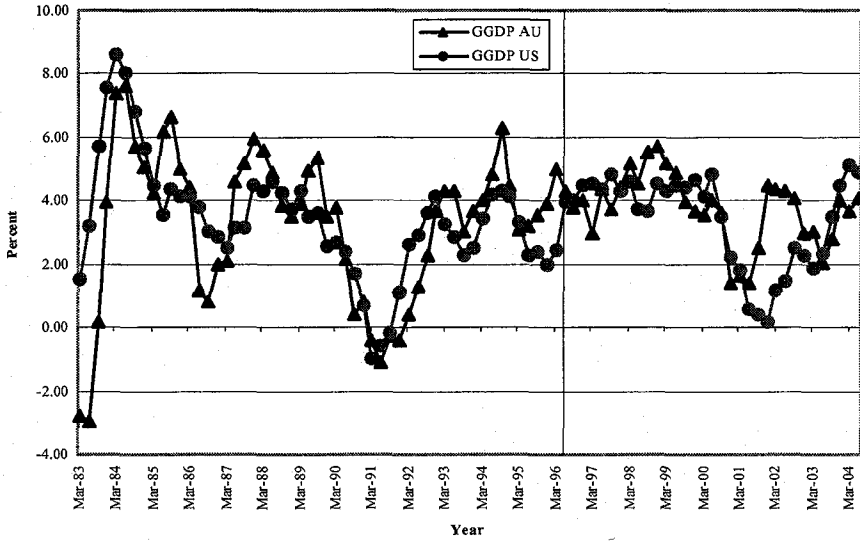


Figure 1b Annual Growth Rates, Australia and the G7

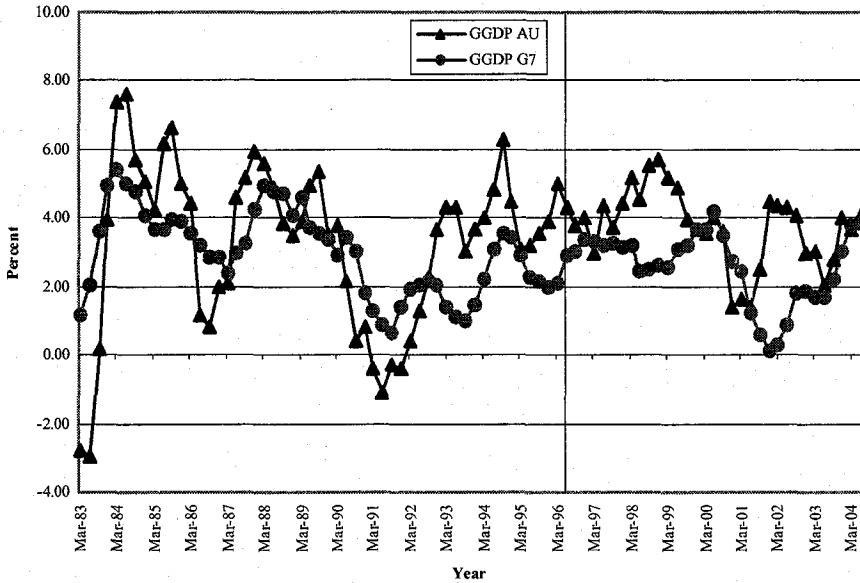


Figure 2a Unemployment Rates, Australia and the US

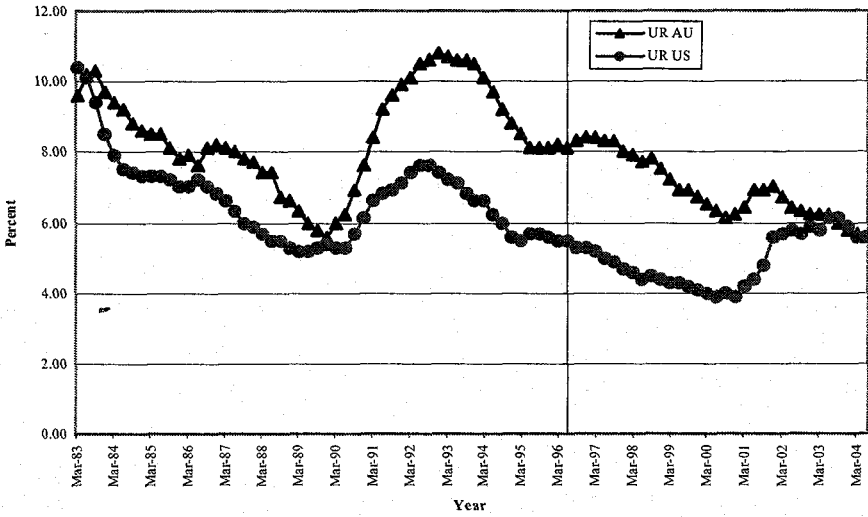


Figure 2b Unemployment Rates, Australia and the G7

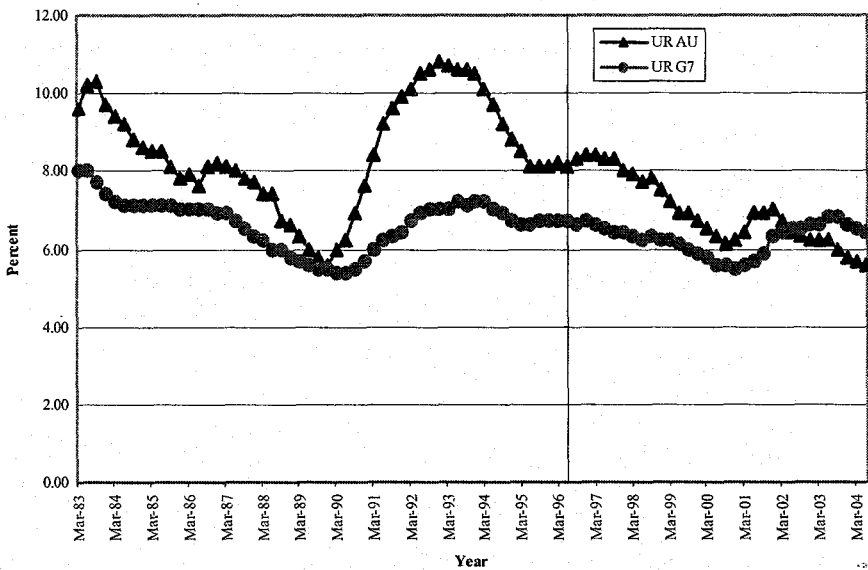


Figure 3a Annual Inflation Rates, Australia and the US

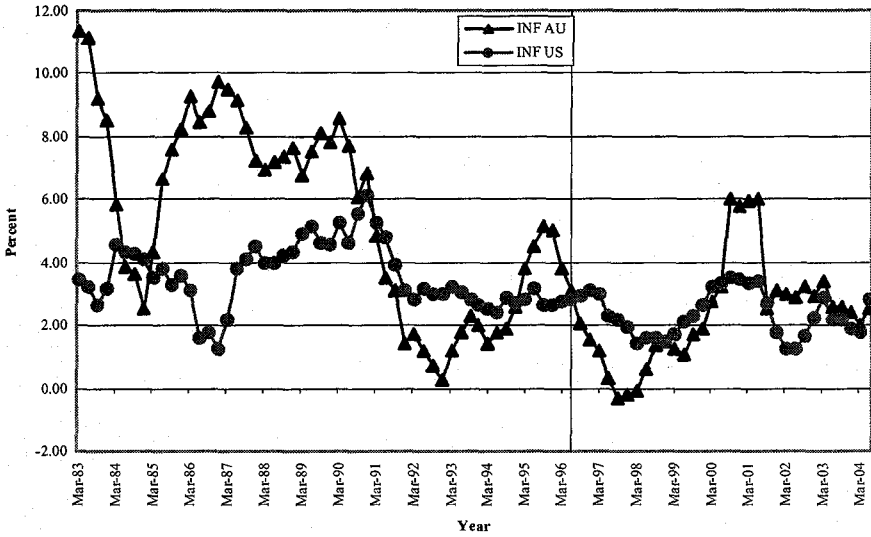


Figure 3b Annual Inflation Rates, Australia and the G7

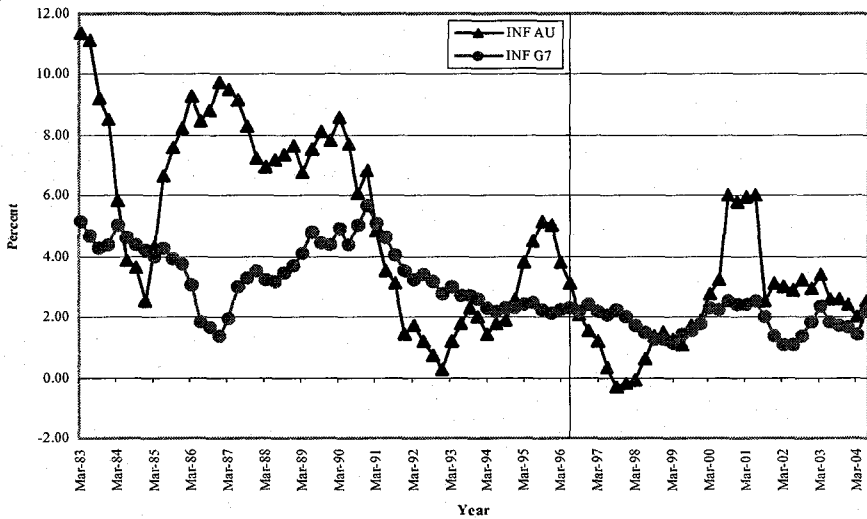


Figure 4a Current Account Deficits as a Percentage of GDP, Australia and the US

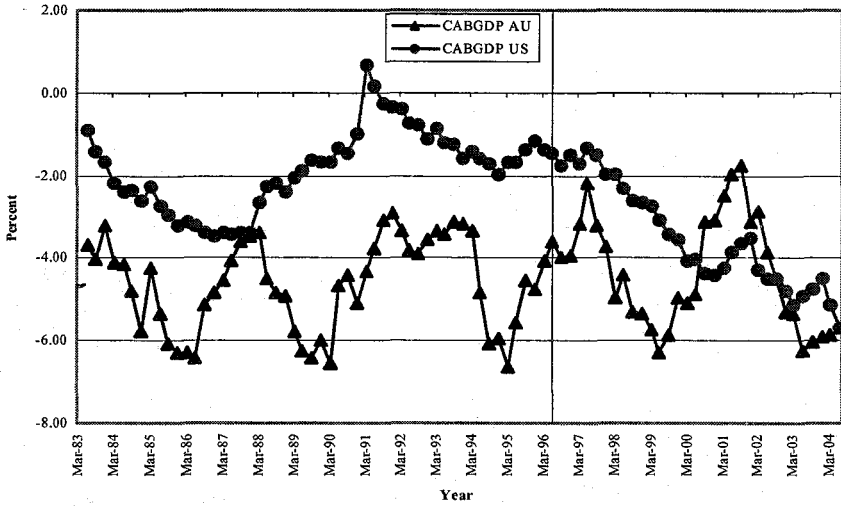


Figure 4b Current Account Deficits as a Percentage of GDP, Australia and the G7

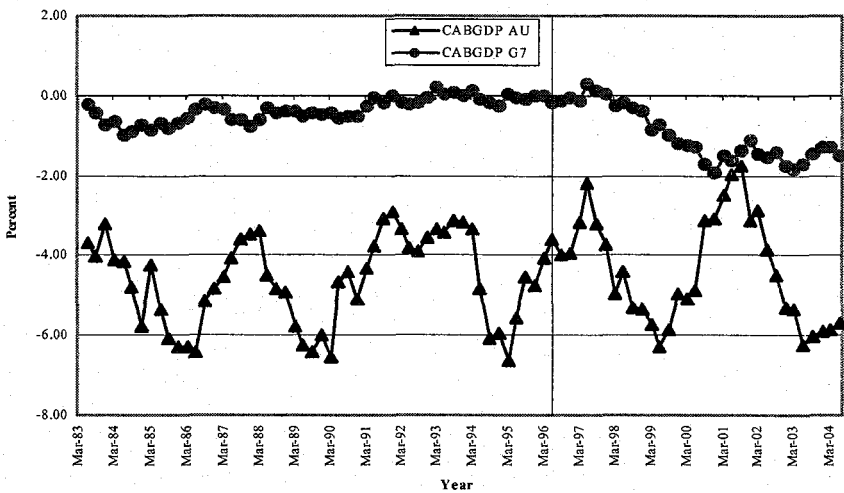


Figure 5a Real Interest Rates, Australia and the US

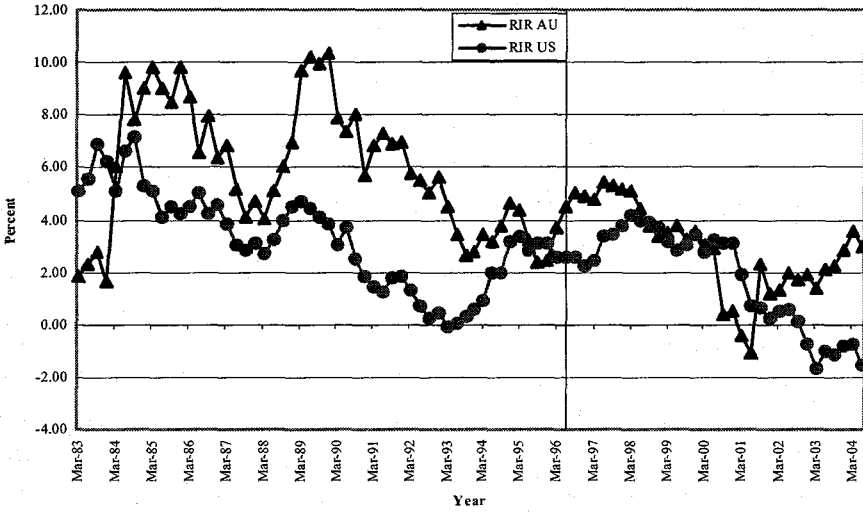
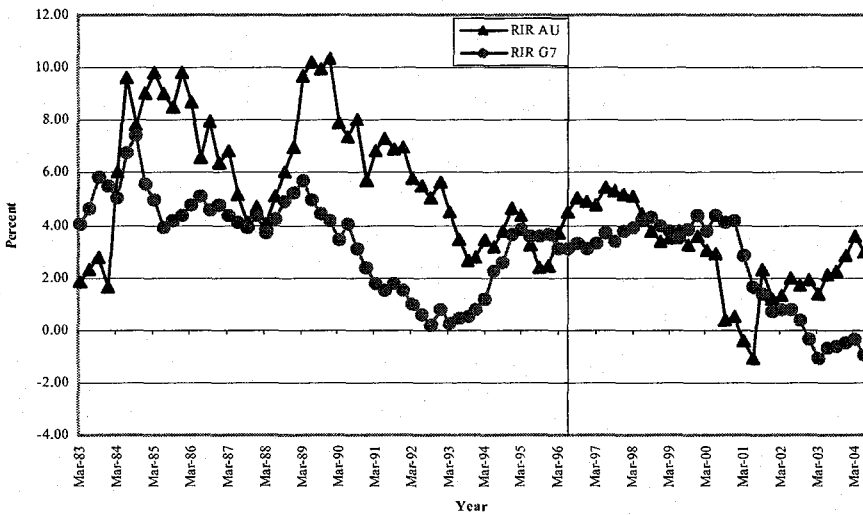


Figure 5b Real Interest Rates, Australia and the G7



4. The Performance of the Australian Macroeconomy

In this section we carry out simple comparisons of the main macroeconomic indicators under the ALP and Coalition governments (All data are seasonally adjusted.) Firstly, we test for significant differences between the averages (arithmetic means) of the main economic variables over the tenure of the two governments. The growth rate is defined as an annual growth rate over the previous four quarters, $(\ln \text{GDP}(t) - \ln \text{GDP}(t-4))$. The inflation rate is defined in a similar way. The real interest rate is defined as the nominal interest rate (on three month government bonds) less the actual inflation rate over the previous year.⁸ (There may be some problems with comparing real interest rates as inflationary expectations may adjust at different rates in different times or in different countries.)⁹ The comparisons are made from the first quarter of 1984 for the ALP and from the first quarter of 1997 for the Coalition.

Table 1 shows that under the Coalition Government (up to the second quarter of 2004)¹⁰ the inflation rate, the real rate of interest, and the unemployment rate were lower than during the ALP period of government. However, there was no significant difference between the average growth rates or the current account deficit as a percentage of GDP between the two periods. All we can say at this stage is that the averages of inflation, real interest rates and unemployment were lower during the period of the Coalition government. *It does not necessarily mean that the policies of the Coalition Government led to the more favourable outcomes.* We shall return to this issue later in this paper.

Given that the ALP came into power in the middle of a recession and the Coalition came into power when the economy was growing relatively rapidly, we shall now compare the improvements in the macroeconomic variables over the terms of office of the two governments. Ideally we should compare two periods that are at similar stages in the business cycle, but the data do not allow us to do that as there has been a long upswing since 1993. Thus we compare the average of the relevant macroeconomic variables in the last year of government (or for the Coalition the last year for which data are available) with the average of the first year in office. These are reported in Table 2. Since the ALP came to office when the economy was in recession, the growth rate, as it came out of recession during the first year of government, was quite high. Its subsequent fall as it came down to normal levels was -2.55 per cent. On the other hand, the Coalition came into power during a prosperous time when growth was fairly high but during last year growth rates have been affected by the slow down in the US economy and have fallen by -0.25 per cent. On this

Table 1. Macroeconomic variables under Labor and Coalition governments (averages)

	Labor	Coalition	Difference	t-statistics	Who did better?
GDP growth rate	3.59	3.74	0.15	-0.41	No significant difference
Inflation rate	5.22	2.45	-2.77	5.35*	Coalition
Real rate of interest	6.24	2.74	-3.50	7.71*	Coalition
Unemployment rate	8.49	6.96	-1.52	6.03*	Coalition
CAD/GDP	-4.62	-4.36	0.27	-0.95	No significant difference

Notes:

- a. * Significant at five per cent level of significance.
- b. *t*-statistics are calculated assuming unequal variance of variables during Labor and Coalition tenures.
- c. Averages for GDP growth rate, inflation rate and real rate of interest during Labor's tenure are based on quarterly observations from first quarter of 1984 to first quarter of 1996 (49 observations), and corresponding averages during Coalition tenure are based on quarterly observations from first quarter of 1997 to second quarter of 2004 (30 observations).
- d. Averages for unemployment rate and CAD/GDP ratio during Labor tenure are based on quarterly observations from second quarter of 1983 to first quarter of 1996 (52 observations), and corresponding averages during Coalition tenure are based on quarterly observations from second quarter of 1996 to second quarter of 2004 (33 observations).
- e. Difference is calculated by subtracting the average for Labor from the average for the Coalition.
- f. CAD/GDP is the nominal current account deficit as a percentage of nominal Gross Domestic Product.

Table 2. Changes in the average of microeconomic variables under Labor and Coalition Governments

	Labor	Coalition	Who did better?
GDP growth rate	-2.55	-0.25	Coalition
Inflation rate	0.65	2.14	Labor
Real rate of interest	-5.20	-2.26	Labor
Unemployment rate	-1.78	-2.53	Coalition
CAD/GDP	-0.98	-2.20	Labor

Notes:

- a. Changes in average for GDP growth rate, inflation rate and real rate of interest over the Labor term of office are calculated by subtracting the average over first quarter of 1984 to fourth quarter of 1984 from the average over second quarter of 1995 to first quarter of 1996, while the corresponding changes over the Coalition term of office are calculated by subtracting the average over first quarter of 1997 to fourth quarter of 1997 from the average over third quarter of 2003 to second quarter of 2004.
- b. Changes in average for unemployment rate and the CAD/GDP ratio over the Labor term of office are calculated by subtracting the average over second quarter of 1983 to first quarter of 1984 from the average over second quarter of 1995 to first quarter of 1996, while the corresponding changes over the Coalition term of office are calculated by subtracting the average over second quarter of 1996 to first quarter of 1997 from the average over third quarter of 2003 to second quarter of 2004.
- c. CAD/GDP is the nominal current account deficit as a percentage of nominal Gross Domestic Product.

basis the Coalition has managed to sustain growth rates better than the ALP Government.

Using the same method, the inflation rate rose slightly over the term of office of the ALP but has risen by a larger amount during the Coalition term of office. The real interest rate (very high during the ALP's first year of office) fell much more during the ALP tenure compared to the Coalition tenure.

The unemployment rate dropped far more during the Coalition's term of office compared to the ALP's term, despite the ALP coming to power when the unemployment rate was high. Figures 2a and 2b show the high unemployment rate in 1983 falling significantly until the Australian economy was hit by another recession in the early 1990s whereupon unemployment

rose again. By the time the Coalition Government came into power, the unemployment rate was falling due to the almost uninterrupted boom of the 1990s and early twenty-first century.

Using this procedure we see that current account deficits (as a percentage of GDP) worsened more during the Coalition term.

This comparison of the behaviour of the macroeconomic variables during the two periods of office suggests that the macroeconomy did better with respect to growth and unemployment during the Coalition tenure, while in terms of inflation, real interest rates and current account deficits the economy was stronger during the ALP's tenure. This is an interesting contrast. Most people would maintain that in the areas of unemployment and growth the ALP would have more success while the Coalition would do better on monetary variables like inflation. However, at this stage we are still not crediting either government with controlling the economy to achieve the outcomes that we have compared.

5. Comparing the Australian and US Economies

In this section we compare the performance of the Australian economy with the US economy over the periods of ALP and Coalition government in Australia.¹¹ In other words, we want to see if the Australian economy fared better than the US during the ALP or the Coalition term of office. To do this, we compare the difference between (say) the average growth rates of the Australian economy and the US economy over the two periods. This method is essentially the 'difference in differences' method used in the evaluation of 'treatment' groups with 'non-treatment' groups in, for example, the evaluation of labour market programs (Heckman *et al.* 1999). Table 3 shows that there were no significant differences between the means of the differences for the growth rate or for the unemployment rate. However, there were significant differences between the differences of inflation rates, real interest rates and the current account deficits. This suggests that the Australian economy performed relatively better than the US during the Coalition term of office.

In Table 3 we compare the performance of the Australian economy during each period of the ALP and Coalition governments with the economy of the US by means of examining the averages of the macro variables under both governments. As in the previous section we now see to what extent the behaviour of the macroeconomy changed over the terms of office of the ALP and Coalition governments using the difference of differences method. The comparison with the US economy is to provide a kind of benchmark against which we compare the performance of the

Table 3. Australian macroeconomic performance under Labor and Coalition governments: Difference in differences compared to the US

	Labor	Coalition	Difference in Differences	t-statistics	Who did better?
Difference in GDP growth rate	0.26	0.42	0.15	-0.49	Not significantly different
Difference in inflation rate	1.62	0.14	-1.48	3.08*	Coalition
Difference in real rate of interest	3.20	1.05	-2.15	4.89*	Coalition
Difference in unemploy- ment rate	1.90	2.00	0.11	-0.41	Not significantly different
Difference in CAD/GDP	-2.79	-0.90	1.89	-6.00*	Coalition

Notes:

- a. * Significant at five per cent level of significance.
- b. t-statistics are calculated assuming unequal variance of variables during Labor and Coalition tenures.
- c. Difference in variable is the simple difference of a US variable from the corresponding Australian variable.
- d. For GDP growth rate, inflation rate and real rate of interest, difference in the difference compared to US is calculated by subtracting the average of quarterly differences during first quarter of 1984 to first quarter of 1996 (Labor tenure) from the average of quarterly differences during first quarter of 1997 to second quarter of 2004 (Coalition tenure).
- e. For unemployment rate and CAD/GDP ratio, difference in the difference compared to US is calculated by subtracting the average of quarterly differences during second quarter of 1983 to first quarter of 1996 (Labor tenure) from the average of quarterly differences during second quarter of 1996 to second quarter of 2004 (Coalition tenure).
- f. CAD/GDP is the nominal current account deficit as a percentage of nominal Gross Domestic Product.

Table 4. Australian macroeconomic performance under Labor and Coalition governments: Change in difference (Australia - US) over term of office

	Labor	Coalition	Who did better?
Difference in GDP growth rate	2.45	-0.22	Labor
Difference in inflation rate	2.18	2.33	Labor
Difference in real rate of interest	-2.06	2.05	Labor
Difference in unemployment rate	1.58	-3.00	Coalition
Difference in CAD/GDP	-1.12	1.20	Coalition

Notes:

- a. Difference in variable is the simple difference of a US variable from the corresponding Australian variable.
- b. Changes in average difference for GDP growth rate, inflation rate and real rate of interest over the Labor term of office are calculated by subtracting the average difference over first quarter of 1984 to fourth quarter of 1984 from the average difference over second quarter of 1995 to first quarter of 1996, while the corresponding changes over the Coalition term of office are calculated by subtracting the average difference over first quarter of 1997 to fourth quarter of 1997 from the average difference over third quarter of 2003 to second quarter of 2004.
- c. Changes in average difference for unemployment rate and the CAD/GDP ratio over the Labor term of office are calculated by subtracting the average difference over second quarter of 1983 to first quarter of 1984 from the average difference over second quarter of 1995 to first quarter of 1996, while the corresponding changes over the Coalition term of office are calculated by subtracting the average difference over second quarter of 1996 to first quarter of 1997 from the average difference over third quarter of 2003 to second quarter of 2004.
- d. CAD/GDP is the nominal current account deficit as a percentage of nominal Gross Domestic Product.

Australian economy. Obviously the US did not have elections at the same time as Australia. However, if the Australian economy were to do better than the US economy under one government compared to the other, we could argue that this was due to better economic management. Table 4 shows that, using this method of analysis, the ALP was more successful in managing growth, inflation and real interest rates. On the other hand, the unemployment rate and current account deficit were much better managed over the term of office of the Coalition.

6. Discussion

We set out in this paper to answer the following questions:

- ♦ Is there a significant difference between the two periods of government in terms of the behaviour of the economy?
- ♦ If there were significant differences between the behaviour of the macroeconomy during the two periods, were these differences *because* of the policies introduced by the two governments or were they due to world-wide factors?
- ♦ Has the ALP or the Coalition Government been more successful in managing the economy?

In Table 5 we summarise the results of the previous section and draw a crude comparison simply by looking at the number of times the Coalition or Labor come out ahead using the different methods (assuming that each method is equally weighted). As we can see the results are not clear-cut. Both governments do equally well if we simply average over the different indicators. Curiously this simple comparison finds that Labor is doing better at inflation and the real rate of interest while the Coalition is doing better at unemployment and current account deficits.

However, as previously argued, we believe that a comparison of the performance of a government should be against another country as a benchmark (as we are a small open economy). If we use the method of difference in differences over the term of office of each government then the ALP does better on growth, inflation and the real interest rate, while the Coalition does better on unemployment and the Current Account Deficits. The latter result on the CAD is primarily because the US government has had large CADs (probably due to the Iraq war). An overall assessment is therefore subject to qualification.

What we can say after our analysis is that there are several significant differences between the behaviour of the Australian economy during the ALP and Coalition periods of government. However, a decision as to

Table 5. A summary comparison of macroeconomic performance

	1	2	3	4	5
	Comparison of averages	Change in average over term in office	Difference in differences compared to US	Change in difference (Aus-US) over term in office	Labor vs Coalition
Difference in GDP growth rate	No significant difference	Coalition	Not significantly different	Labor	Draw
Difference in inflation rate	Coalition	Labor	Coalition	Labor	Labor wins
Difference in real rate of interest	Coalition	Labor	Coalition	Labor	Labor wins
Difference in unemployment rate	Coalition	Coalition	Not significantly different	Coalition	Coalition wins
Difference in CAD/GDP	No significant difference	Labor	Coalition	Coalition	Coalition wins

whether these differences were *caused* by policies introduced by the Coalition government is a difficult one to make. As discussed earlier, the second period, under the Coalition was one of uninterrupted growth that began in 1992 and hence conditions were more favourable for the Coalition compared to those prevailing when the ALP came to power in 1983 in the middle of a recession. The world economy during the second period has also been favourable to Australia with the terms of trade improving since about 1992-93.¹² We attempted to control for any world trends by using the method of difference in differences and found that the results were then mixed. When we compared the averages of the differences between Australia and the US over the two periods we found that the Coalition period was economically more successful than the ALP period. However, when we compared the changes that had taken place over the tenure of each government (compared to the US) we found that (except for unemployment) the ALP was more successful in terms of macroeconomic outcomes.

As discussed in Section 3, the ALP introduced several policies from about the middle of the eighties that, according to the IMF (2004a, 2004b), led to favourable growth outcomes, which in turn helped the other macroeconomic variables like inflation, real interest rates, and current account deficits. Many economists, including Dowrick (2001) and Chand (1989), have argued that the various policies followed by the Hawke/Keating Government – trade liberalisation, competition policy financial deregulation – helped to encourage a revitalisation of the Australian economy.

The third question – did the ALP or the Coalition better manage the economy? – is a difficult one to answer unequivocally¹³. It is clear that the policies introduced by the Hawke/Keating Government laid the foundations for a more dynamic Australian economy while the policies of the Coalition Government were, in some ways, simply an extension of those of the ALP. For example, the introduction of Australian Workplace Agreements was simply an extension of enterprise bargaining. The idea of ‘mutual obligation’ in the provision of social security was simply another step along the path set up under the ALP’s Working Nation programs that introduced a strict regulation with respect to accessing unemployment benefits under the notion of ‘reciprocal obligation’. There had already been a move away from centralised wage bargaining by the Keating Government, followed by the Coalition removing centralised bargaining except for the lower paid subject to ‘living wage cases’ under the Industrial Relations Commission. The big difference in the labour market arena was the transfer from the public to the private sector of the provision of labour market services to the unemployed which occurred under the Coalition.

Although the Keating Government introduced inflation targeting for the RBA in 1993, a significant change was initiated by the Coalition with an exchange of letters in 1996 providing the RBA with some form of independence from day-to-day interference by the elected government. The (unelected) governor of the RBA could use monetary policy to target the inflation rate which had to be within the bounds set by the Government of two to three per cent per annum. The introduction of the GST was another significant change, but it is not obvious how this might affect the macroeconomic variables other than a one-off increase in the inflation rate in 2000.

The Coalition Government’s preoccupation with budget surpluses and its determination to lower the national debt by means of asset sales certainly appears to have been successful, keeping both the financial sector and the IMF happy. These budget surpluses were clearly helped along by the uninterrupted spell of growth in the economy from 1992.

7. Conclusion

This paper has attempted to assess how the Australian economy has developed since 1983 under the ALP and Coalition governments. We have concluded that it is difficult to assess whether each government has been more or less successful in managing the Australian economy as it is difficult to estimate how the economy might have behaved under each alternative government. Since it is difficult to decide what the counterfactual might be, we used a method called the 'difference in differences' that compares the Australian economy with an alternative OECD economy, in this case selecting the US as our benchmark.

We found that if we simply compare the means of the various macroeconomic indicators for the two periods, it appears that the performance of the economy has generally been better under the Coalition. However, when we compare the *changes* in these macroeconomic indicators over the tenure of each government, we found that the Coalition performed better with respect to the growth rate and unemployment, while the ALP performed better where inflation and the real rate of interest are concerned. When we used the difference in differences method (with the US as benchmark) we found that the means of the macroeconomic indicators were generally better under the Coalition. However, when we used this method to compare changes over the tenure of office we found that the ALP did better on growth, inflation and the real rate of interest while the Coalition has a better record on unemployment and the current account deficit. These results appear counter intuitive.

These results confirm that a different counterfactual gives a different result.

Earlier in this paper we mentioned that because the ALP Government came into office in the middle of a recession and had to cope with another global recession in the early nineties, managing the economy was, for it, a much more difficult task. The Coalition Government came into power when the economy was growing rapidly and also benefited from all the structural changes introduced by the ALP (e.g. trade liberalisation, increased expenditure on education, deregulation of the economy and so on). Hence, if the growth rate under the Coalition has been higher than under the ALP, this does not mean that Coalition policies are responsible.

To summarise, it is very difficult to provide an unequivocal answer to whether one political party was better at managing the economy compared to the other political party. There are too many confounding factors that make it difficult to provide an unambiguous answer to the question about which political party was better at managing the economy.

Notes

- 1 In an earlier paper we compared the labour market programs of the ALP and the Coalition governments (Junankar 2000).
- 2 'When the capital development of a country becomes a by-product of the activities of a casino the job is likely to be ill-done' (Keynes 1936, p. 159).
- 3 We have also compared Australia with the performance of the G7 group of economies (comprising the US, the UK, France, Germany, Italy, Japan and Canada) but have found the US is a good proxy for the G7 as a whole.
- 4 They announced that they would balance the budget over the cycle, which is not necessarily the same as stabilising the economy. Michael Keating, in a private communication, believes that balancing the budget over the cycle allows the use of discretionary fiscal policy.
- 5 The Keating government under its Working Nation programs had outsourced 'case management' of the unemployed to the private sector. The Coalition reforms can be seen as an extension of this privatisation.
- 6 The source for all subsequent figures and tables is: OECD *Main Economic Indicators*. All data are seasonally adjusted.
- 7 Real interest rates are formally defined as the nominal interest rate less the *expected* inflation rate. To avoid problems of measuring the *expected* inflation rate we have simply used the *actual* inflation rate in this paper as an approximation.
- 8 This is obviously a simplification as we should really use some estimate of the expected inflation rate. However, since we are using averages it makes little difference to the analysis.
- 9 Michael Keating has pointed out to me in a personal communication that inflationary expectations may adjust slowly when inflation rates are rising and hence this may explain why real interest rates were higher under Labor than under the Coalition.
- 10 At the time of writing the latest data available was for the second quarter of 2004.
- 11 We found similar results when we made comparisons with the UK and the G7 economies. These results are available from the author upon request.
- 12 IMF (2004a) suggests (using statistical methods) that the decline in terms of trade actually reversed in about 1987. It is clear that there was a significant rise in 1987 but this was followed by a big drop in 1989 and then a rise from about 1992.
- 13 In the words of a well known philosopher (sic), Donald Rumsfeld (2004): "There are known knowns. These are things we know that we know. There are known unknowns. That is to say, there are things that we know we don't know. But there are also unknown unknowns. There are things we don't know we don't know."

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