phenomenon noticeable throughout history regardless of place or period is the pursuit by governments of policies contrary to their own interest." So the American historian, Barbara Tuchman, begins her work, The March of Folly, an assessment of misguided public policy from Troy to Vietnam.

It is now understood how, for much of this century, Australia's economic policies were pure folly. How Australia sheltered from the world - its economy quarantined behind tariff walls, White Australia and inflexible wages - while other economies traded their way to success.

The result has been a Third World pattern of trade, where the nation's prosperity is bonded to fluctuations in commodity prices. Australia is the only advanced nation whose ratio of exports to production has not increased through the post-war period. Not so well understood, however, is the role of the Labour movement in fashioning Australia’s economic institutions in the first decade of Federation. The ALP at this time was in a privileged position, holding the balance of power in the new House of Representatives. It developed the clever strategy of 'support in return for concessions'.

This was designed to protect Australian workers from the defeats of the 1890s: high unemployment, falling wages and broken strikes. So came the historic compromise of conceding tariff protection to manufacturing interests in return for centralised wage fixing. This was accompanied by support for White Australia, defending workers against an inflow of low wage Asian and Island labour. The labour movement's defensive strategy was suited to its time. Australia had much to defend - the world's highest living standards, robust mining industries, strong agriculture and well developed cities. The ethos of a lucky country was woven into the public culture. The policies of domestic defence were accepted by both sides of politics.

This entrenched some shallow priorities within the ALP: devising policy around social conditions in the short term, ahead of economic reform and growth. Government enterprise and social regulation were often seen as an immediate solution to social problems. Their function was to protect working families from the exploitation of business, especially the feared 'money power'. This analysis can be drawn from an important work by Francis Castles, Australian Public Policy and Economic Vulnerability. Castles compares the way in which Australia and the smaller European states have responded to the vulnerability forced on them by world markets. Europe's social democratic parties have developed the policies of domestic compensation. This means industrial restructuring, wage flexibility, labour retraining and income maintenance within a strong welfare state.

Castle's conclusion is crucial: "it is immediately apparent that the strategy of domestic compensation has an inherently more dynamic growth potential than that based on domestic defence. Grabbing competitive niches in new markets is built into the former whilst tariffs serve, precisely, to insulate the economy from competition." This is the basis of domestic compensation, building a dynamic economy within which governments can redistribute the benefits of economic growth. Gradually, as other economies have grown past Australia, domestic defence has meant domestic decline. This is the root cause of tensions in the labour movement today. Australia's problems on the external account have forced the ALP to make a bold transition to a new style of economic management. Yet the old Left still clings to the folly of domestic defence.

This has meant reinterpreting the 40s as a romantic era of ALP reform. It is difficult, however, to see Curtin and Chifley as anything but austere and empirical. Fin Crisp's biography describes "Chifley's socialism as the run-of-the-mill, loose Australian trade union variety...he was for mastering particular issues, not for compounding socialist doctrine; for correcting specific injustices rather than for promoting flaring crusades". Moreover, Chifley's address to the 1949 NSW Labor Conference - the memorable "light on the hill" speech - proudly boasted how "no government in the history of Australia has ever given to private industry so much assistance and advice and help as has been given by the Commonwealth Labor Government".

The ALP is now divided in its interpretation of party tradition and the role of the public sector. Perhaps the traditionalists should try the words of Gough Whitlam: where the public sector "should be intent on competing where possible and initiating where desirable. It is as important to protect the customer as the employee. The sins of capitalism in Australia today are areas of omission
rather than commission". What Whitlam saw in 1961 is no less relevant in 1990. The role of the public sector is to perform those functions unfulfilled by the private sector, not to lock up public resources in industries like banking, where the private sector is already competitive and efficient. Or markets like the domestic airlines, where the private sector will not only be more competitive but more efficient.

Whitlam, with his emphasis on the social wage and regional equality, was the first ALP politician to break the mould of domestic defence. He dragged the party away from its narrow obsession with nationalisation, wage fixing and pensions. In many respects, Whitlam achieved in ALP social policy what Paul Keating is attempting for the Australian economy. That is, an historic transition from the policies of domestic defence to a strategy of domestic compensation. This means replacing a regulated and heavily protected economy with one built around structural efficiency and competitive markets. The Australian economy has changed less since the Second World War than any in our region, right through the arc from Pakistan to South Korea. Australians prefer to apply Western standards in thinking of themselves as a young nation. Increasingly, however, the standards of the Asian region in which we live see Australia as an old world economy. Our good fortune in escaping war and internal upheavals has left our parliaments, legal bodies, companies and economic infrastructure much older than those of many nations overseas.

In each of the three world economic crises since 1970 - the two oil shocks of 1973-74 and 1979-80 and the collapse of commodity prices in 1985-86 - Australian corporations were shown to be as vulnerable and inflexible as any in the developed world. Domestic investment in new products and enterprises is weak. Among Australia's top 50 corporations only one, Sarich, could be classed as a new company.

The challenge of economic growth now rests with modernising the economy and finding greater competitiveness on world markets. This cannot be achieved solely by Australian standards. Policy makers must understand how the pace of change is only relative to the economic restructuring of our competitors. The task faced by Keating is immense. Just as the international recession in 1974-75 ended the social programs of the Whitlam government, Australia's vulnerability in the world economy has shackled the Hawke government.

While government revenue increased through the economic growth of the mid-1980s, it has not been used to fund new expenditure programs. Instead, it has been channelled into the budget surpluses needed to address Australia's balance of payments and debt crisis. Whereas real federal revenue from 1983-84 to 1988-89 increased by 24%, real outlays remained constant. The potential of Labor's instruments of equity, those welfare programs and community services which promote an equality of opportunity for all Australians, remain unfulfilled. While this has strained the party's patience, the government has had no other choice. Its policies not only have to repair the complacency of earlier governments but keep pace with the fastest growing economies overseas. It not only has to introduce sweeping structural reforms but drag its own party out of the old Laborism of domestic defence.

For the ALP this means redefining its goals for equity and economic performance. Understanding how the real issue is not private versus public ownership in the economy, but monopoly versus competition in key markets. It means acknowledging that only competition in Australia's infrastructure can lower costs and boost productivity. No longer can the ALP prop up public monopolies, with their inefficiency and complacent customer service, in the name of equity. That is why the telecommunications debate was so important. It is not equity Labor defends in uncompetitive markets but all the privileges and waste of monopolies public and private.

Government intervention in the market economy is needed to maximise competition and incentives. Other policy tools can be developed as instruments for equity. Government spending and taxation, if well targeted, can improve both the nominal income and social wage of the less privileged. The relative size of government is no longer a worthwhile guide to reform goals. What matters most is that ALP governments can generate public resources and allocate them to areas of need. Social democracy has set itself the task of sustaining those things the market either cannot provide or actually takes away. The Hawke government has substantially abandoned the policies of domestic defence. This has been the real significance of its tariff reductions, industry plans, award restructuring and training, occupational superannuation and targeted welfare payments. Its agenda now continues under the banner of micro-reform in transport, communications and new federalism.

By far the biggest reform for the labour movement, labour market deregulation, has been left till last. Like tariff policy, it is difficult to understand how, in the long term, centralised wage fixing has helped Australian workers. If Australia is to trade successfully and build a growth economy, it needs a wages system which rewards industries and employees for their contribution to national income.

Centralised wage fixing has also prevented depressed regional centres from offering wage incentives to industry and comparative advantages in the market. This is where the folly of domestic defence is most exposed: trying to argue that thousands of unemployed workers in regional centres, living in an uncompetitive nation, is somehow in the best interests of the working class.

In the end, for Barbara Tuchman, "persistence in error is the problem". She points to the lack of self-confidence by which politicians rarely admit mistakes and pursue new options. History shows how good leadership comes from lateral thinking. An ability to abandon past practices when they no longer serve the public interest. This is the real test for the ALP: to continue to turn around the march of folly.