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‘Banana Republic’ statement – 40 years on

Remarks by PJ Keating in response to requests for comment

Australia’s terms of trade, the relationship between the value of the things we sell and those we buy, began a secular decline in the mid-1960s reaching a nadir in 1986 – with the Current Account Deficit widening to 6% of GDP.

The terms of trade are an important determinant of economic welfare – how much and how many imports can be purchased as a percentage of exported goods. With the long running decline in the terms of trade, Australia was becoming poorer.

Broadly, Australia exported commodities while importing manufactures. During the 1970s and early 1980s, the cost of imports rose markedly while commodity prices fell. The result was a major widening of the Current Account Deficit to 6% of GDP.

Economic policy indifference to this trend over the decades, was not deliberate obfuscation but nevertheless led to the perpetuation of Australia’s great policy lie – that economic protection was in the national interest. And more than that, that governments could spend to maintain living standards, notwithstanding reliance on mounting levels of international savings and debt.

It was obvious to me that the old order had failed us, that the whole Deakin edifice of protection, broadly carried on by all parties, had to be demolished and that the economy had to be restructured from the ground up. In that realisation, my job was to act rather than commentate.

So, along with my colleagues, we set about the major task of pulling down government spending while two years later, in May 1988, I set about dismantling the whole tariff wall with systematic reductions that completed the job in 2005.

On 13 May 1986 a release on the national balance of payments revealed a Current Account Deficit of \$1.47billion for the month, which happened to be an increase of \$430million over the previous month, a particularly worrying development.

For months, I had warned the Cabinet of Australia's declining terms of trade and competitiveness but given that the remedies needed were country-altering and politically difficult, the Cabinet had taken note while reserving any major remedial policy response.

I rehearsed the warnings and arguments and need of remedies whenever I had the opportunity and had done so again just a day or so before the release of the monthly balance of payments figures for May.

As it turned out, on 14 May 1986, I had accepted a breakfast invitation in support of one my Victorian colleagues, Neil O'Keefe, the federal member for Burke, where at some length I traversed the broad economic settings and problems to hand.

At the conclusion of the breakfast my press secretary, Tom Mockridge, told me the John Laws radio program in Sydney had rung looking for a comment on economic policy in the light of the previous day's Current Account Deficit announcement.

I took the call on a wall phone in the kitchen of wedding venue which had just serviced a very large complement of people for breakfast.

An older lady generating lots of noise, was emptying and washing a collection of large metal pots and plates from the breakfast but was obviously annoyed by my presence on the phone at the end of her bench. She kept looking askance at me, daggers really, and kept up the clanging as I spoke with Laws.

So, I had not intended the call to be long, given the less than amenable circumstances.

As I dealt with the Laws questions, I compressed the commentary to come to the essence of issues more succinctly, which I did by articulating the arguments I had put at the breakfast some minutes before and which I had formerly and recently rehearsed with the Cabinet. As the line of argument sketched its logic and following one of Laws's questions as to the previous day's Current Account Deficit, I made the point that unless the country urgently adopted remedial economic policy, 'Australia would end up a third-rate economy, a banana republic'.

The remark, made under inhospitable circumstances and time pressure, burst from me like a truth fountain – something I was not particularly intent on saying via a radio interview, but which, as the thread of the argument went, the logic of it compelled its delivery. And in the saying of it, the truth of it lifted a weight off me.

From that moment, the century-long cast of Australian economic policy changed. I set about the task of reducing Commonwealth spending from the 30% of GDP bequeathed to us by Malcolm Fraser and John Howard, his treasurer, to 24% of GDP in 1989-1990.

The six-percentage point decline in outlays was the biggest government spending consolidation in the OECD area since World War Two. No other country came near it.

The economic argument went, if the Current Account Deficit reflecting Australia's savings paucity and its call on overseas savings needed to be reduced by 4% of GDP to return to its formerly affordable level of 2% - to make up the shortfall, the government could reduce its call on Australia's savings by 4% of GDP.

With my colleagues, Peter Walsh and John Dawkins, supported in the Expenditure Review Committee by Brian Howe and Ralph Willis, we set about pulling down government spending dramatically. It took four exhausting years to do, program by program, department by department - while the terms of trade shock followed the fundamental reform of the tax system the previous year, 1985 - very large income tax cuts, capital gains, fringe benefits, company tax cuts, imputation etc.

The changes set Australia up for thirty years of low inflationary growth - the income surge which has since made Australia one of the wealthiest countries in the world.

The moral of the story? With imagination and policy ambition becoming the vector forces of change, good policy emerges and ekes its reward.

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Potts Point