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# **The Sweet Spot: How Australia Made its Own Luck – and Could Now Throw it all Away**

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Presentation by

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The book that I wrote three years ago was called *The Sweet Spot*. It was about Australia's national condition, and it was a bit of an update half a century on of where Horne had seen Australia in 1964. It wasn't consciously written that way. In fact, it only occurred to me when one of the reviewers said exactly as you just heard – that it's a 21<sup>st</sup> Century reply to Horne.

I want to start with a fable. It's a fable you've probably heard. It's an old Aesop's fable. It's the story of the wolf and the house dog.

In the fable of the wolf and the house dog, there's a hungry prowling wolf out looking for his next meal. He hasn't eaten in days and he's pretty ravenous, and he happens to come across a sleek, plump, very satisfied looking house dog and he says to the house dog, "You're looking pretty well. How do you get to eat so well?" And the dog says, "Oh well, my master takes care of me, and feeds me every day."

The wolf is instantly envious and instantly wants to work out this scam, and inquires about the detail, and as they're talking the wolf happens to notice around the house dog's neck the mark left by a collar in the dog's fur, and says, "What's this around your neck? How do you get that?" And the house dog says, "Oh, that's from where my master chains me up."

The wolf of course is astonished at this and says, "What do you mean, chains you up? You can't move? You don't have your freedom?" And the dog says, "Oh, but I don't mind so much, because he takes such good care of me."

Of course, that's a fable about the balance between the security and comfort of the house dog, and the freedom, but also the leanness and hunger that comes with it, of the wolf.

Now, Australia's genius, in my view, has been getting a balance of qualities of both the wolf and the house dog, and bringing them together. Economists and politicians have put it a different way. They talk about the US model versus the European model. The US, of course, is the wolf model. The US has a very, very scant social

safety net but in the last century, at least, has had much higher rates of economic growth at higher levels of income with a smaller safety net.

The European model, on the other hand, has put greater emphasis on protection, on security, on the safety net, and less emphasis on economic freedom, deregulation, laissez faire and all of that stuff that goes with the European model.

Australia's genius, and one of the reasons that my book was called *The Sweet Spot*, was bringing those two together in a sensible, workable way to get a balance that brings the best of both models and the worst of neither; that is, relatively high economic growth and high levels of prosperity, together with a sustainable social safety net that is all brought together in an affordable way that the country can support in the long run.

It can be done. We're living proof of it. The wolf and the house dog brought together created the dingo. That's the taxonomy of the dingos. I've had to look it up, I confess, but the dingo is a cross breed – a successful cross breed of those two species adapted to Australia's unique conditions. The dingo doesn't get great press, does it? The dingo isn't very glamorous. There was that whole unfortunate affair with the Chamberlains. It doesn't have a great image, but it's well adapted. It's a sprightly, fit creature and not yet headed for extinction, but there are some fears.

The sweet spot that Australia achieved is the sweet spot that I wrote about in this book that was published three years ago. We're now looking in the rear vision mirror, and I want to update the situation shortly, but first of all let's look at the situation Australia hit while the rest of the developed world was still reeling and recovering from what we call the 'global financial crisis', and what the others called the 'great recession'.

Australia had achieved among the highest income levels in the world. In fact, in 2008 Australian income per person exceeded that of the US for the first time in a century. In the 1990s Australian per capita income was about 40% lower than that of the US. By the time we hit 2010 it was 40% higher than the average US per capita income. In fact, Australia's average income per person was higher than that of

France and Singapore, Japan and Britain. The countries to which Australia had always looked as models and guides Australia had exceeded, and also in living standards. This is not just a question of income alone because, as we know, income alone is an incomplete picture. The two credible international measures of living standards are the UN's Human Development Index, and then more recently the OECD's Better Lives Index. According to the Human Development Index published annually by the UN, Australia's living standards are the second highest in the world out of 190 countries surveyed. Norway was the only country that pips Australia, and that's still the situation by a fraction of a point. Of course, I submit that if you add the weather and the climate to the index of measurement, Norway would have to vacate the dais.

To get that outcome the Human Development Index puts together three indicators: income together with health outcomes and educational outcomes. So it's a slightly broader picture. The OECD Better Lives Index is broader still, and puts together 15 different indicators of living standards. It's only been running for three or four years but it puts Australia at the very top – at the very pinnacle of living conditions in the developed world.

Equality is far from perfect in any human society. Australia does not have the greatest measured levels of equality in the world, but by the time we hit 2010-11, Australian equality had pulled ahead for the first time, according to the OECD average. That is, we'd become less unequal than the average developed countries at that time.

We hear a lot about inequality worsening across the world, which undoubtedly it has and continues to do so, but in the great Australian restructuring renaissance and economic revival that we can now look back on over 22 years of unbroken economic growth, not everybody but almost everybody has participated in that improvement. I'm relying on Peter Whiteford of the ANU for my information. Peter says that in the last 20 years the average Australian household, in terms of percentile band, has increased their real disposable income – inflation adjusted disposable income – by about 50%. The lowest 10% of households have also

improved their real disposable household income by about 40%. The top level has pulled away and inequality has widened, but the point is that Australia managed to bring almost all of the country along with the experience.

Now, the trick is getting the balance between those two outcomes – getting the economic outcome and the prosperity, and then the use of that, or distribution of that, or participation in that, to create the equity, the fairness that makes a functional, happy society.

Now, the great rejoinder that you hear to this, and the general international impression of Australia's unquestioned economic success in recent years, is that it was all just luck. You know, "You guys didn't actually create this. This is just because you happen to live on a bunch of rocks that people can profitably dig up and sell. Your success was predestined in the stuff that you found under the ground when white guys first turned up in Australia."

Well, I would say if you look at where Australia began, if you look at the ingredients in the beginnings of the Australian settlement, I don't think you'd say there's anything inevitable about it at all. Sticking Britain's criminal effluent into the driest continent on the planet (with the exception of Antarctica), the driest inhabited continent, with the most fragile ecosystem, imposing a military dictatorship on it and an incredibly racially intolerant policy set, you would not, if you hoped to create a successful economic outcome, think that those were the starting point ingredients, would you? Of course, they're not. It's like the line from the castle – it's what you do with the love. John Keane, who's an academic at Sydney uni and has written a very large but marvellous book on the history of democracy, has commented on Australia's outcomes. The land called Australia hardly seemed the place that would be remembered for its gifts. Now, in this case he's talking about representative democracy. Only radicals believed that that the sunburnt continent called Terra Australis could make important contributions to the world, yet nonetheless it did so – the eight hour day, the secret ballot, the right of women to stand for parliament, the first workers' party to be elected to majority government,

and in the establishment of other rights for the common people, Australia was democracy's champion and history's pioneer.

At the time Australia federated in 1901, that's the end of Keane and this is now me, Australia was a proudly democratic egalitarian society with the highest average income per person in the world. This is something we overlook. We overlook a lot of our own story in Australia. We're busy looking at others stories, mainly the Americans'. We forget that Australia was the first country in the history of the world to vote itself into existence with the federation referendum. It was a profoundly democratic starting act in Australia's modern history.

I'd also say to anybody who thinks that national destiny and national success is written in, there's a whole literature, as you know, about the reasons for national success, its resource endowment. You know, the whole mining argument. No, it's cultural. No, it's racial or there's even a theory that it's linguistically based. All of these schools of thought have their day, but to anybody who believes in any of those things, I have five words. North Korea and South Korea. Here you have two countries created out of one country, out of one people. It's a pretty recent construct, and it goes back to the Korean War. Same people – linguistically, ethnically identical. In fact, millions of Koreans are related across the border to people on the other side. If you look at the resource endowment it's actually North Korea that got most of the resources. Most of the coal and other mineral resources are under North Korean soil, not South Korean, and yet look at the outcomes. North Korea is one of the most abject countries in the world with sub-Saharan levels of poverty. About a third of the country is in permanent famine and it has just the most dreadful record of human rights and economic deprivation. And there you have South Korea, a thrusting, prosperous, vibrant capitalist economy, one of the most successful on the planet. What does that tell you? It tells you that the determinative of power, of resource deployment, resource endowment or racial type or linguist group or whatever is not the central determining factor. The swing factor is the quality of governance and policy.

With Australia's current prosperity, sure the mining boom has kicked into it, but [it isn't wholly responsible for] Australia's happy, modern situation. Or maybe I shouldn't use the word 'happy' because we all love a good whine. In fact, I don't know if you hear this, but visitors from abroad sometimes comment that they'll turn on the radio or TV or read the newspapers, and you'd think the country were in a pretty bad condition, because we love a good whinge. We fill the media with our complaints, and that's normal – everybody likes a good whinge – but we need to keep things in perspective here. In the available spectrum of actual national conditions and outcomes around the world, Australia did achieve the best living conditions on the planet; in fact, if you look at it historically, the best in human existence. The mining boom has added an increment of income to the late phase of the 22-year boom that Australia had running. But let me just point out to you, because visitors from abroad assume that it was all just the mining boom, and a lot of our politicians tell us the same thing, and of course the mining lobby tells us exactly that, but the truth is that Australia, at the time of the first phase of the mining boom kicked in in 2003-4, already had enjoyed the longest boom in its history. Household income had already doubled under the Howard years, the Howard-Costello years. Unemployment halved. Australia had already been held up by the OECD as a model economy.

Paul Krugman, the Nobel Prize-winning American economist, had already held Australia up as the miracle economy of Asia. Australia had already ridden through. I mean, remember they used to say about Australia that when America sneezes Australia catches cold. Well, Australia had already ridden through undisturbed the Asian financial crisis which took some of our major trading partners into recession, we lived through the 2001 US recession, the so called tech wreck, the stock market crash and the recession that followed, and then the great recession or the global financial crisis. Australia had done all of that – except for the most recent one, the most recent global financial crisis – Australia had done all of that before the mining boom arrived in 2003, roughly. So the mining boom added an extra kick at the end. According to the Reserve Bank it's added about 14%, roughly one-seventh to Australia's national income, and of course it's contributed enormously to Australian

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exports. It's not any minor detail. However, it did not create, set up or sustain the current Australian wave of prosperity.

In fact, it was mining, and mining booms and the mentality that that produces, that led Donald Horne to the central thesis of his complaint about Australia as he found it in the 1960s, and that is complacency. It's the great complacency which so frustrated, angered and annoyed him, and I'll quote him. Now he doesn't talk in *The Lucky Country* so much about the mining boom, but let me tell you what he said and then I'll tell you what he said to me later on. He wrote, and this is the most famous phrase, of course, from *The Lucky Country*, under the sub heading, 'Living on our Luck', Horne wrote, "Australia is a lucky country," and this is a very familiar line, of course, "run mainly by second rate people who share its luck. It lives on other people's ideas and although its ordinary people are adaptable, most of its leaders in all fields so lack curiosity about the events that surround them, they are often taken by surprise." It's a searing indictment of Australia's leadership class and the great national complacency. It's sort of a cargo cult mentality that Australia has long had, that you just need to sit around long enough and another boom will turn up and you don't really need to work for it too hard, and in the same phase Horne was actually very critical of Australian expectations. It was not just the complacency of the leadership class, but the expectation and what today might be called entitlement mentality of the general population.

Horne wrote, the general Australian belief is that it's the government's job to see that everyone gets a fair go, from old age pensioners to manufacturers. A fair go usually means money. Australians see government, which they both trust and despise, as an outfit whose job is to help them where they need help. The fair go, according to Donald Horne, is essentially a non-competitive concept, a demand for protection, an attempt to gain security and certainty. Whether it is an underdog in a factory or a top dog demanding tariff protection, the feeling is that justice lies in a guarantee of existence. To fight for existence in an open market must be avoided, although one may use legal or other lurks. This was the overall mindset that the country was in at the time Horne wrote this in the '60s, and he asked the rhetorical question, can the racket last? And in the only use of all cap letters in the whole

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book, he wrote the answer "NO!" in capital letters, exclamation. Australia's real luck was in breaking out of that leadership void, that complacency that Horne wrote about.

It's not fashionable to say this and we certainly didn't necessarily appreciate these people at the time they were in power, but it's pretty clear looking in the rear vision mirror that we had a generation of high quality political leadership in Australia. We had the Hawke and Keating years, followed up by Howard and Costello. Now, in both of those governments we saw difficult and unpopular reforms implemented in the national interest. Remember, politicians don't need to do anything difficult or unpopular if they choose. They can talk nonsense, muddle their way through and just do nothing, or do what they think you would like them to do. National leaders who do difficult and unpopular things because they think it's the right thing to do are rare. We were blessed with an entire generation of them, the combination of those four individuals and the governments that they led.

People say sometimes, and this is a common question, they say, "What's Australia's biggest problem? Is it your health system? Is it productivity? Is it education? Is it the high Australian dollar? What's the biggest single problem that the country has?" My answer to that is, well the biggest single problem is not so much any individual problem, but the problem-solving mechanism itself – the problem-solving mechanism that we call national politics. In my view, we got lucky. We got lucky with high-quality national leadership. We did not get lucky with a mining boom.

Sure, a mining boom has advantages, and I've mentioned some already, but it also brings high costs. The greatest of those costs is that complacency and that mentality that we don't really need to work for it, because the world will deliver it to us. But there are other costs as well. Why has the Australian dollar spent so long above its post-float average of 75 cents? Why is it being at parity with the US dollar and is today around 92, 93 cents? Well, that's the mining boom, and demand for Australian resources pushed up the Australian dollar to levels which made every other sector uncompetitive. To accommodate the mining boom every other sector has absorbed a competitive disadvantage.

There are lots of reasons that you don't want an economy to be sustained only by a mining boom. It's a really bad idea. Apart from the fact it generates only around \$1 out of \$10 of national income, only employs around 2-3% of the workforce, what successful, prosperous modern economy could possibly run with only 3% of the workforce in gainful employment? So a mining boom is both a blessing and a curse, and needs to be managed and needs to be put in the proper context as being just another event. Just another economic event in a larger framework.

Australia's great economic rejuvenation and reform that snapped it out of the phase that Donald Horne saw it in happened under those reforming governments that I already mentioned, Bob Hawke, Paul Keating and then you had John Howard and Peter Costello; well, certainly the first phase of the Howard-Costello years. Now, it's no coincidence that that phase happened not during a mining boom, but between mining booms. All of those reform years occurred when there was no mining boom going on in Australia.

Likewise it's no coincidence that what the economist Ross Garnaut calls "the great Australian complacency" returned, according to Garnaut, in his dating system, in the year 2000 or thereabouts, and then the mining boom arrived shortly after, around about 2003, depending on exactly where you want to measure your commodity price increases from. Garnaut has called the time that we're in now, starting 14 years ago, "the great complacency", and there is indeed an old adage among policy circles that good times bring bad policy. After a long run of unbroken economic growth and then followed by a mining boom, it's about as good a time as you could get.

Did it bring bad policy? Let me just return to Donald Horne for a minute. When I interviewed Donald Horne in 2005 it did happen to be the last interview of his life, but he was very frustrated. He was frustrated partly because his health was really poor and he was wheezing and coughing as we spoke and he kept apologising for it, but he was also frustrated because of this exact factor. He said to me it's quite appalling to discover people saying today that Australia is still the lucky country because we have all these minerals. There's still a bloody lucky country mentality.

He said that he thought Australia had improved mightily since he'd first written the book, because we had enjoyed the benefit of that economic restructuring. We had enjoyed a recovery in Australia's relative position. Remember that when he wrote the book in the '60s Australia was at the beginning of a long, gentle, slow but very real decline in its relative position in the world. That had turned around by the time I was talking to Horne in 2005, and yet he saw everything that Australia had accomplished being thrown out the window if there were a return to this lucky country mining boom complacency. To my mind, relying on a mining boom to power a national economy is like taking a surf board down to the beach and waiting for a tsunami to get a good ride. You know, you might wait a bloody long time, and when the thing turns up you might regret what you're getting, what you asked for. It's inherently unpredictable. These are massively disruptive events and certainly not a serious basis for building a sustainable national economy.

Now, this great complacency, is this true? Is Garnaut right? Was Horne right? Did Australia return to a great national complacency? Well, I'd point out a couple of things in our recent political history. One is that you'll remember when Australia voted the Howard Government out in 2007 – that was the first time in Australia's history that we had voted out of power a government at a time of unambiguous economic growth. What does that tell us? I suspect that tells us that we'd come to take economic growth as a given. That it's not something that we particularly work at, worry about or place high value on. And then perhaps confirming my suspicion, when the Labor Government under Rudd, with a little help from the Reserve Bank and 1.3 billion Chinese people and their government stimulus programme, when Labor managed to get Australia through the great recession without a recession of its own, we seemed to take that for granted as well, and he was bundled out of power by his own party before the electors could even get a chance to vote on him. Both in the last years of the Howard Government, not the early reformist years, but in the last years of the Howard Government, as well as in the Labor Governments that we've just seen, there was a persistent message that we could have everything.

In my view, they did pander to our complacency and our sense of entitlement. Now we see the mining boom disappearing. What have we got left? I mean, it's tailing off pretty notably. We can now see the end of the thing. What do we have left? What do we have to show for it? You don't hear politicians ever saying this, but I reckon that some of Australia's greatest achievements were bipartisan. Both sides of politics can take some credit. Many of our greatest national failures have also been bipartisan. Both parties can take blame. You won't ever hear a politician say that because they're too busy taking credit for themselves and apportioning blame to the others, but in my view, it was both parties under Hawke-Keating and then Howard-Costello who contributed to the rejuvenation of the country, and both parties under the last years of Howard and under recent years of Labor that have catered to our sense that everything is okay, perfect yet improving, and they can continue giving us everything we want.

What do we have left at the end of the biggest mining boom in the history of the country, and 22 years of unbroken growth? Well, we know we've got much higher living standards and incomes than we had 20 years ago. But we also have a country, if you look at the federal government's finances, it's true that there is no budget emergency, however what we do have is a federal government that spends 26% of GDP equivalent and collects 23 in taxes. Now that's a three percentage point of GDP gap. For how long can you continue to spend three percentage points more than you collect in revenue? I mean, there's only one inevitable outcome of continuing that pattern of behaviour.

We had half begun improvements on some big equity projects in Australia under the initiative of Labor and Gillard, and I think it was actually Bill Shorten's particular personal project at the beginning, the National Disability Insurance Scheme. We saw Labor propose and the Coalition accept on a bipartisan basis the desirability of an NDIS. We see important work going to the foundation of that, and yet it's clear that there are major hesitations now about the funding and the ability to pay for it, and there is now a major rethink going on by the Coalition about what, when and how it can deliver. We see sluggish growth in the economy for some years to come, not terrible but certainly not up to potential either, and we see unemployment in

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Australia almost on the same level – roughly 6%, almost 6%. That's the level of US unemployment, after the US has just come through one of the greatest and most wrenching economic downturns in its history. We can't do better?

In Australia's history I would put it to you that from federation to today we've seen the pendulum swing only four times. Now, the pendulum I mean here is in any policy decision. As you know there's a tension between efficiency on the one side, and equity or fairness on the other. Every major policy decision has to address both equity and efficiency, but inevitably there's an emphasis one way or the other. In my view, from federation until 1983 – it's a long span – the emphasis in Australia and policy making was on equity. This was a new country where the national project was nation building, federating the states and creating out of a colonial society a new country with a new identity, and we saw what's been called the Australian settlement. Under the rubric of the Australian settlement we saw White Australia, a closed enclave, part of the British empirical economic structure with a protected economy, high tariff barriers protecting it from global competition and then arbitrated wages and a very rigid national wage system.

Then the pendulum swung the other way in 1983. When Hawke and Keating took office they began then a phase where the emphasis went off equity and on to efficiency, and that's the rejuvenation of the economy. The trick is to get the balance, of course. It's to try and pursue one without losing the other, and I would submit to you that the emphasis on efficiency ended in 2007, maybe a little earlier, depending on how you interpret the late Howard years. According to the Treasury, by the way, in the last years of the Howard Government the mining boom generated windfall gains of \$320 billion to the federal government. The Howard-Costello Government gave away as tax cuts or spent 94% of that, according to the treasury. So this was not a frugal government by the end of the Howard-Costello years. They were, I would submit, also entering the great complacency.

From 2007 to 2013 we saw the emphasis under Labor switch back to equity over efficiency. Now, it's true that the Rudd Government got the country through the

global downturn without a recession, and it's also true that at that time it was an expensive stimulus project, but it worked, and at that time, the Rudd Government said, Australia's net debt will peak as a result of this stimulus episode – we've spent a lot of money, but the net debt will peak at 7% of GDP and then it will start to taper away. Well, when Labor left office, it was 13%. It is today around 13% of GDP and still increasing. As I was saying before, you can keep that up for a while, but who deals with this? Where is the reckoning? How long do you leave it and how wrenching does it become? The equity gains and equity emphasis from that government, there were some great initiatives – the indexation of the aged pension, the creation of an NDIS, the vision of a needs-based school funding model, the Gonski model, these are all great ideas, which is why they had bipartisan support, or at least up to a point they had bipartisan support. The question is how to get the balance – to get the equity improvements and the economic efficiency – how do you get the balance? How do you achieve that sweet spot?

The Abbott Government, I think we can now say, and this evidence is actually pretty fresh I think, is swinging the pendulum back the other way. Away from equity and back towards efficiency. There were two threshold moments. The first was the decision on protection of the car industry. The second was the budget, where we see the government not only retrenching spending – which was, in my view, at some point necessary, and the Abbott Government hasn't persisted in the fiscal fantasy that the country can continue to spend more than it collects and get away with it forever – but they've also made choices within that fiscal envelope. They've made specific decisions about spending and resources that are very ideological and are trying to force a change in national behaviour, national culture, national thinking explicitly, as we know from the treasurer, to break what he calls the age of entitlement. In my view, I won't develop this theme at the moment, but I've written about this, this budget reveals a more ideologically driven conservative party than the Howard Government itself, which had been thought to be the high watermark of conservative ideology in this country. It's not. Now the trick is that the government not forget – and the pendulum does swing, there are lurches and movements and emphasis – but the trick is that the government conduct the



necessary fiscal repair without forgetting the essential value of equity. Now, there's a common assumption, especially among hardline conservatives, and especially among economists, that the concept of equality or equity, which are two different concepts but related, is some warm and fuzzy thing. It's an ideological thing. It's an emotional thing, and for many people it is, but it's much more than that. There's no such thing as perfect equality, but reasonable, manageable, sustainable equality is a highly utilitarian concept. We know that with increasing certainty from the mounting pile of research that we see.

The groundbreaking book *The Spirit Level* by Richard Wilkinson and Kate Pickett summarised beautifully the body of empirical work building on this subject to make an overpoweringly, in my view, persuasive case that inequality contributes to social ills and problems. It's taming, managing and buttressing the balance between equality and inequality [that is] essential to the success of a modern society. They summarised more than 200 published peer review papers testing the link between income inequality and health, and more than 50 on the link between income inequality and violence, and wrote that it is clear that greater equality, as well as improving the wellbeing of the whole population, is also the key to national standards of achievement and how countries perform in lots of different fields. Inequality contributes to violent crime, depression, mental illness, obesity, educational failure, even personal debt among the social ills of Western societies that grow worse as inequality grows worse and improve as equality increases.

This is empirically based. This is not ideologically asserted evidence. Equality is not just something that makes you feel good, and it's not just rooted in some fond, fuzzy concept of mateship or being nice to each other. It's actually a hard utility of a modern society and the greatest contributors to equality, we now know from mounting evidence as well as, I guess, common sense, are education – and we heard Julia Gillard on that subject yesterday – and employment. These are the two great equalising factors in Australian or in any society.

Knowing that then you have to kick in the efficiency factor. How do you pay for quality education? How do you have a successful economy that generates



employment for everyone who wants it? You need the economy to be sound, sustainable and generating the prosperity to pay for the social equities that we mustn't forget. We hit a sweet spot. We need to work out how to sustain it. Governments have to keep in mind both parts of the equation.

Australia is neither a fat, lazy house dog nor an aggressive lone wolf. We have produced a unique national combination. We need to develop, sustain this well-adapted, sprightly local model. I hate to use the word dingo again, but this is the balance that the country has pioneered between the house dog and the wolf, the US model and the European. It's a unique thing. It's an immensely valuable thing. We need to preserve it. We need to work both sides of the equation, and contrary to common belief, it will not eat your baby.

Thank you.

