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ON THE DRY SIDE 403

Oh! where have all the industries gone?

John Hyde

Victorians contemplating their Government's most recent tax hike (about 9% in real terms) might, with profit, also contemplate the recent history of the American State of Massachusetts.

During the 1970s Massachusetts earned the epithet, 'Taxachusetts'. Income tax rose to 25% above the national average and, at the same time economic growth fell from 97% of the national average to 57% of it. Then, in 1978, a little known Conservative, Ed King, defeated Massachusetts' Governor Mike Dukakis (the same who was nominated for the presidency but not elected). Interestingly, Dukakis held the upper middle class vote but lost by a landslide in blue-collar areas.

King reduced taxes until they were 5% below the national average. Real personal income grew at 45% more than the national average. Unemployment fell. Massachusetts Bonds gained a AA credit rating. In only five years the Taxachusetts swamp became the Massachusetts miracle.

Another turn of the wheel saw Dukakis re-elected in 1984. State payrolls took off. State government expenditure rose 30 to 40% faster than the nation's. In only four years, manufacturing employment fell from 684,000 jobs to 560,000, while unemployment rose from 3.3% to 5.6%. A 4% State surplus was turned into a 6% deficit. The State's bond rating dropped to BBB (Standard and Poors) and Baa (Moody's)---the lowest of any US State and only one notch above junk bonds.

Not only was the change in fortune, on each occasion, in the opposite direction from that predicted by Keynesian economists, but it was far greater than anyone predicted. How so?

This is a plausible explanation: faced with higher taxes now, and debts that would insure that taxes remained high, well-managed firms took off for better-managed States from New Hampshire to California. In Victoria's case, good managers will relocate in New South Wales, Queensland and South Australia. Since Sydney will obviously benefit from Melbourne's dalliance with the Loony Left, the Australia-wide consequences of the Cain Government will not be as serious as they appear from Melbourne.

Brisbane should also gain. The Goss Government has been at pains to point out that fiscal management in Queensland is second to none. However, not all costs are fiscal. It would not take many decisions like the banning of voluntary employment agreements to frighten at least the more labour-intensive industries away from Queensland.

Victoria's departing firms will not go to Tasmania where the fiscal mess is even greater---although, in that case, the mess cannot fairly be laid at the feet of the current government, which has taken the first steps toward cleaning it up. Nor will many choose the Northern Territory for fear that that subsidised society might lose some of its support from the Federal Government's taxpayers. WA Inc has not yet reduced the Lawrence Government's financial affairs to the sorry condition of Victoria's. But this is only because the Western Australian Government started from a far better position than Victoria. Nevertheless, I do not think many ex-Victorian firms will be moving into the premises vacated in WA.

WA's fiscal problems, though less serious than Victoria's, have similar and smellier origins. What is more, unlike Kirner, Lawrence has not yet been prepared to lift the lid on State Government Inc by holding a proper judicial inquiry. An inquiry into the government's role is important to investors, because disclosure is the best guarantee they are likely to get that the errors will not be repeated.

The Cain and Burke/Dowding governments' selection of favourites was not only wrong in principle but inept in practice. While an investor may know that he can make big money (at the expense of general welfare) should an improper government favour him, he needs to be reasonably sure that it will not be his rivals who receive the favoured treatment. That openness in government tends to produce honesty is hardly a novel insight.

Although Victorian affairs are not yet as bad as Massachusetts, the comparison with Massachusetts is not idle. Only last week I was talking to a Western Australian businessman with substantial overseas interests. By providing nothing more than a guarantee to his overseas company he would have incurred some hundreds of thousands of dollars of Western Australian stamp duty. He might pay up once, but his comment was that he was considering shifting his head office off-shore to avoid such charges. When he does that, Western Australia will lose not only the value added by a head office including the taxes it pays, but Western Australians will also lose contact with the best brains in the company and much of the charitable, political and industry work these people do voluntarily.

Returning to the American experience: At the heart of Massachusetts' bond-rating problem was a serious loss of political authority which initially made serious budget cutting or significant tax increases very difficult---so Governor Dukakis spent and borrowed like a drunken sailor. When the boom collapsed, property values and the State Government's tax base collapsed also. When the borrowing option was seen to be nearly used up---that is, when the Government credit rating approached that of junk bonds---even higher taxes became seen as an inevitable next step and so on. It had become a vicious cycle, not only affecting the government. Boston's four major banks, for instance, were required to set aside over $2.2 billion against losses on real estate loans. WA Inc's meddling in the Perth real estate market will have a similar but, it is to be hoped, proportionately smaller effect.

The lesson is obvious: these days, businesses and skilled people are mobile and becoming more so. Governments that do not offer commercial environments that are at least as attractive as those in other States and nations, will kill the geese that lay all of their golden eggs.

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