

## Attachment

### **Contemporary Record of Conversation with Leslie Melville and Heinz Arndt, On Sunday Afternoon, 28 April, 2002.**

I called around at Heinz's house in Deakin a bit before 2 pm. We had a chat about family — including about the great grand-daughter, who's photo was prominently displayed; a photo that was familiar to me because Heinz had brought it around on a visit to Jayne a week before. That's when I noticed the book in French to which I referred at the funeral of Heinz.

We drove around to the Grange in my car. Leslie opened the front door for us and we sat down in the armchairs just inside and to the left of the door.

Both Leslie and Heinz were looking particularly frail if anything, Heinz more so. Both were very alert and active in conversation.

Leslie said that he had read with interest the Background paper to the Review of Commonwealth-State Funding that Vince Fitzgerald and I are conducting for the States of NSW, VIC. and WA. He went on to talk about the early development of ideas to guide the Commonwealth Grants Commission, particularly views of Giblin and himself in the 1930s. He said that he thought that Vince and I might think of some better ways of doing some things, but that there would still be a place for those early ideas about how to look after the fiscally weak States. That is what he had concluded when Chairman of the CGC much later.

He said that he could not tell whether the CGC had stayed on track. The thing that had most obviously gone wrong since the days when he had been Chairman of the CGC was the huge growth in conditional Special Purpose Payments from the Commonwealth. He couldn't see how a Federal financial system could function at all well when the States were tied up in this way, and when it was not clear to anyone who was responsible for what. There would need to be change to sort this out.

Leslie remarked that the need for fiscal equalisation in Australia was a by-product of the centralised arbitration system that set more or less equal wages all over Australia. Some States just weren't competitive at the centralised wage, and there wasn't much they could do about it themselves. So extra payments had to be made to keep them going. Centralised wage fixing had turned out to be a deeply entrenched feature of Australia, that still was hard to change. We discussed the greater wage flexibility over the last decade, and noted that now it was mainly the minimum wage that was the inflexible part of the system, which made it hard to deal with unemployment. I went over the point I have made in a number of papers about the potential role of social security payments in allowing disposable incomes of low-skill workers to be maintained alongside downward flexibility in wages. Heinz noted that Dick Downing had advocated something similar in the early 1940s. Leslie said that he had read the newspaper reports of my paper to the Melbourne Institute Conference in April, and he thought that that was a good way to go in Australia seeing that it was otherwise impossible to get wage flexibility.

The conversation branched out in two directions from this point: implications of Australian wage rigidity and uniformity; and some of the things I had said in the Melbourne paper. We went backward and forward between these two themes.

On the Melbourne paper, we discussed the much better performance of the Australian economy in the late twentieth century relative to the rest of the world. Leslie and Heinz were both happy about how Australia was going. Heinz said that the Melbourne Institute paper had underplayed the pivotal role in the improvement of Australia's performance of the reductions of protection and opening up the financial system. I said that I thought I had given the external liberalisations quite a big role. They both made additional points to emphasise the importance of the external liberalisations. Leslie noted the importance of timely depreciation of the Australian currency, now that it was floating, when it was required for the maintenance of stability and growth. It had taken a while for all relevant people to see that currency depreciation could be effected without disaster during the Depression, but once the devaluation had happened it helped a lot. The timely depreciation over recent years had been important to keeping growth going in Australia through big external shocks. Heinz mentioned that there were a number of other points in the paper that we needed to discuss and we agreed that we would do that when we met for lunch the next Wednesday.

We discussed how the absence of wage and cost flexibility had been a huge problem in the reunification of Germany. This was the problem of uniformity in the Australian Federation in much more acute form. Leslie noted that the impossibility of changing the Australian wage-setting system and the obvious impossibility of applying Australian regulated wages in Papua New Guinea was the point at which conversations about the possibility of New Guinea being the Seventh State had always ended. I asked whether New Guinea as the Seventh State had been seriously considered. He said "yes...it came up from time to time in the back rooms, never as a public statement" in the 1950s. But in the end it was always judged to be economically impossible. We then talked about the PNG economy. Leslie noted that if PNG had been a State of Australia and within the Australian wage-setting system, the scale of equalisation transfers to hold up the PNG economy would make the current transfers to the Northern Territory look modest. Conversation shifted to whether it would have been good for New Zealand to be the Seventh State. The large differences that had now emerged in wages and incomes meant that New Zealand could only be a State of Australia if there were fundamental changes in the Australian fiscal and wages systems.

We discussed recent development in the international financial system, and whether the strength of the United States dollar over the past half dozen years was a bubble that would burst, giving rise to big problems of adjustment everywhere. No strong conclusions, but noting along the way that the strong dollar seems to be exacerbating protectionism in the United States, and that this was a big problem.

I began to take our leave. Leslie said he had greatly enjoyed the conversation, but felt like Pigou when he (Leslie) had called on him at Cambridge after the War. Pigou had said that he was very pleased to meet Leslie, but felt that Leslie was talking to the remnants of an economist. I said that it wasn't like that at all. I gave him a copy of the recently published book by Ligang Song and myself, *China 2002: WTO Entry and a World Recession*. Leslie said he looked forward to reading it...what was happening in China was one of the really interesting things in the world economy at this time.

I dropped Heinz off at his house. I didn't check the time, but guess it was about 4 PM.

Postscript: Leslie Melville's daughter-in-law, Pat Melville, told me of a sequel to the visit at Heinz Arndt's funeral. She said that she had often offered to read to Leslie, but that mostly he didn't take her up on it, preferring to struggle on himself with his magnifying lenses. On the Monday the day after our visit, he asked her to come over and to read from the book that I had left. Pat went over to the Grange Monday afternoon to read to him. Leslie died at dinner Monday evening, and Heinz on his way to Leslie's funeral a week later."

Ross Garnaut  
23 May 2002  
Canberra