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Editorial

Jeremy Bentham, the English philosopher who first tried to place public policy on a scientific footing, defined agenda as the desirable activities of government. He contrasted agenda with sponte acta — activities that individuals carry out spontaneously — and with non-agenda — undesirable activities of government. With economic development, so Bentham believed, the agenda would gradually shrink as more and more activities became sponte acta. ‘Be quiet ought . . . to be the motto, or watch word, of government.’

Bentham wrote these words in the first few years of the 19th century. A few decades later, Britain was in the midst of a long period of reform in which many obstacles to individual freedom and enterprise were swept away. But by the end of the same century, opinion had begun to turn against Bentham’s vision of small and shrinking government. In the 20th century, this trend in thinking has continued. As a result, government has grown greatly in size and scope.

Yet in the last 20 years the agenda of government has become controversial. With the slowing of post-war economic growth in the early 1970s came the realisation that well-intentioned government interventions often did more harm than good. Since then, the systematic study of public policy has grown and become a private-sector as well as a public-sector activity whose findings are widely broadcast. But although some critics of public policy are inspired by a priori views of the limits of government that stem from the liberal tradition, most of them remain within the Benthamite framework of utilitarian pragmatism by searching for policies that work.

In choosing the title Agenda for this new journal, then, we allude not just to the ‘desirable’ role of government but to the more common definition of the term: ‘items to be considered’. No proposal for a government role in the economy is ruled out. But it must observe the hallmarks of serious policy analysis: comprehensive and reliable evidence, and sound interpretation. This includes an emphasis above all on the remote, unseen and unintended consequences of policies and policy proposals.

Neither the title nor the subtitle limits the journal’s scope to economic policy. We aim to give space to articles on the ideas and doctrines that inform policy debate, and on the institutions and processes through which policies are formulated and implemented. We welcome contributions from all disciplines relevant to public policy: this inaugural issue includes two articles by lawyers on the legal protection of human rights, for example. Academic specialisation may be unavoidable, but it need not result in ‘narrowness’ if experts in their chosen fields retain a curiosity in and openness towards other disciplines. But if these qualities are to bear fruit, there has to be easy and lively communication between writer and reader, which in turn requires an effort to write English plainly and with as little resort to technical terms as the topic under discussion allows.
The growth of government, combined with the expansion of media technology, has produced an explosion of policy information that threatens to become overwhelming. But we are confident that a place exists for a policy journal that, while observing the traditional standards and procedures of academic publishing, appeals to a public that takes the long view and does not allow each government statement to obliterate its memory of all previous ones. We await your verdict.
Why Labour Is Not Different

Gerald T. Garvey

The notion that the labour market and the employment relationship are fundamentally different from other markets and contractual relationships underpins a great deal of government interference in the lives of Australians. The centralised approach to wage determination, the privileged status of trade unions, and recent proposals that purport to ease the burden of the long-term unemployed are all based on the idea that many of us lose the ability to perceive and protect our own interests when we are on the seller side of the labour market. Short shrift is given to the basic economic insight that labour-market outcomes for all parties can be improved simply by removing the huge number of policies that impede the formation of employment relationships on terms that are acceptable to both buyer (employer) and seller (employee).

Why do labour-market policies give so little weight to the goal of allowing and encouraging voluntary exchange between consenting adults? The standard argument is that the assumptions of economic theory are so drastically at odds with the realities of the labour market that economists have nothing to contribute. It is widely believed that the suspension of awards, monopoly unions, penalty rates, and 'comparative wage justice' would not move us closer to the ideal world of economics textbooks, in which employers and employees contribute to one another's future prosperity. Rather, we would have, in the words of Paul Keating, Australia's Prime Minister, 'a return to the dark ages of master and servant... a matter of taking the bosses' conditions or taking the sack' (Australian Financial Review, 15 October 1992, p.15).

The reality is that although many labour markets differ substantially from markets for stylised commodities, they do not do so in a way that invalidates basic economic principles or policy prescriptions. The benefits of free choice in the terms and conditions of employment are, if anything, greater than those we enjoy in more mundane areas such as the supply and demand of foodstuffs, lawn mowers, or housing.

The Standard View of Labour Markets

A clear statement of the standard view that labour is somehow different from other economic goods, and that the differences justify the Australian approach to labour-
Brook sets out her free market model for dealing with labour relations. The marketplace should govern the free exchange of labour, as well as decisions about investment and the purchasing of goods and services. Employment contracts should be between individual employees and their employers. Any laws that are perceived as giving trade unions advantages must be repealed. As I believe that the marketplace for human capital cannot be equated with the market for investments and for goods and services, I disagree with her approach. . . . For those like myself who argue that collective labour law is essential in a capitalist society as the best means of equalising employee power, this book shows that it is time to defend the collectivist elements of our labour laws.

This passage exhibits a fundamental ignorance of the basic principles behind the market for investments, goods, and services as well as that for labour. All markets involve human beings. All exchanges within markets enhance the well-being of all parties involved, in their own judgment. Forming and maintaining a long-term employment relationship no doubt involves a great deal of uncertainty and complexity, and has a large impact on the material and psychological welfare of the parties involved. So it is with the provision of venture capital or the purchase of a home. The participants in these markets also experience the anxiety, hope, trust, disappointment, and so forth that characterise all important social interactions. And every economic interaction provides at least expected benefits for both sides. Even the profits that the 'capitalist' is often portrayed as expropriating from workers, in fact accrue to people who entrusted the fruits of their own past labour to the enterprise.

The preceding discussion is based on the most basic economic principles. As Judith Sloan (1994) observes, modern labour market research goes well beyond the textbook conception of the labour market as involving once-off deals between faceless parties. The research also highlights the importance of allowing precisely the sort of contractual freedom that McCallum disparages. The message that individual free choice is the best policy for both sides of the labour market is amplified by recognising the uncertainties, complexities, and long-term nature of many employment relationships. It is the collectivist approach that understates the complexities, uncertainties, and importance of the labour exchange process, and that facilitates the exercise of capricious power over the fate of individuals.

The following sections examine, first, several arguments for regarding labour as different, and second, some policies that flow from these arguments.
The ‘Humanistic’ Argument for the Uniqueness of Labour

Perhaps the most fundamental argument for the uniqueness of labour is that a person’s job is a critical determinant of his or her psychological as well as financial well-being. This argument holds that ‘good jobs’ are vital to achieving ‘self-esteem’ and ‘empowerment’. Whatever these terms mean, it is hard to imagine how they are enhanced by labour-market policies that dictate the terms on which one may accept a job and often the methods one may use once on the job.

It is undeniable that unemployment and/or unpleasant, low-paid jobs are undesirable for the individuals involved and perhaps for society at large. But this observation has special implications for labour-market policy only if a person’s psychological and financial well-being is not affected by any other item he or she might consume or sell. One’s home, automobile, investments, child-care arrangements, holidays, and so forth would have to be mere ‘commodities’ that exist only to sustain biological life; and the quality of the goods and of the relations one has with the sellers of these goods, for example, would have to be a matter of pure indifference.

In fact, the economic value of anything is solely determined by the benefits that it provides for people. The value of a motor vehicle can be stated in terms of ‘empowerment’ (in concrete terms, it delivers the ability to travel, to take romantic interludes, to take one’s children to see their relatives, and so forth).

Suppose we took seriously the logic that we must impose heavy-handed regulations on all markets that, like the labour market, have a vast potential to affect the welfare of the buyers and sellers involved. Since, as already established, motor-cars are an important good, we should have a centralised automobile tribunal that specifies exactly the type of motor-car that each type of person shall have. Or we might take a more laissez-faire approach and specify minimum prices that sellers must demand (in order to protect them from receiving less than the equivalent of the minimum wage). As experience in the ex-communist world showed, such systems tend to provide the population with very few automobiles of very low quality, allocated to those with inside privileges. This is a disturbingly accurate description of many areas of the Australian job market.

Nor is the labour market different in involving interpersonal relations. Unpleasant fellow workers or superiors certainly may compromise one’s self-esteem; but so can a tradesman who highlights one’s own inadequate knowledge of plumbing or mechanics. Presumably no one would suggest that the ideal way to ensure against such personal pain is to force all those who use tradesmen to join a single union with the ability to call out one’s fellow consumers on a general strike. The idea that no one should be able to contract to have leaky taps fixed or motorcars repaired until the individual grievance was resolved is no less absurd in the context of labour markets. It is merely more familiar.
The ‘High Moral Ground’ Argument

Closely related to the humanistic argument is the notion that working conditions agreed to by employers and employees are somehow morally inferior to those mandated by a tribunal. Shann (1930:375) describes the genesis of the Australian wage-fixing system in just such terms: 'In 1907, a Judge of the High Court of Australia, presiding over a Federal Arbitration Court, took high moral ground in claiming for the workers a wage independent of supply and demand' (emphasis added).

This statement relies on a depersonalised vision of the market as involving 'merely' supply and demand. When we recall that suppliers and demanders are in fact people looking to better their own lives, we see that Justice Higgins was really claiming for himself the right to decree the terms on which suppliers (that is, workers) were able to offer their services. The coercive and immoral consequences of this approach are with us today. Johnston (1993) reports that in November 1993 the Maritime Union of Australia fined nine workers from Australian Stevedores for an offence in which, according to the workers involved, 'instead of taking their time, they got in and got things done'. The union’s defence of the fine was that the employer had ‘coerced’ the men into working in this manner: as if no coercion were involved in the collection of the fine!

The Unequal Bargaining Power Argument

The textbook treatment of markets assumes many buyers and sellers, none of whom individually has any impact on the market outcome. It is often claimed that many labour markets are in fact dominated by large employers, or at least would be so dominated if it were not for the 'countervailing power' exercised by monopoly labour unions. The conditions allowing a firm to exercise power in the labour market are, however, far more stringent than is generally supposed. It is not sufficient for the firm to employ many people, although this makes it look 'large' relative to the employee. The employer must be the sole demander of a particular type of labour, or must collude with all other potential employers to prevent them from 'poaching' his underpaid workers. Unless these conditions are satisfied, the fact that an employer is large relative to an individual employee says nothing about the relative amount of market power these parties exercise.

Clearly, there are cases where a single employer is dominant over a geographical area and hence exercises some potential market power. On the other hand, in many such cases the employer is equally reliant on the 'isolated' workforce. This is in part what allows workers in remote areas to use the strike threat in order to extract high wages and/or luxurious working conditions. More generally, the key problem of market concentration and collusion is far more severe in markets other than that for labour and is the concern of trade-practices law. Labour is not unique in having 'size' imbalances between buyer and seller; in fact, it is characterised by
relatively mild problems of market power. Moreover, where market power is detected, the appropriate response is to support or enhance competition, not to compound the problem by enforcing monopoly unionism on the other side of the market.

The Ignorance Argument

A related concern is not that employers actually collude but that potential employees do not have sufficient information to use the bargaining power they possess. Isaac (1982:499) claims that ‘real people often behave irrationally in economic terms because they lack the information to behave otherwise’.

It is true that no one makes decisions with complete knowledge of all available alternatives. But it is a huge leap to conclude that this causes people to behave in a way that is counter to their interests (this is what it really means to ‘behave irrationally in economic terms’), since decision makers have every incentive both to recognise gaps in their knowledge and to take steps to fill them. An employee who relies on a false representation by his employer bears the full cost of this naivety. To be sure, choosing a job is far more demanding than choosing a cabbage. But this added complexity increases the importance of allowing the individuals involved to choose for themselves. Although a member of the Industrial Relations Commission might be able to select an appropriate cabbage for most people, none is able to select an appropriate job. Of course, this argument unfairly understates the difficulties and complexities involved in producing and distributing cabbages. Citizens of centralised economies, past and present, have been notably deprived of such ‘commodities’.

The Authority Argument

One further feature of the employment relationship may give the impression of unequal bargaining power. This is the fact that, in many workplaces, employees are to some degree subject to the directions of their supervisors and managers. Indeed, as Masten (1988) argues, a key distinction between the independent contractor and the employer/employee relationships is that the employee agrees to obey a (limited) set of directives from his employer. But this ‘managerial prerogative’ to direct the manner of work does not in any way suggest the oppression of employees by employers. It is simply an efficient way to organise production in some circumstances (see Garvey, 1993 for details and references on the efficiency attributes of authority arrangements). Employees voluntarily agree to work under these conditions. It is also a delusion to claim that they do so only because they have ‘no choice’. If employees find the exercise of managerial prerogative to be irksome, they will receive

1 Ironically, some of the excess profits that large firms are able to make at consumers’ expense seem, in practice, to accrue to the employees of the seller. This linkage was explicit in the Australian policy of granting of tariff protection to allow employers to pay high wages; but it is also observed in the US and elsewhere (Krueger & Summers, 1988).
higher remuneration than for equivalent jobs offering greater personal autonomy. In this way, the cost of exercising authority over employees is borne by employers, a fact that is reflected in many recent employer-led drives to allow greater autonomy and ownership for their employees.

**Minimum Standards to ‘Protect the Weak’**

A number of labour-market policies are based on arguments for the uniqueness of labour. The distinction between labour and other ‘commodities’ sometimes represents a justifiable (and provisional) simplification that serves to facilitate analysis of specific markets. But it is more often invoked to banish economic reasoning from the labour-market policy debate. For example, mandated minimum prices or conditions are no longer seriously defended as a way to help wool growers or landlords. The perverse side-effects of rent control and wool-price floors are widely recognised: outright physical waste such as decaying buildings and unused wool-stocks, and serious additional hardships for poorer tenants and for wool farmers. Only by asserting that labour is fundamentally different can one defend our comprehensive system of minimum wages and conditions. In fact, low prices in each case reflect the fundamentals of supply and demand: wool growers cannot prosper when the price for their good falls, nor can workers whose current stock of skills is not in high demand. Australia's labour-market policies even make it illegal for workers to enhance their skills through on-the-job training (see Boot, 1992, for further discussion of the training issue).

The recent Green Paper on unemployment (Committee on Employment Opportunities, 1993) espouses the belief that labour is different in a way that justifies mandatory minimum standards. Chapman (1994) argues that the New Zealand case demonstrates that deregulation of conditions is not the way to help the long-term unemployed. But, as Brook (1991) pointed out even before the New Zealand Employment Contracts Act came into force, minimum wages and conditions of employment were not removed, but have continued to curtail the job and training opportunities of those whose current stock of skills would place them in the 'low-paid' category. And, consistent with basic economic theory, these people have not been much helped by economic recovery.

**Using Labour Market Policy to Encourage Specific Outcomes**

The business press has for some time been preoccupied with the idea that we are entering a new era featuring employee empowerment, total quality management, better employee relations, decentralisation, and devolution of authority, to name just a few of the current buzz-words. The Business Council of Australia (1990) has argued that the new world of global business requires enterprise bargaining and representation at the enterprise level. This may encourage lead unions to be more responsive to the demands of their members and their employers. But, as Brook (1991) points out, it simply replaces one form of mandated structure with another
Why Labour Is Not Different

that is more attractive to business. Enterprise bargaining may not be the optimal way for some employer/employee pairs to conduct their affairs, and there is no gain to mandating such structures. Indeed, the central goal of introducing enterprise-based employee relations seems to be to ensure that no workplace has more than one union representing its workers (see especially Hilmer, 1993). Although this is probably a sensible arrangement in many cases, such a structure would emerge quite naturally in a system where employees were free to choose the sort of representation they wish. Labour-market efficiency and fundamental human rights for sellers of labour require freedom of contract and representation, not a new mandated structure.2

Conclusions

It is a common delusion to treat people’s choice to sell their labour as fundamentally different from other economic choices they might take. Every market interaction involves people seeking to enhance their own personal ends (which can easily include charity and altruism as well as concern for one’s own immediate family). The exchange of labour services certainly involves a great deal of uncertainty and open-ended commitment by both buyer (employer) and seller. As with the purchase of many complex goods, there is more to effecting mutually gainful exchange than merely exchanging a good for money. Far more sophisticated contractual arrangements are called for. But the parties involved have every incentive to choose the appropriate set of arrangements and safeguards (see Garvey, 1994, for a more detailed discussion). The appropriate set of safeguards might well include labour unions where there is a demand for such organisations to support rather than impede exchange. Indeed, some New Zealand unions have been increasing their membership since the Employment Contracts Act 1991 relaxed their monopoly hold over workers (Boxall & Haynes, 1992; Kiely & Caisley, 1992). Some other unions whose role in the labour contracting was less benign did lose membership. Labour is not different from other commodities in any economic or moral respect that removes it from the scope of conventional economic analysis. Workers are not well served by a system that restricts their freedom to engage employers on mutually acceptable terms. Individual employers and employees are the parties who can best manage the complexities encountered in exchanging labour services and developing human capital. Since unions and other ‘collectivist’ aspects of the labour relationship will be chosen where appropriate, there is no case for mandating them.

2 Matthews (1992) argues that mandated minimum standards are required to ensure that businesses prosper in the world of the globally competitive, total-quality managed business. This argument rests on the bizarre premise that low-quality products will out-compete high-quality ones. But the argument is no more bizarre than the one implicit in the Business Council of Australia’s advocacy of enterprise unions, namely, that companies will forgo the high profits they could allegedly realise by shifting to enterprise unions.
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An Economist’s Guide to the Industrial Relations Reform Act

Judith Sloan

Most economists despair when they consider the complex and obscure industrial-relations (IR) arrangements that apply in Australia. Conversely, many of those who follow the details of IR regulations and institutions in Australia know little about economics. This chasm has unfortunate consequences. Economists tend to support more rapid IR reform, yet often have little idea about how change might actually proceed from the present institutional starting point. More damaging are the recommendations for IR changes that are uninformed by any understanding of their economic effects.

The re-election of the Labor government at the 1993 federal election had profound implications for the direction of industrial-relations reform. Whereas the Liberal-National Coalition had been advocating an effective transformation of IR arrangements through the phased abolition of compulsory arbitration and its replacement by enterprise bargaining, ALP policy involved only marginal change. Commentators were therefore taken by surprise by Prime Minister Keating’s first major speech after the election, when he spelt out an IR reform agenda that had much in common with the Coalition’s policy. He spoke of the primacy of bargaining over awards; of agreements becoming more than add-ons to awards; of the need for awards to become simpler; and of the need to open up bargaining to non-unionised enterprises. At the same time, he foreshadowed a legislated ‘right to strike’ and the use of Australia’s signature to International Labour Organisation (ILO) Conventions to guarantee minimum entitlements to all workers.

As the year wore on, however, it became increasingly clear that the Labor government would not deliver real labour-market reform because of the binding constraint of its relationship with the union movement. What eventually emerged was a piece of legislation, the Industrial Relations Reform Act 1993, which paid lip-service to the rhetoric — ‘flexibility with protection’ — yet which involved complex and convoluted extensions of the centralised IR system combined with a highly regulated bargaining stream.

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An Overview of the Industrial Relations Reform Act 1993

The Industrial Relations Reform Act 1993 is an extremely complex document of over 200 pages. To operate in conjunction with (and amending parts of) the Industrial Relations Act 1988, it provides for highly detailed and transcending regulation of almost every aspect of industrial relations.\(^1\) The Act is divided into six parts. Some of the key changes include: new objects for the Act; the spelling out of the role of the award system and rules for award variation; a range of minimum entitlements; the promotion of bargaining and facilitation of agreements; and new provisions governing secondary boycotts.

The objects of the new Act emphasise the prevention and settlement of disputes through conciliation and the making of agreements. But the arbitral option is retained. In addition, an object of the Act is to provide the means for 'establishing and maintaining an effective framework for protecting wages and conditions of employment through awards' and 'ensuring that labour standards meet Australia's international obligations' (p.2). A further object is to 'prevent and eliminate discrimination on the basis of race, colour, sex, sexual preference, age, physical or mental disability, marital status, family responsibilities, pregnancy, religion, political opinion, rational extraction or social origin' (p.3).

Part 3 outlines the award system. Awards are seen 'as a safety net of minimum wages and conditions of employment underpinning direct bargaining' (p.3). The Industrial Relations Commission (IRC) is instructed to ensure that 'the system of awards provides for secure, relevant and consistent wages and conditions of employment' (p.4).

In Part 4, a number of minimum entitlements of employees guaranteed by the Act are detailed. Resorting to the External Affairs power of the Constitution and Australia's signature to a number of international conventions, the Act establishes minimum entitlements in five main areas: minimum wages, equal remuneration for work of equal value, termination of employment, parental leave, and leave to care for immediate family. Of the five categories, the most radical changes from previous practice relate to termination of employment. Employers are now required to prove both substantive and procedural fairness when dismissing employees. Employees who have, in their opinion, had their employment unfairly terminated can apply to the new Industrial Relations Court (which takes over the industrial-relations functions of the Federal Court) for re-instatement and compensation, although the Commission may conciliate on the matter.

Part 5 deals with 'Promoting Bargaining and Facilitating Agreements'. Use is made of the Corporations power in the Constitution, in addition to the Conciliation and Arbitration power. As a result, the strict interstate test for an industrial dispute

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\(^1\) It is ironic, given the government's intention to promote enterprise bargaining, that the current legislative framework is now more prescriptive and regulatory in substance than the Industrial Relations Act 1988. Under this latter Act, over-award bargaining was essentially unregulated.
becomes unnecessary to trigger the involvement of the IRC. Moreover, the new concept of an ‘industrial situation’ is introduced in the Act, which allows the Commission to become involved to prevent an industrial dispute occurring. In addition, the legislation stipulates a definition of ‘enterprise’ that refers to a single employer or business with workplaces at different geographical sites. The importance of this definition is the implied preclusion of individual contracting and agreements that apply to only a portion of an enterprise’s workforce.

There are two routes by which enterprise agreements can be ratified by the IRC and thereby override awards (where an agreement is silent on a matter, the award provision applies.) The first route is that of Certified Agreements, which can be made only with a registered union or unions as parties. The provisions governing the making and ratification of Certified Agreements are highly prescriptive and involve the satisfying of a ‘no disadvantage’ test, which states that workers must be no worse off on balance under such agreements than under award conditions.  

The second route is that of Enterprise Flexibility Agreements, which is ostensibly the means of ratifying non-union agreements made directly with workers. Again, the provisions are highly prescriptive and indeed involve steps in addition to those required for Certified Agreements. Where any union members are on-site, an employer is required to notify the relevant union or unions of impending negotiations. The union or unions may then elect to become a party to the negotiations. Where there are no union members, the relevant union or unions have the right to intervene prior to the IRC ratifying the agreement, although they have no veto power. The IRC may refuse to ratify an Enterprise Flexibility Agreement if it deems it not to be in the ‘public interest’, although this test does not refer to compliance with IRC principles. One of the many tests that an Enterprise Flexibility Agreement must pass before being ratified is that a majority of the workforce must favour the agreement.

Under the Act, the Commission is to be restructured into a Bargaining Division and the traditional award stream. The main function of the Bargaining Division is to oversee bargaining and ratify agreements, as well as handling Paid Rates Awards, which latter cover public servants and are important in a number of industries. Arguably, the Vice-President of the Bargaining Division holds the most powerful position in the Commission. One of the functions of the Bargaining Division is to supervise ‘bargaining periods’ while agreements are being negotiated, during which an immunity from civil liability applies to industrial disputes. In other words, a ‘right to strike’ is introduced by this Act. There is a ‘bargaining in good faith’ provision within the Act that unions can use to force employers to the negotiating table, although they are not obliged to make any concessions or to reach agreement.

Finally, Part 7 contains provisions related to secondary boycotts, which have been repositioned and significantly reworded from the Trade Practices Act. The definition of a secondary boycott is tightened in the Act to exclude a range of activi-

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2 Note that greenfields enterprises cannot enter directly into an agreement with the workers. A necessary first step is the granting of an interim award against which ‘no disadvantage’ can be gauged.
ties, including peaceful picketing and industrial action undertaken in the name of an industry campaign. A period of 72 hours of compulsory conciliation becomes mandatory.

The Economics of the Industrial Relations Reform Act

The process of policy formation that led to the Industrial Relations Reform Act has everything to do with politics and the relationship between the political and industrial wings of the labour movement, but virtually nothing to do with economics. This is so despite the speech made by the Prime Minister in April 1993, which related the need for further labour-market reform to the requirements of a globalised economy. What eventually emerged had little connection with microeconomic reform because of the need to produce an overwhelmingly pro-union package.

Perhaps the most favourable economic interpretation that can be placed on the Act is that, in the context of a recovering economy, the damage to business may only be marginal. Moreover, there is some scope within the legislation for the Commission to use its discretion in certain ways — to vary awards reluctantly or to reject vexatious objections from unions about Enterprise Flexibility Agreements, for instance — that may alter the direction of the labour-market reform process.3

A less favourable, but probably more realistic, interpretation of the Act is that it retards the process of labour-market decentralisation and reform that is required to enable Australia to compete effectively in the world economy. Rather than provide a simple and streamlined framework for enterprise bargaining that allows the parties to agree to establish wages and working arrangements that suit their circumstances, the Act over-regulates bargaining while simultaneously retaining and codifying centralised awards. The following sections consider the economic effects of a number of specific aspects of the legislation.

The Award System

The significance of the new Part 3 ("The Award System") is that it entrenches awards, explicitly states that awards will underpin enterprise bargaining, and stipulates the basis on which awards will be varied. However, awards are not suited to perform a safety-net function. Mainly configured along occupational lines flowing on from union respondency, the implied bargaining structure of awards cuts across enterprise lines. Most larger enterprises are covered by several awards, so in effect there are several safety nets underpinning agreements. When it comes to agreements, the Act is firmly prescriptive that all workers in an enterprise must be covered, even though in many instances workers are covered by different awards. Moreover, employer respondency to awards is not removed when enterprise agreements are made (as is the case under the new West Australian legislation, for

3 In the light of the appointments to the Commission, including that of Iain Ross, former Assistant Secretary of the ACTU, to the position of Vice-President of the Bargaining Division, it seems highly unlikely that the Commission will use its discretion in these ways.
example). As a consequence, employers are made to comply with several instruments, with agreement provisions overriding award clauses only where inconsistencies occur.

Apart from these regulatory arrangements that all but guarantee that agreements are mere add-ons to awards (many agreements already are only partial documents to be read in conjunction with relevant awards), most awards are detailed and prescriptive instruments setting out the terms of the individual employment contract and restricting the collective aspects of employment arrangements. Examples of the latter include restrictions on the use of part-time or casual workers and demarcation lines. In other words, awards are not simple statements of minimum entitlements that can be described as safety nets. Indeed, if the legislators simply wished to deliver on their rhetoric — 'flexibility with protection' — the range of minimum entitlements set down in the Act is surely sufficient to provide the protection, and to act as a safety net for enterprise bargaining.

This implies that the inclusion and wording of Part 3 have less to do with the protection of workers than with other considerations. One such consideration is the trade union movement's support for a hybrid arrangement, with continuing awards bolstered by (over-award) bargaining — a case of having the best of both worlds. A second, more cynical, consideration is the protection of union recognition and representation rights implied by awards. With few exceptions, most awards have only one union respondent. Since awards can be imposed on employers by arbitration, employers are forced to accept the representational role of the relevant union even if no employees belong to it. A third, and again cynical, consideration is the union movement's ambivalent attitude to enterprise bargaining, which may require substantial effort and resources. Seeking award variation from the Commission to apply to large numbers of employers is much less costly. It is even easier where award variation can be justified to the Commission on the basis of variations of other awards.

It is here that the adjectives 'secure, relevant and consistent', given prominence in this part of the Act, are so important. Market rates of pay (set by enterprise agreements) are likely to set the basis for relevance, and the relationship between rates of pay for key classifications across awards is likely to be achieved through flow-on award variations to ensure consistency. In other words, comparative wage justice is alive and well in this Act. (It is true that flow-ons are not strictly automatic but depend on the interpretation of the words 'secure, relevant and consistent'. Some limitation on them could come from an emphasis on conciliation over arbitration, that is, the making of agreements over the variation of awards.)

A number of economic arguments can be made against institutionalised comparative wage justice. First, it runs counter to the micro-level flexibility that might otherwise be expected to accompany true enterprise bargaining. That is, decentralised agreement-making should guarantee responsiveness between the actual circumstances of an enterprise and the contents of the employment contracts of employees. But comparative wage justice drives a high degree of uniformity of outcomes across occupations and industries.
Second, a potentially dangerous upward bias is imparted to wage movements by the provisions in this part of the Act, as well as those contained elsewhere. By dint of the ‘no disadvantage’ rule that applies to agreement-making, both Certified Agreements and Enterprise Flexibility Agreements must, on balance, be at least as favourable to workers as award conditions. Moreover, as long as the other conditions attached to the making of agreements are met, there are no grounds for the Commission to refuse ratification. To the extent that agreements are used to establish relevance as the basis for award variation, the only direction for wage movements is up. With consistency of awards laid down as another criterion, the variation of one key award could easily trigger the rapid variation of a large number of other awards.

Such a situation is inferior to the admittedly second-best *modus operandi* that developed in the 1980s, with the Commission promulgating wage-fixing principles governing award variations and using the devices of a ‘public interest’ test and the extraction of ‘no extra claims’ commitments from the unions. In these ways, there was some control over nominal wage movements (Sloan, 1993). These options have been completely scuttled by the new Act, leaving the responsibility for wage moderation in the hands of the union movement and possibly restrictive macro-economic settings.

In fact, the legislation has removed the Commission’s discretion to establish its own principles to apply to award variations, including insistence on productivity trade-offs. In essence, the Act codifies the principles that will apply to awards and award variation, principles that are completely consistent with the union movement’s agenda developed since the days of award restructuring. Key elements are skills-based career paths and consistent minimum rates of pay across awards.

It should also be noted that the union movement’s agenda in this area is intimately connected with its preferred direction of reform in the training area. Thus the Carmichael Report’s vision of an Australia-wide skills classification where all workers are grouped into a small number of skill levels (eight in all) will continue to spill into industrial relations, with rates of pay in awards increasingly set on the basis of these skill levels. Again it is a far cry from the flexible, decentralised IR arrangements that were expected to result from enterprise bargaining.

Indeed, the straight-jacket around wages and wage flexibility implied by these new developments make previous arrangements look quite flexible. These developments also raise a serious problem for employers: attainment versus application. Will employers be required to pay workers on the basis of the skill level they have attained or the skill content of the tasks they actually perform? At this stage the answer is unknown, but there are very clear economic consequences one way or the other.

**Minimum Wages**

An extremely important aspect of the new Act is the use of the External Affairs power of the Constitution to establish a range of minimum entitlements for all
workers, including non-award workers, ostensibly to comply with a number of ILO Conventions and other international agreements to which Australia is signatory. In this way, the jurisdictional authority of the States is significantly undercut and the influence of the federal legislation is greatly enhanced. It is not clear that Australia has been contravening international conventions and agreements. The critical aspect of Part 4 of the Industrial Relations Reform Act is the interpretations placed on minimum entitlements.

Take, for instance, minimum wages. In most countries, compliance with the ILO Convention on this matter is achieved by the legislature stipulating a minimum hourly wage to apply to all workers. This route was also open to the federal government, since it based the Act on the External Affairs power of the Constitution as well as on the Corporations and the Conciliation and Arbitration powers. However, the government instead opted to interpret compliance by reference to minimum rates of pay as laid down in awards. As a result there is a multitude of minimum wages, which by no means apply only to low-paid workers.

It is not necessary here to traverse the economic arguments about the harmful effects of minimum wages on employment, particularly the employment prospects of workers with the lowest productivity. The point is that while these potentially harmful effects are entrenched in the system, the interpretation placed on minimum wages means that the legislation in respect of minimum wages cannot be defended on the normal grounds of protecting low-paid workers. An illustration of this anomalous situation is the $8-a-week pay rise that began to flow from December 1993. Some very highly paid workers, in the banks for instance, were entitled to this pay rise as they received only minimum rates of pay — of over $1,000 a week.

**Employment Termination**

As noted above, one of the most radical departures in the new Act is the section on termination of employment. The Act deals with three basic categories of employment termination: termination initiated by the employer for good reason; termination resulting from redundancy; and unfair dismissal. It sets down minimum periods of notice according to years of service. In the case of redundancies, employers are required to consult with unions and to notify the Commonwealth Employment Service where the number of redundancies is 15 or more.

Within 14 days of dismissal, any employee or trade union can apply to the new Industrial Relations Court for a remedy in respect of termination. To defend a charge of unfairly dismissing an employee, employers are required to prove both substantive and procedural fairness. The Court may refer the matter to the Commission for conciliation. However, the Court is empowered to order reinstatement and/or compensation.

The significance of these provisions is that whereas previously only award workers could seek industrial remedies for alleged unfair dismissal, now a larger proportion of workers may do so. As well, the compensation for dismissed em-
ployees could be very generous. In other words, the legislation increases, perhaps markedly, the costs to employers of dismissing workers.

However, under proposed amendments to the Act announced on 30 May, compensation will be limited to six months' salary for award employees. In addition, non-award employees will have access to the unfair-dismissal provisions only if they earn less than $60,000 annually, with compensation limited to $30,000. Nevertheless, it is ironic that Australia should be heading in this direction precisely at the same time as several European countries are questioning their strong statute-based employment protection laws. The countries with the strongest laws in this area — Spain, Greece and Italy — are those that face both the highest rates of unemployment and the most intractable structural unemployment problems (CEC, 1993). Where dismissal is made difficult and/or costly, firms become reluctant to take on workers. Moreover, the power of the 'insiders' (the employed) in the labour market is enhanced by employment-protection law. The ability of 'outsiders' (the unemployed) to compete with the 'insiders' becomes extremely limited (hence the structural nature of the unemployment problem) and the rate of unemployment at which wage pressures emerge is markedly increased.

It can be further argued that strong employment protection laws work against the interests of the most disadvantaged in the labour market. If a worker taken on is potentially a worker for life, employers are likely to adopt very cautious recruitment practices and recruit only workers who look like safe bets. Those who have been out of work for a long time are unlikely to be suitable, even though employing them might attract significant government subsidies. Like minimum wages, employment protection laws are ostensibly designed to protect workers but actually damage the prospects of the most disadvantaged.

Non-discrimination

One of the new Objects of the Act is to 'prevent and eliminate discrimination on the basis of race, colour, sex, sexual preference, age, physical or mental disability, marital status, family responsibilities, pregnancy, religion, political opinion, national extraction or social origin' (p.3). A number of the factors now mentioned in the Act were included in the very final amendments made to the legislation as it passed through the Senate.

On the face of it, these sorts of non-discrimination factors sound laudable enough and, in any case, innocuous. Yet this new Object raises a host of problems, particularly by referring to age. For example, junior rates of pay exist in very many awards, and explicitly or implicitly, in a number of agreements. Does this new Object of the Act mean that junior rates of pay will no longer be allowable, because they imply discrimination on the basis of age?

The economics of junior rates of pay are very straightforward. If pay is set on the basis of age, the time path of pay can track increasing skill attainment. Junior rates of pay broadly impose the cost of general training on workers and an appropriate sharing of specific skill acquisition between firm and workers. Since age acts
as a cheap proxy for increasing competence, there are strong economic grounds for retaining junior rates of pay. Other methods of assessing competence carry high transactions costs and generate approximately equal results in any case.

Another important aspect of non-discrimination on the basis of age is the implication for mandatory retirement. Again the economics are straightforward. If average productivity declines around retirement age, it is efficient to impose a simple rule whereby all individuals are required to retire at a set age. Obviously, some individuals could continue to work quite effectively after the age. But if on average the rule predicts declining productivity, there is a strong case for keeping it. The alternative involves bribing the least efficient to quit, with obvious cost and equity implications.

The Regulation of Bargaining

In a first-best world, a degree of regulation of bargaining is desirable, particularly in order to enforce agreements. In a practical sense, this would always be necessary because of the backdrop of the common law. That said, the extent and nature of the regulations governing bargaining in the Industrial Relations Reform Act are absurd. The legislation not only firmly prescribes the processes but also severely constrains the actual outcomes of agreements. The transactions costs implied by the provisions render agreement-making a serious, lengthy and potentially costly business. Eighteen separate steps are needed to make a Certified Agreement and 21 an Enterprise Flexibility Agreement.

In practice, the provisions governing agreement-making have much less to do with protecting workers than giving a central role to trade unions (whose membership covers less than 30 per cent of private-sector workers). This is done in a number of ways. Suppose a union notifies the Commission of its intention to make a Certified Agreement with a nominated enterprise. The employer is reluctant, foreseeing that little will be gained in terms of enterprise efficiency and a substantial pay increase is being sought. However, the employer is forced to 'bargain in good faith', including attending meetings, divulging information, and so on. Because a 'bargaining period' is in existence, any industrial action is immune from civil liability. The union informs the workers that a short strike will result in a substantial pay increase. A strike takes place, which is very costly to the enterprise. An agreement (possibly including a compulsory unionism clause) is reached, even though the enterprise may have few union members and the employer was unenthusiastic in the first place.

Now imagine a completely non-unionised plant where relations between employer and workers are extremely congenial and productive. Some new working arrangements, which, strictly speaking, contravene award provisions, are negotiated in exchange for a pay rise. The vast majority of the workers are in favour of the agreement. However, when the agreement is taken to the Commission, the relevant union objects because parts of the agreement do not conform with the award. The Commission refuses to ratify the agreement, the workers are disenchanted because
they do not receive the pay rise, and the union, now aware of this enterprise, begins
a recruitment campaign.

These two examples illustrate how the legislation allows unions to become in­
volved in the bargaining process, as well as providing them with a powerful recruit­
ment tool. Arguably, it is principally this agenda, rather than the objective of provid­
ing simple, streamlined and stand-alone regulation of bargaining, that is addressed
by the legislation.

Finally, it should be noted that a ‘no disadvantage’ test applies to both Certified
Agreements and Enterprise Flexibility Agreements. This states that ‘the agreement
does not, in relation to their terms and conditions of employment, disadvantage the
employees who are covered by the agreement’ (p.32). Clearly, the effect of this test
is to limit the flexibility of agreements, ensuring that, on balance, employees are at
least as well off as under the award. In other words, the routes for enterprise bar­
gaining amount in effect to institutionalised over-award bargaining. There is no
scope for an enterprise suffering a slump in product demand, for instance, to seek
temporary downward flexibility in an agreement, even though the workers might
endorse such a strategy. In theory, award conditions can be traded-off on ‘public
interest’ grounds; in practice, this is likely to be difficult and expensive to achieve.
The legislation tempts unions to drip-feed changes at the enterprise level to extract
maximum payment for each.

Conclusion

Many of the adverse economic consequences of the Industrial Relations Reform
Act 1993 will be disguised by the economic upswing now under way. For instance,
the full impact of the employment termination provisions will not be felt until a
slowing down or contraction of output results in widespread job loss. Similarly, the
‘no disadvantage’ rule is less significant during times of prosperous business condi­
tions. This is not to downplay the economic consequences of the Act; indeed,
more than anything, the choice of direction for the legislation represents a missed
opportunity to make the labour market more flexible in order to cushion the effects
of changes in market conditions.

A very fundamental criticism of the legislation is its inordinate complexity.
Whatever the Act’s real intentions, regulations should always be simple and mini­
mal. But ‘simple’ and ‘minimal’ are not adjectives that anyone would apply to the
Industrial Relations Reform Act. The Act is most easily interpreted as an over­
whelmingly pro-union package that pretends to protect ordinary workers, but will
probably do them more harm than good, especially marginal workers.

Could anything good economically emerge from the Act? Certainly, it empha­
sises conciliation and the role of bargaining. Depending on the Commission’s in­
terpretation of some provisions, there may be some scope for genuine non-union
agreements, at least in cases where workers are clearly in favour of an agreement
negotiated with management. But this remains to be seen. It is more likely that
most employers will shy away from the Enterprise Flexibility Agreement route for
fear of inviting the unwanted attention of unions. It is not that there is no demand for non-union bargaining; the demand is not satisfied by the restrictive provisions of the Act. Another point is that, for large unionised plants, the Act represents something like the status quo, although the loss of an effective threat via secondary boycott provisions is important to certain companies, particularly those in the resource sector.

As a 'last hurrah' for regulated labour markets in Australia, the legislation certainly covers nearly all the bases. With union membership on the wane, and now below 30 per cent in the private sector, it has been a do-or-die effort by the union movement to engineer such favourable legislation. In the short term, it is likely that unions will be able to use various provisions of the Act to rebuild membership. This will not take the form of winning the hearts and minds of workers or of demonstrating the benefits of membership. It will involve forcing employers to do deals that involve forms of compulsory unionism. Eventually, such a strategy is likely to be self-defeating (Costa, 1992) and the requirements of competitive business will eventually force further legislative change. But policy must always start from somewhere; and in this case, it will be starting from a markedly inferior position than even existed before the Industrial Relations Reform Act 1993.

References


National Savings and Fiscal Policy

James Cox

Twenty years ago, excessive saving by households was considered likely to delay economic recovery by reducing consumers’ expenditure. Today, a shortage of national savings is counted among Australia’s economic problems. For example, in his report on savings, Dr Vince FitzGerald (1993:2) stated ‘Australia’s saving was consistently about 25 per cent of GDP for most of the period until the mid 1970s. Over the 1980s it fluctuated in the region of 20 per cent of GDP, but from 1989 onwards has fallen progressively, reaching a low of 16 per cent in 1991/92, its lowest level in two generations’. The report called for a national savings strategy to increase the ‘underlying savings rate’ by about 5 per cent of GDP over the coming decade. Government savings could be increased by reductions in outlays and increases in revenues, whereas household savings could be increased by higher contributions to the Superannuation Guarantee.

The FitzGerald report shows (pp.3,27) that the fall in national saving as a share of GDP over the past 20 years is largely due to a fall in government (‘public’) savings. Moreover, government saving is the more variable component. Private savings have also fallen as a share of GDP but, given the slow growth in incomes in recent years, and increases in welfare-state benefits, they have arguably held up surprisingly well. What then is the relationship between government and private saving? Some writers (e.g. Barro, 1974) have argued that taxpayers react to government deficits (negative savings) by increasing their saving in anticipation of the higher taxation (stemming from increased debt-servicing costs) or the faster inflation that will eventually occur. Yet taxpayers cannot easily obtain information about the public finances. As well, they may be less concerned about the effects on others (such as their children or the young generally) than those on themselves. So whereas changes in private savings are likely to offset changes in government savings to some extent, the significance of this offset remains controversial.

What is certain is that the decline in government savings has been the most important factor in explaining the reduction in national savings. Based on national accounts data (ABS, 1993a,b) the correlation coefficient between national savings and general government savings is 0.87. So around three-quarters of changes in total saving can be ‘explained’ by changes in the saving of the general government sector.

*Saving* here means the total finance of gross accumulation for the relevant sectors.

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Government Saving

Government (or public-sector) saving is here defined as the difference between current outlays and current revenues. The consolidated accounts of both the general government sector and the public trading enterprise sectors of all governments show the effects of changes in the pricing policies of public enterprises. The ABS has classified the expenditures, revenues and financing transactions of all Australian governments (Commonwealth, State, Territory and local) from 1961/62 on a consistent basis. Data from 1988/89 to 1993/94 have been published (ABS, 1993c), and unpublished data for the earlier years are now available from the ABS (for a substantial fee).

Figure 1 presents data on current outlays (the sum of final consumption expenditure, interest payments, subsidies to public enterprises and transfer payments), total revenue (taxes, fines and fees, the net operating surplus of public trading enterprises, interest received and other revenue), and the balance on current transactions, which is taken here to be the measure of government savings. In Figure 1,

2 The balance on current transactions is measured by subtracting current outlays from the total of revenue plus increase in provisions minus capital revenue. 'Provisions' include public-trading enterprise provisions for depreciation, and provision for superannuation, long-service leave and the like. See ABS (1993c) for further information.
the data for 1992/93 are preliminary; those for 1993/94 are based on forward estimates and should be used with particular caution.

As Figure 1 shows, before 1974/75, current government outlays were around 20-23 per cent of GDP, revenues 25-28 per cent, and government savings 5-7 per cent. Current outlays then increased sharply to 30 per cent of GDP by 1977/78. Despite an increase in revenues, government saving declined to 2 per cent of GDP by 1978/79.

Outlays remained at about 30 per cent of GDP between 1977/78 and 1981/82. Government savings recovered to 4 per cent of GDP by 1981/82, significantly below the level achieved before 1974/75. In 1982/83, current outlays surged again, to 33 per cent of GDP.

Current outlays stabilised and then fell to 31.5 per cent of GDP by 1989/90. Government savings reached 6.5 per cent of GDP by 1988/89. Since 1988/89, outlays have risen again, and are estimated to have been 36 per cent of GDP in 1992/93. Meanwhile, revenues have fallen as a share of GDP, resulting in low levels of government saving; indeed, government savings are expected to be negative in 1993/94.

The record shows that, as current government outlays have risen as a share of GDP over the past 20 years, government savings have fallen. The correlation coefficient between government savings and government current outlays as shares of GDP was -0.82 between 1961/62 and 1993/94, which suggests that two-thirds of the variation in government savings over the period was associated with the variation in current outlays. By contrast, the correlation between savings and revenue over the same period was -0.60. Government savings tended to be lower as a share of GDP in those (later) periods when revenues were higher as a share of GDP than in those periods when revenues were lower.

Arguably, government spending on health and education should be treated as investment in human capital (a kind of saving) rather than current expenditure. But, as such spending has increased rapidly, this would be to redefine into non-existence much of the government (and national) saving problem. The growth in government health spending has largely replaced private expenditure: Medicare has partly replaced private health insurance, for example. It is also doubtful whether much health and education expenditure is really investment. So it seems unreasonable to treat government education and health expenditure as an addition to national saving, although an (unknown) proportion of it may be so.

Explaining Short-Term Changes

How can these developments be explained? Two levels of explanation seem relevant here: for the annual changes in outlays, revenue and savings as a share of GDP, and for the long-term changes that have occurred over the decades.

Changes in political and economic circumstances seem to be responsible for the year-to-year movements in these data series. In a study of the effect of elections on the Commonwealth budget, Gruen (1985:ii-iii) concluded that
On average real outlays increased by 5.1 per cent in election budgets compared to around half that level in pre-election budgets. In election years, there are typically tax concessions averaging around 1.8 per cent of revenue — compared to discretionary tax increases of 2.3 per cent in pre-election years... The two budgets which preceded the loss of office by the two Liberal Prime Ministers produced large outlay increases.

Although we are here concerned with the total public sector rather than just the Commonwealth budget, our data confirm that in the election periods of 1972/73 and 1983/84 public saving declined significantly as a share of GDP. The closely contested federal elections in 1990 and 1993 may also have tended to reduce public savings in those years and the immediately following ones. Political competition also occurs at State and local-government levels, and closely fought elections there may also have some effect on public savings.

Recessions tend to increase government outlays (for example, on unemployment and other benefits) but to reduce revenue and GDP. They therefore increase the share of outlays in GDP but have an ambiguous effect on the ratio of revenue to GDP. Years in which there has been an upsurge of unemployment (1974/75, 1976/77, 1982/83, 1990/91, 1991/92) have seen an increase in government outlays and a reduction in government savings as a share of GDP.

Explaining Medium-Term Changes

Political influences and changing macroeconomic circumstances are less satisfactory as explanations for medium-term changes. After all, the fiscal damage done by election budgets can be subsequently repaired if there is the will to do so. Although an upsurge in unemployment may lead to an immediate increase in government spending, governments may be able to take advantage of subsequent quieter periods to reduce other items of spending (or increase taxes). Any reluctance on the part of governments to do these things needs to be explained.

As already observed, outlays have increased as a share of GDP throughout the period under discussion. Revenues increased until the mid-1980s but were lower as a share of GDP during the early 1990s than during the late 1980s. Government savings tended to be highest during the 1960s when the outlays share was at its lowest and during the 1980s when growth in outlays was restrained. Government savings were at their lowest when the outlays share was increasing rapidly or when (during the early 1990s) the revenue share was falling.

Governments seem to have become increasingly unwilling to raise revenues sufficiently to finance higher levels of current spending. (The introduction of a new, more efficient, tax such as the GST might possibly restore the appetite for tax increases.) Two influences seem to be at work here: a limit to the extent to which governments are prepared to increase taxes in any one year; and (more speculatively) a limit to the total amount of revenue that governments are willing to collect.

Over the 31 years from 1962/63 to 1993/94 (forward estimates) the revenue
share of GDP increased year-on-year by over 1 per cent in only six years and by over 1.5 per cent in only two years (1974/75 and 1984/85). Governments seem unwilling to increase revenue in any one year beyond 1-1.5 per cent of GDP. The permissible increase may depend on income growth: the faster incomes are growing, the larger is the acceptable increase in revenue. Yet the revenue share declined slightly during the prosperous late-1980s, and had increased during previous recession years (1974/75, 1982/83).

Evidence for the existence of a limit to the revenue share in GDP comes from the late 1980s and early 1990s, when the 25-year trend towards a higher revenue share was reversed. The revenue share peaked at 37.4 per cent of GDP in 1987/88, but is projected (on the basis of forward estimates) to be 34.2 per cent of GDP in 1993/94. The changes proposed in the Commonwealth budget are expected to increase the revenue share by 1.4 per cent of GDP above the level that would otherwise have been achieved. (Allowing for economic growth, the revenue share in GDP is expected to grow by around 1 per cent of GDP between 1993/94 and 1996/97.) These fairly modest proposals have proved to be controversial.

Perhaps the argument about the limit to the revenue share overinterprets what was really just an accidental sequence of events, and the upward trend of revenue share may reassert itself. The first year of the next Commonwealth parliament might be a good time to review whether the revenue share has surpassed its previous peak. Yet the idea of a limit to the revenue share of GDP is a useful simplification. The cost of taxation to an individual in terms of opportunities forgone is likely to increase more than proportionately with the amount of revenue collected. A given level of taxation is more burdensome for some taxpayers than for others; but if taxation is severe enough it will become salient as a political issue. The level of income at which this occurs is not fixed but depends on the methods of tax collection and the distributional impact of taxation and the spending that it finances. Taxation, however, has undoubtedly been an important factor in recent Australian elections.

In a famous article, Colin Clark (1945:380) reviewed data on the share of taxation in national income and inflation in several countries during the inter-war period and concluded that

the data appear to give very considerable support to the hypothesis that once taxation has exceeded 25 per cent of the national income (20 per cent or less in some countries) influential sections of the community become willing to support a depreciation in the value of money; while so long as taxation revenue is below this critical limit, the balance of forces favours a stable, or occasionally an increasing, value of money.

It is true that most other OECD countries raise a larger share of GDP in revenue than Australia does. But most other OECD countries have a broad-based consumption tax, which Australia lacks. Because Australia has a targeted age pension system, the distributional impact of government expenditure is likely to be different in Australia from that in the countries that raise in taxation (and spend) a higher percentage of GDP. That is also likely to be relevant.
Clark was assuming that important elements of public expenditure (such as interest on the public debt) would not respond fully or immediately to an upsurge of inflation. Unanticipated inflation would then be one way to reduce the share of government spending, and hence taxation, in GDP. Other methods (such as electoral competition) must be used in modern conditions when important elements of public expenditure are governed by indexation commitments and where inflation interacts with progressive tax scales to increase government revenue in real terms. Clark's data were collected, moreover, before the introduction of innovations such as PAYE, which have made it easier to collect a large share of GDP in taxation. Even so, the idea of an upper limit to the amount of income that taxpayers will permit governments to collect in revenue is a suggestive one.

If governments find it hard to collect much more than 35 per cent of GDP in revenue, they will need to show great restraint in spending if they are to continue to meet their savings targets. This effort will need to be more sustained than any that has been mounted over the past 30 years. Governments could usefully emphasise this in response to the pressure for greater spending that undoubtedly exists. The FitzGerald report, in contrast, seemed to emphasise taxation increases rather than reductions in government current spending. Perhaps this is the wrong emphasis.

What About Private Savings?

The FitzGerald report suggested that private savings should be raised through increases in compulsory contributions under the Superannuation Guarantee. As it stands, the Superannuation Guarantee is projected to increase national savings by 0.75 per cent of GDP within ten years and by 1 per cent within 20 years. The report proposed increasing this amount to well over 1.5 per cent of GDP in ten years and ultimately to over 2 per cent.

This raises a number of issues. First, should governments have national savings goals, or is this something best left to individuals and families to decide for themselves? And is it in the interests of governments to politicise something so important to people's long-term economic welfare as private savings? What will happen when some superannuation plans turn out, as some surely must, to be poor long-term investments?

If governments are concerned about the effects of age pensions on private savings, it may be better to re-examine the conditions under which pensions are paid than to add regulation to regulation. For example, the age of eligibility for the age pension could be increased — as the FitzGerald report itself recommends.

Second, the goals the FitzGerald report suggests for adoption and the process for adopting them are both questionable. The report suggests that governments should compel people to save enough to provide themselves with a retirement income equal to 60 per cent of their pre-retirement earnings. This benchmark is selected by comparison with what happens in some overseas countries. Its implemen-

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4 Clark (1945:372) attributes the idea to Keynes.
tation would require contributions in the order of 18 per cent of pre-tax earnings. The report recognises (p.57) the importance of further public discussion before goals are set for superannuation and the age pension. Nevertheless, a retirement contribution of 18 per cent of earnings would be a heavy burden for the young who would be required to finance not only their own retirement but also that of the current retired generation. The young (and especially those with children) might well consider that current expenditure is a higher priority than a more comfortable retirement. Any retirement goal should therefore be chosen by the community in full knowledge of the substantial costs that might be involved.

Third, how effective is the Superannuation Guarantee likely to be in boosting private savings? The FitzGerald report (p.51) notes that

the Superannuation Guarantee cannot effectively serve its retirement income objectives in the face of rapid aging of the population unless it raises national saving, so as to finance ahead of time a build up of the capital stock per employee in the economy . . . The key element producing increased saving — over the longer term — through the Superannuation Guarantee is that it is compulsory, raising the saving of many that without it would not be saving much in any form.

Dr FitzGerald argues that, because it is compulsory, the Superannuation Guarantee can increase the total amount that an individual saves over his or her lifetime. He notes (p.24) that 'below the seventh decile of gross income there are very low financial savings' and that 'for a substantial proportion of Australian households — 35 per cent to 50 per cent — consumption is constrained by current income' (i.e. they spend all the income they receive).

The problem is that the Superannuation Guarantee will be successful only if it raises savings over the whole of the working lifetime; but the evidence refers only to whether or not the Guarantee will increase the savings of particular people in a particular year. It may well be true that one-third to one-half of households spend all their income in any year. A compulsory program can increase the amount that these people save in the year. But it is by no means certain that it is the same one-third to one-half of the population who spend all their income in every year. Indeed, there are stages in life when many people spend most of their income (for example, when young children are present in the household) and others when they are able to build their financial assets. If people have been required to save more than they wanted to in earlier years, they may well save less than they otherwise would have done in later years. The effect of the Guarantee on national savings may therefore be dissipated. Equally, people may be able to borrow against their accumulating superannuation assets to support consumption or to purchase non-financial assets such as housing.

On the other hand, if people believe that the Superannuation Guarantee will provide adequate provision for their old age, governments may find it easier to take
action that will have an effect on savings, such as raising the age at which the (unfunded) age pension is payable.

It remains to be seen whether governments can require people to save more than they otherwise would have done. Compulsory savings may cause hardship to some families who have to reduce spending on necessities in consequence. It is surprising that the equity implications of compulsory superannuation have not received more attention.

Conclusion

It is hard for governments to induce people to save more than they otherwise would have done, and, in current circumstances, to increase the share of GDP that is paid in taxes. If governments are concerned about the low level of national savings, the most effective remedy would be to reduce public spending on items that substitute for private savings (like raising the age of eligibility for the age pension), though they may be constrained by the political and social consequences of such changes. And economic recovery will boost national savings by reducing current unemployment-related spending. Even so, low levels of national savings may persist for some years.

References


The Folly of Regional Policy

Tony Sorensen

Over the years, regional development has proved to be one of the Australian Commonwealth's more misguided policy endeavours. For example, in the early 1970s the Whitlam Government's Department of Urban and Regional Development (DURD) was a by-word for grandiose ideas and wasted expenditure. Likewise, the exaggerated resources boom of the early 1980s generated few immediate long-term benefits and some questionable investments like the Portland aluminium smelter. Then came the Multi-Function Polis. This ill-formed concept, like DURD's unlauded new city of Monarto before it, has sunk virtually without trace in Adelaide's hinterland.

Unfortunately, Canberra's resurgent interest in regional issues risks triggering a re-run of these events. This belief reflects three major difficulties. First, the formulation of regional policy stems from the Commonwealth's perception of unacceptable regional inequalities. However, one doubts that the correct problem has been identified. The second concern relates to our understanding of the issue — a critical precursor to effective policy formulation. The government appears to have at least three separate and widely contrasting sources of advice from the Industry Commission (1993a), its own 'Kelty Taskforce' (1993), and consultants McKinsey & Co. (1994). Of course, the utility of this advice depends on the extent to which the correct problems have been identified. The resulting decision-making fog is all the thicker because of a third difficulty. Although the Industry Commission's analysis translates readily into policy recommendations, the thinking behind the other two reports yields dubious prescriptions. How, for example, is the Commonwealth supposed to improve the quality of regional leadership, a key deficiency identified in the McKinsey paper? In short, a lot of money, including well over $1 million in the case of the McKinsey Report, will have yielded little progress towards regional policy Nirvana.

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Defining the Regional Problem

Economic change during the last two decades has impacted unevenly across Australia (Walmsley & Sorensen, 1993; Sorensen & Epps, 1993a). Some locations, particularly in the heartland of rural Australia and in some of the older industrial regions, have experienced the full force of recession, international competition, and adverse terms of trade. Yet others attract a disproportionate number of the unemployed, offer their residents a narrow range of opportunity, have failed to realise their growth potential, or suffer from slow and long-term economic decline. Many areas have experienced severe production losses through the vagaries of drought and flood. Although endemic to Australia, such events are rarely anticipated sufficiently by primary producers, and exacerbate the damage to regional economies already inflicted by other mechanisms. In contrast, some places have benefited greatly from a combination of good fortune or sound management. Many of these are located in the areas of high environmental quality that drape our coastal fringe, or adjacent to the capital cities and larger regional centres, or in places blessed with great mineral wealth.

In short, place matters. One's wealth, occupation, and employment conditions depend significantly on where one lives. Moreover, such spatial variations in well-being are increasingly apparent to the average person in the street. Private travel, television, print media and a welter of government statistics, not to mention the arcane calculations of the Commonwealth and State Grants Commissions, provide ample testimony to the situation.

Unsurprisingly, numerous lobby groups have formed to draw governments' attentions to spatial variations in prosperity that they perceive to be excessive and growing. In New South Wales, for example, such groups include the Country Mayors’ Association, which represents the larger country towns whose populations exceed 10,000; Regional Organisations of Councils like Sydney's WESROC; State-funded agencies like the New England and Northwest Regional Development Board; local chambers of commerce; private or public regional-development bureaux such as the Armidale and Tamworth Development Corporations formed to promote individual towns and cities; and environmental lobby groups who think that Sydney's growth should be curtailed.

‘Balanced Development’

Many groups or individual participants, though by no means all, advocate the rather nebulous concept of ‘balanced development’. This seems to mean the dispersal of economic and population growth away from city centres, capital cities or coastal locations towards suburban, rural and inland places. However, the scale of the shift, its precise location, and the type and quality of jobs involved are generally unstated. The proponents of 'balanced development' clearly imply, probably mistakenly, that Australia's current pattern of development is both unfair and inefficient.
Unfairness is seen to arise from the lower life chances that some people suffer because of where they live (see Sorensen & Weinand, 1991, for a recent discussion of the topic). Inefficiency, on the other hand, arises principally from three aspects of alleged market failure. The first is a form of opportunity cost: regional areas (those lying away from urban and coastal cores) offer many excellent development prospects that remain undiscovered because of investors' inadequate knowledge of the opportunities available. Second, negative externalities, especially in the form of pollution, congestion, and long journeys to work, may exceed the benefits arising from the concentration of economic growth. Finally, community infrastructure costs in core locations may exceed those in regional localities, especially if we take into account existing under-utilised facilities. If this is true, the decentralisation of growth could save government and the wider community considerable expenditure. These issues have been discussed extensively in recent reports (for example, Industry Commission, 1993b; House of Representatives Standing Committee for Long term Strategies, 1992; NSW Legislative Council Standing Committee on State Development, 1993).

These notions of unfairness and inefficiency, and therefore the merits of 'balanced development', still lack credible empirical and theoretical support, notwithstanding many public enquiries and the efforts of academic researchers. For example, the idea that spatial variations in life chances are intrinsically unfair is by no means self-evident and raises tricky moral issues. We could argue that people who choose to live in a disadvantaged area and could improve their lot by migrating elsewhere do not need special treatment. This line is reinforced if, as will nearly always be the case, the diversion of resources to improve the lot of disadvantaged areas has its own opportunity costs. Britain realised at least a decade ago (Hallett, 1981) the dubious merits of reducing the wealth of society as a whole in order to promote the interests of one or more broad regions. This is especially so if variations in intra-regional well-being exceed those between regions — as appears to be the case in much of Australia. The three aspects of alleged market failure are similarly open to question. Arguments about wasted infrastructure are particularly problematical where facilities are old and fully depreciated. And the benefits arising from the chaos of urban living, particularly technological advancement and the pace of innovation, are easy to underestimate (Jacobs, 1972).

None of these doubts has deterred lobby groups from demanding public intervention to promote regional development. Nor has it prevented State and Commonwealth governments from feeling on occasion a strong moral obligation to rein in regional disparity. The regional lobby is durable, though its vigour, cohesiveness, and political influence wax and wane according to regional conditions and the difficulty in assembling a coalition of interests with sufficient power to command political attention. At the federal level, this has occurred only three times in the last 50 years: in the late 1940s during post-war reconstruction; in the early 1970s leading to the Whitlam Government's New Cities Program; and in 1993-94. In contrast, State governments have been more consistently involved in promoting regional development, though often in only a token way. The States' somewhat schizophrenic
responses reflect two antithetical conditions: their constitutional responsibility for development of their territories, and lack of control over factors affecting regional well-being.

The Resurgence of Regional Policy

The current resurgence in regional thinking in Canberra arises from strident campaigning by regional interests coupled with an electorally driven commitment by the Keating Government to pursue remedial action for perceived regional disadvantage. The congruence of economic and political interests is primarily a child of the severe recession of the early 1990s, which greatly accentuated regional variations in well-being. This outcome results from at least five inter-related processes. First, much of rural Australia has been economically depressed by a combination of several years of low commodity prices; a long, severe and widespread drought; heavy debt servicing; out-migration to coastal locations; the decline in the textile, clothing and footwear (TCF) industries; a filtering up of service provision to regional cities; the rationalisation of State government administration; and reduced domestic travel.

Second, industrial centres like Newcastle, Wollongong, and Geelong, whose narrow economies depend heavily on comparatively few major activities or firms (such as BHP steel production), had not fully recovered from labour shedding in the early 1980s when they were hit by further job losses. These stemmed from an unusual combination of recession, industrial restructuring, and capital investment by major companies striving towards international best practice.

Third, Australia began to imitate the 'rust-belt' conditions of the north-eastern United States. Two states, Victoria and South Australia, shared above-average employment in manufacturing, a portfolio of mature, but increasingly less protected auto and TCF industries, and large government-inspired financial debacles. They also experienced a deeper and longer recession than the rest of the country. In contrast, Western Australia and Queensland rode out the recession comparatively well, relying principally on their modern mining and tourism sectors.

A combination of the 'rust-belt' phenomenon, earlier retirement, the rise of the woopie (well-off old person) class), and changing lifestyle preferences in favour or warmer and environmentally attractive regions saw continued large-scale migration towards northern New South Wales and south-east Queensland. This fourth event was reinforced by the rapid growth of international tourism.

Finally, the recession impacted differentially within the capital cities. Although the financial and property sectors shed considerable labour after 1990 and jobs were lost in many areas of middle management, growth in public-sector employment provided some relief. In contrast, those losing often un- or semi-skilled manufacturing jobs often found it difficult to acquire alternative employment. Thus industrial suburbs like Melbourne's Coburg in the federal electorate of Wills recorded up to 25 per cent unemployment.

Many of this enormous number of difficulties are discussed at length in Sorensen and Epps (1993a). Some of them, perhaps most, are cyclical and short-
term, while others are structural and sometimes long-running. Opportunities also display dramatic spatial variation, reflecting in part Australia’s highly uneven distribution of resources. In turn, the conditions prevailing in metropolitan, country-city, coastal, rural and remote areas all differ greatly. In short, virtually no two places are alike. Moreover, many of the forces underlying these events — including changing demography, lifestyle preferences, transport and communications technology, business strategy, and international economic development — are substantially beyond the control of government (Sorensen & Epps, 1993b).

The policy implications are uncomfortable. Attempts to resuscitate particular localities by swimming against the economic tide are apt to be difficult and expensive. As well, different policy packages are required for each place. Given the Commonwealth’s limited budget, care must be taken to target areas that have substantial regional problems to which the application of resources yields a significant positive return. Yet, paradoxically, places capable of generating such returns may well not need assistance. This agenda appears frankly impractical. Thus, it is doubtful that the Commonwealth, which is charged primarily with managing national well-being, should or can be interested in the well-being of individual places. An alternative, and more acceptable, approach to regional development is to eschew spatial particularity in favour of sound national macroeconomic management that has incidental and unforeseen regional benefits. Although this path may impact adversely on some localities, the harm is probably little different from what would have occurred under a spatially targeted regime.

**The Industry Commission Report**

The Commonwealth decided to develop a regional program in early 1993 for largely electoral reasons. In pursuit of its elusive goal the government is able to draw on three main but widely contrasting external sources of advice. The Industry Commission, which began its work in 1992 before the government announced its commitment to regional development, was first into print when its draft report appeared in late September 1993. True to the Commission’s philosophy, its recommendations took an overwhelmingly national rather than regional perspective and advocated continued market-oriented microeconomic reform.

Key recommendations included:

- according greater recognition to regional labour-market conditions during enterprise bargaining;
- reviewing the costs and benefits of the Superannuation Guarantee Charge for casual and itinerant employees;
- examining the ways in which social-security arrangements, in conjunction with the tax system, exacerbate regional unemployment;
enforcing those provisions of the Social Security Act that aim to discourage people moving to regions with lower job prospects;

• using greater flexibility in wages and work practices to increase training and retraining by employers;

• review of the number of Labour Market Programs (LMPs)

• revision of the eligibility criteria for various LMPs to meet the needs of smaller regions;

• differentiation of environmental regulations to take into account the circumstances of different regions;

• requiring comprehensive cost-benefit analysis for public infrastructure investments and publication of economic impact statements for major projects to ensure greater transparency in the decision-making process;

• making regions more attractive to capital in general rather than sponsoring individual firms to locate in target regions; and

• removal of regulations on intrastate aviation and coastal shipping and termination of the policy of cabotage for coastal shipping.

Not surprisingly, these recommendations met with hostility and vituperation from many trade unionists and members of the Labor Party. The report was construed as an attack on the working conditions of people living in locations already suffering from weak economic conditions and relatively high unemployment. It was also felt that the report’s recommendations placed too big a burden of structural change on low-income earners, and insufficiently considered such matters as poor-quality management and the rights of individuals to live in communities where they experienced strong social ties.

Yet much of the logic of the draft report seems irrefutable when the 18 main recommendations are considered either separately or as a package. Moreover, the recommendations involve little cost. Indeed, the government stands to save money from some of the LMP and social-security reforms advocated. Unfortunately there is a real risk that many sensible ideas could be thrown out because the report has been branded with the pejorative ‘economic rationalist’ label.

The Kelty Report

The Kelty Report on regional economic development was launched in December 1993 with much goodwill and high hopes. This reflected two main factors. Most parts of ‘regional Australia’ are desperately seeking means to ameliorate employ-
ment difficulties and low incomes. Moreover, regional communities felt they owned the report given their substantial contribution to it through numerous workshops conducted by the taskforce around the country. The Report is certainly the most wide-ranging and ambitious attempt ever to revive regional fortunes. Since then, if press reports are anything to go by, the report has disappeared with little trace within the Canberra bureaucracy, to the alarm and despondency of many regional development practitioners and agencies.

This outcome should come as little surprise. The Kelty Report is flawed in many important respects: from problem definition and its analysis of regional processes through to recommendations and implementation mechanisms. There is an element of financial naivety when it deals with the four expensive and Canberra-dominated policy arenas that have greatest potential to influence regional well-being: finance, transport, the labour market and industry policy. For example, the recommendations aimed at resuscitating infrastructure bonds seem doomed to failure on account of the highly speculative nature of, and the difficulty in creating any meaningful market for, such financial instruments. The special treatment advocated for investors in (Regional) Pooled Development Funds appears to be an unwarranted distortion of investment opportunities. The latter's cost to Treasury is neither estimated nor justified. And where are the skilled fund managers needed to yield a sufficient return to attract investor capital to high risk regional areas?

The transport proposals amount to a wish-list of expensive projects. None of the cost-benefit calculations wisely recommended by the Industry Commission is supplied. Nothing is said about constraints on private involvement in new infrastructure supply that are imposed by the Loan Council. The proposals appear to place unproved reliance on the economic benefits of infrastructure expenditure. Yet the McKinsey paper (discussed below) sets little store by infrastructure improvements in Australian regional development.

Additional or augmented, but uncosted, vocational-training schemes are proposed to help reduce regional unemployment. This is despite the obvious point, subsequently embraced by the government and the ACTU, that a training wage might be more efficient. It also contradicts the Industry Commission's view that such programs should be rationalised. Unsurprisingly, no mention is made of wider labour-market reforms to give management greater flexibility in use of labour.

Finally, the recommendations on industry policy are, despite some protestations about focusing investment on industry sectors where Australia is internationally competitive, unashamedly interventionist. The report supports plans to develop the downstream processing of raw materials (whether minerals, crops or fibres), maintain the ship-building industry, develop information technology, and control the development of various industry sectors. There seems little merit in extending industry policy into the vibrant services sector or in courting excessive dependence on downstream processing industries. Once again, there is no statement of the relative costs and benefits of the strategies.

Apart from the absence of financial data, the Kelty Report makes no credible attempt to identify which regional problems deserve particular attention on account
of their severity and likely responsiveness to government action. The report also fails to notice that remedial action or investment in one place often exacerbates the situation elsewhere. For example, improved links between the capital cities have traditionally served to reinforce the competitive power of the cores at the expense of the periphery. It is therefore difficult to see how policy-makers can estimate either overall funding requirements or the allocation of funds between spending options. The effective allocation of funds is further complicated by the intrinsic difficulties of coordinating the separate plans of numerous government departments. These analytical black holes raise the possibility that resources will be wasted by scattering them too thinly. The Kelty Report therefore hardly constitutes the basis of a large-scale spending program.

On a positive note, the main report (Volume 1) is valuable both for its documentation of regional communities' aspirations and as a slate of ideas to promote their well-being. Many of the latter require further careful analysis, for inadequate information and analysis have raised more questions than they answer. Despite previous criticism, some recommendations relating to education, water, the environment, energy, business support, and empowering the regions generally reinforce current policy directions at various tiers of government. Few would disagree with the goal of creating an increasingly educated, efficient and environmentally sound society. However, the report's more considered policies seem likely to benefit Australians wherever they live rather than remedy the regional ills previously identified. The likelihood of this outcome interestingly mirrors the intent, though not the substance, of the Industry Commission's findings. Kelty's recommendations supplement rather than reinforce the Commission's preferences, a fact myopically ignored by a committee intent on promoting the welfare of particular places.

The McKinsey Discussion Paper

The McKinsey discussion paper, released in late March 1994, offers a third and quite different perspective on regional development by asking businesses for their views about impediments to investment and job creation. The accuracy or representativeness of the figures and opinions presented in the report is unknown, as no precise details are given of who was surveyed or of the questions asked. One potential problem with business surveys is that respondents are apt to blame governments, other firms, international markets, environmentalists and so on for their problems rather than such internal factors as inadequate financial skills, lack of vision, maladaptive organisational structures, poor product design, and inadequate marketing. A final worry about the report lies in its focus on business already located in regional Australia. While their perceptions may be useful, it is equally important to evaluate the reasons why metropolitan firms who could locate outside the capital cities choose not to do so.

McKinsey make three main findings. First, rejuvenation of regional leadership is the most important lever for improving regional investment. Second, regions need to increase the focus on growing existing local businesses, and businesses need
to pursue export opportunities. Regions can also foster investment growth by attracting people to the region through improved lifestyle, environment and entertainment. Third, establishment of a world-class investment environment is essential if businesses are to pursue growth opportunities. Reducing uncertainty is an important element of the investment environment.

The first finding is very important and corroborates current research being conducted by the author in Central Queensland. Much overseas research also testifies to the importance of leadership in the development of depressed or small communities (Gittell, 1990; Judd & Parkinson, 1990; Pigg, 1991; Sorensen, 1991). However, it is difficult to see any implications for Commonwealth regional policy. High-quality business and civic leadership appears to emerge accidentally rather than through policy initiative. Nor are lifestyle, environment and entertainment matters among Canberra's core interests! Thus, by inference, central government's core regional development interest revolves around export enhancement, especially through improving regional areas' access to existing programs, and the creation of a world-class investment environment.

The latter, together with the expressed view that the challenges facing regional Australia mirror those facing the nation as a whole, appear consistent with the Industry Commission's ethos. The key labour-market condition affecting investment is not, according to McKinsey, direct wage costs but rather labour flexibility, motivation and skills. Nor is overall spending on infrastructure the constraint that Kelty envisaged. What is important is the allocation of capital between competing investments so that returns are maximised and the stock of existing capital is effectively maintained. This approach to infrastructure investment would horrify members of the Kelty Taskforce, for it clearly implies that non-metropolitan growth would be maximised through investing selectively in infrastructure — almost certainly in successful localities where growth pressures are already substantial.

McKinsey's findings seem to omit several factors that are crucial to regional development: unwillingness of firms to undertake research and development, aversion to risk-taking and innovation, the failure of business to respond flexibly to changing circumstances, insufficient market orientation, and lack of critical mass (or the difficulty under Australian regional conditions of developing nodes of interrelated industries along the lines advocated by Michael Porter of the Harvard Business School). These omissions warrant several comments. First, these failings have, until recently, been endemic to Australian business — with a few exceptions. The picture appears to be changing nationally for the better, but best business practice seems to be slower at filtering to conservative provincial localities from the capital city cores. The change to a more entrepreneurial culture is yet again a national, not a regional, issue. Second, these deficiencies in business practice are not likely to emerge prominently in a business survey of the kind that McKinsey conducted. Firms find it much easier to criticise government, markets, and other external factors than their own internal shortcomings. The finding that 71 per cent cite lack of sales or demand as a constraint on investment (p.13) is an indictment of the blink-
Another peculiarity lies in the emphasis on increasing population as a mechanism to promote regional development — especially from a policy perspective. Regions offering a high quality of life have few development problems and, moreover, Australia has a large number of them. Unfortunately, most of the problem regions are not in the same league and never will be. In addition, some problem areas like the western suburbs of Sydney and Melbourne, or the City of Logan adjacent to Brisbane, might be better off with reduced population growth! Focus on the Cairns economy as a shining example of what a regional economy can achieve is also odd. The region is quite exceptional in terms of its external contacts, both nationally and overseas, and it is difficult to see the policy implications of its experience for the great bulk of regional Australia.

Implications for Regional Policy

This survey has demonstrated two things: lack of clarity about what, if anything, constitutes a regional problem when viewed from a national perspective; and uncertainty about the underlying causes of regional conditions. Moreover, three reports delivered to the federal government during 1993/94 are simultaneously contrasting, contradictory, and even, in places, mutually supportive. Many of the findings are trite, insufficiently considered, ill-conceived, partial (in the sense that important variables are omitted), or based more on theoretical expectations rather than observed fact. Taken as a whole, the reports offer little guidance to policy formulation, except in one interesting respect.

There is an element of agreement that pursuit of national efficiency rather than particular regional benefit is likely to improve both the sum of national wealth and, through a filter-down effect, regional well-being (albeit some places more than others). This may well be correct. Much regional development in the 1990s is likely to be a spin-off from metropolitan development, immigration, or the internationalisation of the Australian economy. Very simply, the growing wealth and size of Australia’s population and that of its immediate region (Southeast and East Asia), coupled with greater opportunities for leisure and recreation, are having an enormous effect on place prosperity. It follows, ironically, that policies that indirectly reinforce metropolitan dominance may nevertheless bring increased prosperity to non-metropolitan areas through the spill-over effects of travel, recreation, hobby-farming, retirement, the demand for high-quality produce, and so on. Note, however, that these effects may largely be missing from the industrial cities and the outer areas of the capital cities, testifying once more to the diversity of problem confronting policy-makers.

Retrospective analysis also suggests that the federal policies most assisting the economic development of regional Australia in the last 20 years have been largely national policies: the winding back of manufacturing protection; increasing deregulation of the labour market; the adoption of the user-pays principle for the pricing
of public services; improved efficiency in public infrastructure brought about by privatisation, corporatisation, and deregulation; and a growing emphasis on training and research and development. Of course, some localities whose economies depend heavily on protected industries have been adversely affected by the process: for example, Wollongong, Geelong, and some regional centres with concentrations of TCF industries. But in view of the complexity and uncertainty of the regional policy environment from a Commonwealth perspective, prudence points towards the default option of chasing sound national management rather than the hare of place-specific policy.

References


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The Achievements of the GATT
Uruguay Round

Alan Oxley

The 1993 agreements negotiated in the Uruguay Round constitute the most comprehensive overhaul of the multilateral trading system since the GATT was initiated in 1948. They strongly reinforce and extend the multilateral rules for trade; they alter the geo-politics that shape international trade; and they embody fresh commitments by the major economic powers to continue promoting global growth through expansion of global markets. But they will not diminish growing interest in regional arrangements.

The GATT System

The goal of the GATT is to convert all trade barriers to tariffs and progressively to reduce them. Thus, the GATT provides a mechanism to achieve free trade. When countries accede to the GATT, they agree to use only tariffs to regulate trade and to treat imports from all trading parties equally, and in a manner comparable to treatment of domestic products. They also agree to participate in successive 'rounds' of trade negotiations to reduce tariffs. The Uruguay Round is the eighth such round in 40 years.

The GATT has been successful. Industrialised countries adopted its rules and used its mechanisms to reduce trade barriers steadily throughout the 1950s and 1960s. However, GATT has never been uniform in its effect, since countries have

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1 In my experience, the best account of the basic commitments of the GATT which addresses both the legal and economic aspects of how GATT rules function is Hudec (1975), which is unfortunately rather dated. A more concise, contemporary and useful account of the international trade environment is found in Low (1993).

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been unwilling to liberalise certain areas of trade. They have ignored GATT rules, or created exemptions from them, or applied other rules.

**World Trade Before the Uruguay Round**

When the Uruguay Round began in 1986, a number of features of the organisation of world trade had come to be viewed as impediments to liberalisation.

- The level of protection, particularly in the United States, was rising.

- GATT rules were generally not applied in two key sectors of trade: agriculture, which constituted about 12 per cent of world trade, and clothing and textiles, which constituted about 7 per cent of world trade.

- Most developing countries did not apply the GATT rules on tariffs.

- Quotas and agreements that disregarded GATT rules restrained trade in particular sectors, notably EC2 and US imports of steel and electronic consumer equipment.

- GATT restrictions on subsidies were weak.

- The US and the EC were using anti-dumping procedures to harass and restrict imports, particularly from Japan and other rapidly growing East Asian economies.

- GATT rules designed to obviate the negative impact of customs unions or free-trade areas on the trade of third parties were being ignored.

- The authority of the GATT dispute-settlement procedures had been weakened by the reluctance of the US and the EC to accept their jurisdiction in the agricultural sector.

Although tariffs had been reduced significantly in the 1960s, the benefits to trade had been considerably eroded in the 1970s by increasing use of non-tariff barriers, especially in agriculture, clothing and textiles, steel, automobiles and consumer electronic goods. A number of codes to reduce the incidence of the impact of

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2 The European Community has three times changed its name: from European Economic Communities (EEC) to European Communities (EC) to European Union (EU). In this article, EC is used in references to events that occurred before the Maastricht Treaty came into effect in late 1993, when the abbreviation EU was adopted.
non-tariff barriers were negotiated at the Tokyo Round (1976-79), but these had little impact.

The EC was unenthusiastic about a fresh round of trade negotiations. It had committed itself to its Single Market, which was intended to reduce barriers to trade inside the EC as well as to open up services markets. It was generally more interested in liberalising commerce within the EC than between the EC and the rest of the world; moreover, the EC’s agricultural regime would be challenged in the GATT.

In retrospect, it is clear that developing countries in the 1980s were willing to convert their unilateral reductions of trade barriers into multilateral commitments under the GATT. In the 1980s trade economists were largely preoccupied with the rise in global levels of protection. A number of studies indicate that in the late 1970s and early 1980s the effective rate of protection in the US rose. This led to claims that during the 1980s global levels of protection rose markedly. Since trade with the US is such a significant component of world trade, a rise in protection in the US is likely to push up any measure of the level of world protection. By the same token, the significant cuts in protection undertaken by many developing countries were overlooked. These changes have not received the recognition they deserve.

The main impetus for the Uruguay Round stemmed from international concern about the US Congress’s growing interest in raising trade barriers across the board in order to restrain imports, especially from Japan. The US Administration promoted a GATT round as a way of deflecting this pressure from Congress. At the same time it encouraged interest groups to support multilateral trade liberalisation. Two interests emerged: the US finance sector, which wanted multilateral rules to promote liberalisation of global services markets; and the US pharmaceutical, information technology and recording industries, which wanted to graft rules into the GATT to promote protection of intellectual property. These had not traditionally come under GATT’s jurisdiction; indeed many countries, particularly developing ones, fiercely contested their inclusion in the trade round.

The Uruguay Round Outcomes

A large number of agreements were negotiated in the Uruguay Round. The principal agreements were to

- reduce tariffs globally by one-third over ten years;

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3 The most comprehensive account publicly available to date is a synopsis and summary of the drafts of the agreements prepared by the author for Baker and McKenzie, London, and published as part of the Single European Market Reporter by Kluwer, The Hague. The Australian Department of Foreign Affairs and Trade is preparing a comprehensive account of the outcome. A CD Rom providing the full texts of the agreements and a commentary on them is being prepared by IMPFORMIT, Royal Melbourne Institute of Technology.
reduce protection in agriculture through: conversion of all trade barriers to tariffs; reduction over six years of budgets for agriculture by 36 per cent; and reduction of budgets for export subsidies by 36 per cent and reduction of the volume of produce exported by 21 per cent;
• convert all barriers to trade in clothing and textiles to tariffs over 15 years;
• impose new restrictions on subsidies, involving the phasedown of more directly trade-distorting subsidies;
• increase the authority of the GATT dispute-settlement systems;
• give the GATT Secretariat authority to review the trade policies of members;
• establish new standards for intellectual property and provide for enforcement of those standards;
• establish multilateral trade rules for the liberalisation of trade in services;
• create a World Trade Organisation to administer the GATT and other trade agreements negotiated under GATT auspices (some of them, such as the agreements on services and intellectual property, have no formal relationship to the original GATT).

It is clear that the Uruguay Round process helped contain the threat by the US Congress to impose an across-the-board barrier against imports. But we will never know how important it was in comparison with other factors, such as the gradual decline in the value of the dollar, which reduced the US trade imbalance and eased political pressure to 'do something'.

Cuts in Across-the-Board Protection

The agreements secure a commitment by all parties to reduce tariffs across the board by an average of one-third over a ten-year period. As well, a number of ancillary non-tariff arrangements will be negotiated away in particular sectors. This will not mean much in industrialised countries, where (with the exception of Australia and New Zealand) the average level of tariffs is 5 per cent. But it will have a noticeable affect in developing countries, whose average tariff levels range from 20 to 50 per cent.

What about the non-tariff barriers? In two areas where these have been high — agriculture and clothing and textiles — there is a commitment to phase them out. In agriculture, all non-tariff barriers have to be converted almost immediately into tariffs. This will not result in immediate cuts in protection. It was clear that the US and the EC would replace their non-tariff measures with tariffs set so high that
The Achievements of the GATT Uruguay Round

even after the general cut of tariffs by a third (which was to apply also to these newly established tariffs) the effective level of protection would not be lower than before. However, given the different effects on trade of tariffs and non-tariff measures, the conversion of all barriers to tariffs over time is likely to have a (limited) liberalising effect.

In the case of clothing and textiles, a different mechanism to achieve conversion to tariffs is to be used. Tariff quotas (which allow a specified quantity of a product to enter at a lower than normal tariff level) are to be used to effect the adjustment over a twelve-year period. This should also produce a steady liberalising effect.

The agreements also affect other non-tariff barriers, such as ‘voluntary restraint arrangements’ and ‘orderly marketing arrangements’, which the EC and the US in particular have used in electronic consumer, automobile and steel markets. A Safeguards Agreement revises GATT rules on imposition of protection in emergencies. The US and the EC agreed to phase out ‘voluntary’ arrangements to manage trade, although the EU sought a specific exemption for its quota system to restrict imports of automobiles from Japan. (These arrangements are almost never properly ‘voluntary’. The euphemism was coined in the 1970s, when Japanese exporters were told they could ‘voluntarily’ restrain the level of exports to avoid the costs of defending anti-dumping cases in the US.) On the face of it, this is a significant agreement. Oddly, it has not been criticised by industries in the US and the EU that were protected by ‘voluntary’ and ‘orderly’ arrangements. In the American case, this may reflect official assurances that the Section 301 retaliatory mechanisms in the US Trade Act remain unaffected by Uruguay Round commitments. Perhaps criticism will surface when the agreements are scrutinised by Congress later in 1994.

Separate negotiations to develop a Multilateral Steel Agreement, designed to phase out the network of steel import quotas, particularly those imposed by the US, were not completed by the end of the Uruguay Round and, at time of writing, there is no certainty that there will be a successful conclusion.

The most important across-the-board changes in the rules of the GATT (as opposed to changes within existing rules) are those affecting subsidies. The Subsidies Code has been renegotiated, and now contains tangible commitments to avoid using trade-distorting subsidies (though some exceptions are provided for). Under the old rules, only direct subsidies of exports were prohibited, and then only on non-agricultural products and only by those parties to the GATT that subscribed expressly to that commitment. However, these changes will not have visible effects in the short term.

The agriculture agreement sets lower quantitative levels of government support for agriculture. A principal target is to cut general levels of financial assistance by 36 per cent (some exceptions permit direct payments to farmers). However, the base period for measuring the cuts is one in which levels of support to farmers were historically high. At lot of work needs to be done to assess the impact of these changes.
What does all this amount to? It is too soon to make an educated guess at the quantitative impact of the Uruguay Round agreements on global levels of protection. But it seems reasonable to conclude that, among industrialised countries, the outcome will consolidate the liberalising trend of the early and mid-1980s. The agreements include several new policy instruments that will constrain over time the use of non-tariff measures by industrialised countries, thus improving greatly on the meagre results of the Tokyo Round. Among developing economies too the agreements will consolidate the trend to liberalisation, and in a number of instances accelerate it. The agreements represent tangible commitments to cease increasing support for agriculture and are likely to achieve distinct reductions over the six-year period. The big issue in this sector is the extent to which the changes introduce market forces as determinants of shares of trade.

Has the Authority of the GATT been Enhanced?

The authority of the GATT has indeed been enhanced, through several, discrete agreements.

The regulatory systems of two major sectors of trade — agriculture and clothing and textiles — are to be amended to bring them into conformity with the rules of the GATT. In a legal sense, this goes beyond merely agreeing to convert non-tariff measures in these sectors into tariffs.

In the case of agriculture, the US will surrender a formal authority that it secured in 1955 not to apply GATT rules to certain aspects of agricultural trade. Switzerland will have to give up rights to special treatment for agriculture that it won when it negotiated its right of access to the GATT. The agreements formally abrogate the Multifibre Agreement, which provided GATT cover for the use of quotas, otherwise prohibited under GATT rules, that restricted imports of clothing and textiles from developing countries.

For the first time in the history of the GATT, developing countries have embraced GATT rules on tariffs in toto. Before the Uruguay Round agreements, the GATT’s rules on tariffs were primarily applied by industrialised countries. Critics of the GATT in developing countries traditionally dubbed it a ‘rich country club’. Yet developing countries themselves often refused to bind their tariffs according to GATT rules. The Uruguay Round largely rectifies this shortcoming.

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The GATT’s rules are structured so that undertakings to cut tariffs become binding obligations to other contracting parties. When one party commits to another to reduce tariffs on a product to a particular level, the deal is sealed under GATT rules when it lists this new tariff level in a schedule to its terms of accession to the GATT. The act of listing is to ‘bind’ the tariff. Once bound, it cannot be reversed without the approval of all members of the GATT. In the unusual event that a party wishes to raise a bound tariff, the usual pattern is to negotiate with the parties with whom it originally negotiated the tariff, generally conceding some change in a tariff in another area to compensate for the loss of trade agreed to occur as a result of a lifting of the previously bound tariff. The system has the general effect of making tariff cuts irreversible. It should not be forgotten that because of the rule that imports from all countries
In addition, the right that developing countries had previously enjoyed to impose trade barriers in order to protect their balances of payments has been significantly curtailed in a specific agreement on the terms of application of the relevant provision of the GATT (Article XVIII). This provision had been abused by many developing countries.

Another result of the Uruguay Round, which has surprised close observers of the GATT, has been the strengthening of the authority of the GATT dispute-settlement procedures. To a very large degree, this system operated only if the parties to the dispute gave their consent. Virtually all small-country members of the GATT have respected these procedures. But the US and the EC, especially in disputes over agricultural subsidies, were able to undermine the procedures if they were unhappy with the results (though this inclination diminished considerably from the mid-1980s). The Uruguay Round agreements make important changes to the dispute-settlement procedures, and commit all parties to accept more readily their findings.

The agreements give the GATT secretariat a new executive function of reviewing the trade policies of GATT members. This was agreed at a mid-term review of the Uruguay Round negotiations in 1988 and the new system has been in operation for three years. Previously, the primary function of the GATT secretariat had been to service administration of fulfilment of and challenges to rights that parties to the GATT enjoyed under the agreement. The surveillance function is an important extension of the functions of the GATT.

The conversion of the GATT into the World Trade Organisation is a significant constitutional change that will bring under the umbrella of the one organisation the operations of the two most important new treaties, the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related aspects of Intellectual Property. A common secretariat will service these agreements and a common system of dispute settlement will be used to deal with challenges under them.

Broadening the Scope of the GATT

The agreements on services and intellectual property represent the most radical alteration of the jurisdiction and mandate of the GATT, which was originally intended to apply only to trade in goods. The GATS applies to all sectors other than those formally excluded. Financial services and telecommunications are the two most heavily traded service sectors and therefore represent touchstones of the effectiveness of the agreement. Further negotiations are to be held in both sectors.

Extending the GATT to services is a visionary move that recognises that continuing promotion of the efficiency of global markets requires globalisation of...
services markets, which are acquiring a greater share of world trade. Greater efficiency in global services markets is also becoming an increasingly important factor in global competitiveness in international trade in goods. The effort to remove remaining barriers to trade in goods among industrialised economies may have reached the point of diminishing returns compared to the greater benefit potentially available from liberalisation of international trade in services. Work on this will have to await a greater familiarity with the issues among trade economists.

The intellectual-property agreement extends the GATT's dispute-settlement provisions to intellectual-property standards. Any country will be able to use the GATT dispute-settlement mechanism in challenging non-application of intellectual-property rights in another country. Securing this change was a major source of US support for the Uruguay Round agreements.

The GATT has thus been substantially refurbished. But two areas of weakness remain untouched. The rules designed to ensure that regional trade agreements (free-trade areas and customs unions) do not undermine the general benefits that GATT parties are entitled to expect from their trading partners are not substantially changed. GATT requires that regional agreements must not increase trade restrictions between members of the regional arrangement on the one hand and other parties to the GATT on the other. Application of the relevant GATT test for this outcome has waned over the years, and regional agreements are nowadays reviewed in a rather perfunctory manner.

Nor do the Uruguay Round agreements properly address anti-dumping. The anti-dumping code has been revised, but not significantly. GATT rules give individual members considerable discretion over the working of anti-dumping systems, thus leaving intact an emerging protectionist measure.

The Geo-political Significance of the Uruguay Round

The Uruguay Round began in 1986 and was supposed to finish in 1990. It formally concluded in 1994. While the negotiations dragged on several important changes to the structure and institutions of international trade occurred. The most important were in Europe and North America.

The EC negotiated and implemented the Single Market. The European Economic Area was also established to enable the countries of the European Free Trade Area (except Switzerland) to participate in the Single Market. The US negotiated a free-trade agreement with Canada and then extended it to Mexico in the NAFTA. Other moves towards regional trade liberalisation included the ASEAN countries' commitment to a free-trade area, and the move by Brazil, Argentina, Uruguay and Paraguay to establish a free-trade area customs area, the MERCOSUR arrangement. Discussions about economic integration also took place among countries in the Pacific Rim. APEC was launched and the Malaysians promoted the idea of an East Asian Economic Caucus.

The collapse of the Soviet Union while the Round was in progress discredited the command-economy model and focused attention even more on the export-
oriented East Asian development model. Two effects were to increase the number of countries seeking membership of the GATT and to promote the importance of trade in international relations. In international debate on trade, the issue was whether the multilateral trade system promoted by the GATT was being supplanted by regional trade arrangements. The conclusion of the Uruguay Round has shown that the GATT was not supplanted. The patterns of trade showed that its rules were robust. Analyses by the GATT secretariat showed that trade between regions was growing faster than trade within regions, mainly because of the rapid growth of the East Asian economies.

But the GATT was in some danger of being pushed to one side. The EU and the North American countries had promoted regional trade agreements. The impetus for these changes was as much political as economic, especially in Europe after the collapse of the USSR. The risk for the GATT was that the US and the EU had given a higher priority to these regional arrangements than to the GATT. But the Uruguay Round outcomes represent a renewed commitment by the major economic powers to promote growth by creating and expanding global markets. Nevertheless, the pressures towards regional agreements will not disappear. The EU has a long-term commitment to further expansion and integration. Other countries will seek free-trade agreements with the US. But the successful conclusion of the Uruguay Round allows us to view these regional tendencies with less concern.

Conclusion

The long-term influence of the Uruguay Round agreements on the direction of international economic management may be as significant as the influence of the GATT itself when it was negotiated in 1948. The scope of economic activity that is to be subject to multilateral rules has been extended, warranting reconstruction of the GATT into a World Trade Organisation. Acceptance of the basic precepts of the GATT has spread from industrialised countries to most developing countries. At a time when interest in regional trade arrangements has been strong, the authority of the GATT system of multilateral rules has been renewed.

References


Environmental issues are becoming increasingly enmeshed with economic policy debates, including trade policy discussions (Anderson & Blackhurst, 1992; Low, 1992; Whalley & Uimonen, 1994). This greening of national and international politics offers many economic opportunities, as well as challenges, to the Australian community generally and to the primary export sectors in particular. Australian exporters could gain significantly from this development, but whether they ultimately are net beneficiaries depends heavily on the policy choices to be made both here and abroad. There is a considerable risk that the policies adopted in response to environmental concerns will reduce welfare in many countries, including our own, and possibly even damage rather than improve the natural environment.

Australia's primary exporters have been concerned mainly with the erosion of their export competitiveness (because of the adoption of ever-more stringent environmental standards in Australia) and with the reduced incentive to invest further (because of policy uncertainty). This concern has a clear parallel with the uncertainty over property rights because of Mabo. But in addition to this direct effect of the greening of domestic politics on Australian investment and exports, there are two important indirect effects. One is the impact of environmental policies in other countries on the competitiveness of Australian exporters in international markets. The other — less obvious, but potentially more important — is the effect of linking environment to trade policies on the international trading system as a whole. This article examines each of those two indirect effects, and then draws out some implications for Australia.

The Impact of Environmental Policies Abroad on Australia's Export Competitiveness

Concern about the natural environment (and for product safety) fluctuates with the business cycle. But the long-run trend of concern is clearly upward (especially in

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1 An elaboration of points made in this section can be found in Anderson (1993). See also Leonard (1988) and MacNeill et al. (1991).

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the more developed economies) partly because, despite uncertainties, the scientific basis for many of these concerns is thought to be more solid as research proceeds, and partly because the demands for the services of the natural environment increase with rising incomes. These services include clean air, potable water and filtered sunlight; the capacity to absorb waste; and pleasure from visiting or even just knowing of the existence of unspoilt wilderness areas. In fact, the demand for environmental services tends to grow faster than demand for many other goods and services in middle- and high-income countries. But the supply of these environmental services is not unlimited, and for many of them the markets necessary for rationing their use are incomplete or yet to emerge.

To help overcome this market imperfection, the more advanced economies are establishing institutional structures for arriving at something approaching a social consensus on appropriate environmental policies, for allocating clearer property rights, and for implementing and enforcing policies (Grossman, 1994). These developments are tending to occur faster as an economy’s income grows faster, and they tend to begin at a lower level of per capita income the more densely populated the economy, other things equal.

As a resource-rich, lightly populated economy, Australia has a comparative advantage in goods and services whose production requires relatively intensive use of the natural environment: land for farming and grazing, raw materials for energy, minerals and metals, coastal areas for tourism, open spaces for the discharge of pollutive industries to be dissipated, and so on. That comparative advantage is strengthening with economic growth abroad, and more so the faster other economies grow relative to ours and the more that growth abroad is concentrated in densely populated middle- and upper-income countries (as it has been, notably in East Asia). That is, our terms of trade are improving and we are sharing some of the benefits of their faster economic growth. We would gain even if those countries did not change their environmental policies in the course of their economic growth; but we are gaining additionally to the extent that they are raising their environmental standards and charges and thereby effectively increasing their demand for the goods and services of our natural environment that are embodied in our exports.

An obvious example is agriculture. Because land in Australia is relatively cheap, our farmers use relatively few agricultural chemicals (such as fertiliser, pesticides, animal growth hormones) which are effectively substitutes for land. Consequently, Australian food contains few chemical residues: a feature we can, and are, increasingly exploit in marketing our farm products abroad. Furthermore, in so far as any taxes or restrictions are imposed on the use of farm chemicals in Australia, they are likely to be less severe than those imposed in more densely populated and higher-income countries. Hence the net impact of the greening of farm policies at home and abroad on the export competitiveness of Australian farmers is likely to

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2 This is likely to be least so for chemicals that end up in waterways, given Australia’s relative scarcity of fresh water.
be positive: likewise for mining and other producers who take advantage of our abundance of natural resources.

Australian exporters would be delighted if the story could end here; but unfortunately it cannot, for several reasons. One is that foreign producers who are becoming less competitive because of their government's imposition of stricter environmental standards and charges are demanding higher import barriers to protect them from that loss in competitiveness. Such protectionism is unwarranted on economic efficiency grounds, since the environmental standard is aiming to eliminate an unjustifiable implicit subsidy rather than add an unjustifiable tax. Yet sometimes it is the workers rather than the owners of industries who are demanding protection, afraid that the owners will transfer their operations offshore to locations with more lenient environmental standards, so destroying local jobs.

Another complication is that environmental concerns are taking on more of an international and even global orientation, well beyond the earlier intra-national or trans-border concerns with neighbouring countries. Possible climate changes and ozone depletion prompt concern about the emission of carbon or the use of CFCs not just at home but also abroad. The NIMBY (not-in-my-back-yard) phenomenon is becoming less relevant as awareness increases that relocation of a pollutive industry to a country with laxer environmental standards may well increase global pollution. The irony is that that relocation and increased environmental damage may have been stimulated by the raising of environmental standards in one's own country!

Such pressures are likely to increase as the world economy becomes more integrated and more countries begin to industrialise, particularly since global population and consumption growth will be concentrated in these poor but modernising countries for the foreseeable future. Yet they are among the countries where the new institutions to reduce environmental degradation will be slow in coming, because the costs of sacrificing consumption of material goods in order to achieve higher environmental standards weigh much more heavily in poorer than richer economies. Moreover, national differences in willingness and capacity to preserve the natural environment apply not just to physical pollution. They apply also to the abuse of animals, species extinction, and the logging or flooding of pristine wilderness areas from which people derive varying degrees of aesthetic pleasure, regardless of national boundaries.

Since personal values play an important part in international debates on these issues, the scope for friction between countries is considerable. Yet cooperation between sovereign states is required for efficient solutions to such international environmental problems. It is therefore not surprising that institutional innovations to address these concerns have been slow in coming — certainly much slower than environmental groups in some rich countries would like. It is out of frustration over the pace of progress towards international environmental agreements that such groups have turned their attention to one of the few instruments they perceive their national governments to have for influencing environmental outcomes in other countries, namely, trade policy.
Trade Policy and Environmental Objectives

Consider the recent dispute between the United States and Mexico over the alleged use of dolphin-unfriendly nets by Mexican tuna fishermen. US environmentalists, distressed at the netting of dolphin by American tuna fishermen, succeeded in getting the practice stopped — only to find the reduced domestic supply of tuna being made up by imports from Mexico. The remaining US tuna fishermen therefore joined environmentalists in calling for a ban on those imports, even though it is impossible to tell whether a particular batch of tuna was caught in dolphin-unfriendly nets or otherwise. The motive for US policy action in this case is evidently a mixture of traditional competitiveness concerns and a concern felt by some in the US (not entirely shared elsewhere) for the global commons and/or for the welfare of dolphins. And the GATT's dispute panel argued in support of Mexico's objection to the import ban partly because the policy was incapable of distinguishing between the dolphin-friendly and dolphin-unfriendly product (whereas it would not have objected to a ban on the sale of tuna products unable to carry the label 'dolphin-safe', for that ban would have applied equally to domestic and imported goods).3

Such use of trade measures to address environmental issues should concern the world at large, and Australian exporters in particular, for at least three reasons. First, trade measures are typically not first-best instruments for achieving environmental objectives, so their use in place of more efficient instruments reduces the level and growth of economic welfare unnecessarily, and may even add to rather than reduce environmental degradation (see Anderson, 1992a). Second, concern for the environment may be used (or rather abused) as an excuse to raise trade barriers in ways that are difficult to prove to be inconsistent with a country's obligations under GATT. Accepting the US tuna ban, for example, would have opened a large loophole in the GATT for any country unilaterally to apply trade restrictions not for the purpose of enforcing its own laws within its jurisdiction but to impose its standards on other countries and/or to effectively override previous commitments not to raise import barriers. Third, if it leads to an escalation in trade disputes, it could be followed by retaliation and counter-retaliation, the result of which would be to undermine the multilateral trading system's provision of predictable market access opportunities on which the prosperity of small open economies such as Australia depends.

Some environmentalists would welcome the demise of the GATT rules-based trading system, wrongly believing that GATT is bad for the environment. They believe this for two reasons. One is that it appears to undermine their efforts to raise environmental standards (as in the tuna-dolphin example mentioned above), even though there is nothing in the General Agreement that precludes a country from applying measures to protect human, animal or plant life or health within its jurisdiction. The other is that GATT's purpose is to promote trade liberalisation, two effects of which are to boost global incomes and to cause some international

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3 A discussion of this issue can be found in GATT (1992:27).
relocation of production and consumption. Both of these effects worry some environmentalists, yet they need not.

Economic Growth and the Environment

Consider first the economic growth point. Some believe an expansion of global production and hence consumption is undesirable simply because they think it will increase demands on the natural environment. This is a neo-Malthusian view of the world that is as misguided as Malthus's original concern that our growing population would be incapable of feeding itself. It ignores the fact that income growth brings with it numerous changes in behaviour patterns. One such change, already noted, is that as incomes rise in response to trade reforms, more-stringent environmental policies tend to be implemented. This is because the demand for such policies rises with income: they are both more desired and more affordable. As well, higher incomes in poorer countries lead eventually to lower population growth rates, which reduces pressure on both rural and urban environments. And as the value of poor people's time in developing countries increases as trade liberalisation boosts the demand for labour, the relative cost of using wood as a source of household fuel rises also because of the time taken to collect it. Since four-fifths of the timber harvested in developing countries is used as household fuel, this alone could have a major beneficial impact in reducing deforestation and carbon dioxide levels.

For all these reasons, countries tend to go through an environmental transition, just as they tend to go through a demographic transition as their incomes rise. That is, instead of environmental degradation continuing to worsen as it would with output and consumption growth if no abatement policies were introduced, the extent of damage per capita tends to level off and then fall with economic growth as the government responds to demands for tougher environmental laws. Systematic evidence of the extent to which this has been happening is not yet well documented, but the recent survey by Grossman (1994) is cautiously supportive of this view.

The Case of Coal

Just as these behavioural changes are not appreciated, so the environmental effects of trade liberalisation through the relocation of production and consumption are poorly understood. It is not inevitable that a particular environmental problem will diminish as a consequence of trade reform. But that often will be the case, and all the more so if well-targeted environmental policies are introduced at the time of the liberalisation.

Consider the case of one of the world's most distorted commodity markets, namely, coal. As a supplier of nearly one-third of the world's energy, coal is a major contributor to local, trans-border and global environmental problems, includ-

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4 Agriculture is another important case of obvious significance for Australia where trade liberalisation would probably help rather than hurt the environment. See Anderson (1992b).
ing climate change and acid rain. Advanced economies in the northern hemisphere tend to restrict imports and overprice coal (while developing countries, particularly the former centrally planned economies, tend to restrict its exportation and underprice it), relative to the price in international markets (see Steenblik & Wigley 1990; Jolly, Beck & Savage 1990). Reducing coal price supports in the advanced economies might be expected to increase coal use and therefore worsen the environment; but not necessarily. On the contrary, if the consumer price of coal in those countries remains (or is set) at its optimal level and just the producer price is lowered to the international level, domestic coal consumption would not rise. But two other changes would improve the environment. One is that cleaner-burning imported coal could substitute for the lower-quality domestic coal, the production of which would fall. The other is that the international price of coal would rise, thereby reducing energy consumption and hence carbon emissions in the rest of the world. Since such a reform would at the same time raise real incomes, for the usual gains-from-trade reasons, it contrasts markedly with proposals to reduce climate change by imposing carbon taxes globally — proposals on which international agreement in any case would be extremely difficult to reach.

Some Implications for Australia

Concern for the natural environment almost certainly will increase over time, will gradually spread beyond the richest countries, and will have more of a global orientation. This, together with the increasing interdependence among the world's national economies as barriers to international trade and investment fall, ensures that even if Australia did not alter its own environmental policies, its economy will be affected by changes in other countries' environmental policies. Given our abundant natural resources, the direct effects of those changes are likely to be beneficial to Australian exporters, since they are likely to outweigh the direct effect of our own environmental policies on domestic cost structures. But there is the very real danger that those potential net benefits will be more than offset by several negative developments. These include using the environment as an excuse to raise import barriers, using trade measures to bludgeon Australia and other countries into adopting higher environmental standards than are appropriate or desired in our more spacious and lower income setting, and lobbying against trade liberalisation — all of which are tending to corrode the GATT rules-based multilateral trading system on which Australia's prosperity heavily depends.

Countries will genuinely disagree on how to deal with some international environmental issues, just as groups within countries do — only more so because of wider differences in incomes and preferences between countries. The optimal solution is to be found in more negotiations, informed by results of research on the environmental as well as economic effects of alternative policies.

Despite the interest shown in it by environmental groups, the GATT (or rather its prospective replacement, the World Trade Organisation, WTO) is not the most obvious forum for such negotiations. But if it is left to do what it is designed to do,
namely to facilitate an open, predictable, rules-based global trading system, it will indirectly foster a better use of the world’s natural (and other) resources. And it will not be stopping countries implementing appropriate environmental policies within their jurisdictions. Nor does GATT stop trade measures being used in international environmental agreements, so long as a dispute between GATT-contracting parties does not arise: witness their undisputed use as part of the Montreal Protocol on the phasing out of CFCs (Enders & Porges, 1992), and in the Convention on International Trade in Endangered Species. As well, the GATT could serve as a transparency agency if contracting parties were to agree to notify the Secretariat of any new trade-related environmental measures (TREM’s — a likely new word in GATT-speak).

As a small open economy outside the two major trading blocs (the European Union and the North American free-trade area), Australia relies heavily on the continued health of the multilateral trading system. Now is therefore not too soon to expand our investments in forums such as APEC and the OECD, as well as the WTO, to maximise the advantages and minimise the damage from the inevitable inter-linking of trade and environment issues. Among other things, that requires persuading environmental groups that, instead of opposing trade liberalisation and/or looking to the GATT/WTO to provide sticks to police international environmental agreements, they should advocate less costly and more effective direct measures for addressing environmental problems. But it also could include forming a group of unsubsidised coal-exporting countries, to complement the Cairns Group of lightly subsidising food-exporting countries. Both could advertise the fact that liberalising trade in those two highly distorted commodity markets (coal and food) would yield not only the conventional economic gains from trade expansion but also improvements to the environment. A coal-exporting group could also promote the idea that lowering coal-producer subsidies and import barriers offers a far more certain route to reducing carbon emissions than the less practical idea of an international agreement to impose a carbon tax.

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Forecasting: A Mug's Game or a Productive Role for Economists?

Garry M. White

Many economists earn their keep by forecasting economic data. Economic forecasters are generally employed by governments, who use forecasts to help policy formulation, or by market participants, who attempt to profit from superior knowledge of economic trends. In recent years, forecasters have been less than completely successful in forecasting the direction and pace of economic activity in the Australian economy. The reasons for this poor forecasting record include a lack of appreciation of the impact of financial deregulation, an underestimation of the importance of the world economy, and an excessive faith in the ability of domestic policy to influence domestic growth (White, 1992). As well, there are a number of practical difficulties that, at first sight, suggest that the whole enterprise has little social value.

Responding to a recent period of market turmoil, P. P. McGuinness (1994) has argued that ‘nobody here, in the United States, or anywhere else has the slightest idea of what is happening to bond prices, interest rates, exchange rates or economic growth rates, and why’. He likened economic forecasters to priests who ‘have perfected the technique of always sounding as if they know what is happening while explaining away what they got wrong the last time’. In a similar vein, David Clark (1994) has reminded his readers that official forecasters have difficulty in advising governments on the conduct of monetary policy. Because ‘we know far too little about the key relationships between interest rates, budget deficits, the level of economic activity and inflation and inflationary expectations’, he likened interest-rate forecasting to a ‘tea leaf reading exercise’, and compared monetary policy to ‘trying to fix a computer in a blacked-out room using a jackhammer’.

In a more serious commentary on economic forecasting, Tom Valentine, a respected professor of economics with strong links to the finance sector, recently wrote that ‘a correct job description for an economist should not include short-term forecasting’ (Valentine, 1994). He was arguing from the propositions that the forecasting record of economists is abysmal and that successful forecasting is a necessary condition for successful speculation. He also noted the widespread assumption that markets are efficient and that, therefore, nobody should be able to make consistent profits from forecasting. I argue below that Tom Valentine’s test for successful forecasting is too severe; forecasts do not have to be accurate in the commonly used
sense to be profitable. Before that, however, it is worth asking why forecasting seems to be so complex as amount to a mug’s game.

The Complexity of Forecasting

One problems forecasters face is illustrated by data set out in the Table 1. The single most important measure of activity in the economy is growth in Gross Domestic Product (GDP). If governments aim to stabilise the growth rate of economic activity, then forecasting GDP is the key to policy formulation. Table 1 includes the initial budget forecast of GDP growth contained in each year’s budget papers (in bold); the Australian Bureau of Statistics’ first estimate of GDP growth for that year when the following June quarter national accounts are first released (in standard type); and then subsequent revised estimates issued by the ABS (in italics). For example, GDP growth for 1988/89 was forecast by Treasury to be 3.5 per cent in the Budget Papers published in August 1988. A year later, when the first ABS estimate for 1988/89 became available, growth was estimated to have been 3.3 per cent; but subsequent revisions have raised the official growth estimate to 4.7 per cent. What had been a good estimate turned out to have been a major underestimate. Should policy settings be the same at 3.5 per cent annual growth and 4.7 per cent growth?

Table 1

Annual percentage GDP growth at constant prices, 1985-94

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Numbers in bold are Budget Papers forecasts; non-bold are the ABS Australian National Accounts first estimates; and italics are subsequent ABS estimates. Data are for GDP(A) from 1992/93 and GDP(I) for previous years.

The example of GDP estimates for 1988/89 illustrates that even after several years the ABS continues to revise its estimates of economic activity. For almost all collections the ABS undertakes sample surveys (thereby introducing sampling er-
rors) and, even where the full population is enumerated, data are obtained with less than perfect accuracy and over extended time periods. In addition, some data are not readily collectable and must be 'estimated' by the ABS. The National Accounts, in which GDP estimates are published, are based on a wide range of data of varying reliability and timeliness (see ABS, 1990). It is not surprising, therefore, that estimates of GDP for any particular year vary as different components of the data are revised. The problem for economists is that they are attempting to forecast something that is itself a moving target: it is particularly difficult to forecast the future if we are unsure of the past.

Economists not only forecast major time series such as GDP and the consumer price index but also a range of minor time series such as building approvals, housing finance, motor vehicle registrations, current-account deficits and the level of unemployment. These data are often issued and forecast monthly and suffer major fluctuations that can often have little to do with underlying trends. Typically, a market economist would be forecasting two to three economic series every week. Policy economists in Treasury or the Reserve Bank are often also called upon to forecast these data in order not only to understand what is happening in the economy, but to warn politicians about possible public and market reactions.

**Figure 1**

**Australian GDP growth forecasts, 1988-92**

![Australian GDP growth forecasts, 1988-92](chart.png)

Source: Adapted from Commonwealth of Australia (1992/93:2.10).

Another, more important, observation to be made about the data presented in Table 1 is that government economists have a very mixed record in forecasting economic activity one year ahead. But private-sector forecasters are no better. Figure 1 compares the forecasting efforts of an average of private sector economists to those of the government and the actual outcomes. The private-sector forecast in
each year is the average forecast published in the *Business Review Weekly* following release of the June quarter national accounts. The outcomes are the latest available from Table 1. Both official and private forecasters understated the boom and overstated growth during the recession. However, government forecasts are not only forecasts but may also represent an expression of the intent of policy and be a method of manipulating business confidence.

Among the items that a market economist is expected to forecast are the government's official forecasts, such as those set out in the annual budget. This requires not only the usual forecasting techniques of economics and statistics, but a knowledge of the models, approaches, motives and opinions of the key official forecasters. As already observed, government forecasts are partly expressions of what politicians and officials want to happen. It would be untenable for a government to forecast a recession, for example, since to do so could well be self-fulfilling, amount to political suicide, and imply (albeit correctly in some circumstances) that recession was beyond the control of government.

Government forecasts are often constructed to impart confidence to the economy (if growth is too low) or, less often, to dampen enthusiasm (if growth is judged to be too strong). Talking the economy up may well be a factor in the excessively positive forecasts for GDP growth in 1990/91 and 1991/92 as set out in Table 1. However, if governments are seen to be consistently inaccurate in their forecasts (for whatever reasons), their credibility will probably decline over time and their policy initiatives may thereby become less effective. How can a government make good policy decisions if it cannot demonstrate that it understands what is happening in the economy or is likely to happen in the immediate future?

**Paradigm and Data**

A further complication for the forecaster is trying to link economic outcomes or announcements to market reaction. Imagine that a higher than expected current-account deficit is announced. Our economist is particularly concerned with the value of the Australian dollar. One model of exchange-rate determination would suggest that this should see a depreciation of the Australian dollar (the current-account balance model). However, the market might interpret the deficit as a sign of excessive growth in domestic demand (as it did in 1988) and anticipate an increase in official short-term interest rates as the Reserve Bank raised interest rates. Under an alternative paradigm (Mundell-Fleming), the exchange rate would be expected to appreciate in response to higher market interest rates (market interest rates would rise in anticipation of higher official rates).

The official paradigms also change over time. Treasurer John Willis made clear in an ABC radio interview on 2 February 1994 that a major shift has occurred in the way the government will react to higher current-account deficits. The emphasis will now be on fiscal policy rather than monetary policy. He said, 'what exactly happens to interest rates has some relationship to what happens to fiscal policy... if we don't do that then certainly there would be more pressure on interest
rates'. These views contrast with those of the government in 1989, when the then Treasurer Paul Keating, in a press conference on 19 June, said 'high interest rates are associated with our trade circumstances . . . this is the only policy prescription to get that demand under control and to get imports under control and it's only then we'll see any prospect of interest relief'. Subsequently, the then Deputy Governor of the Reserve Bank, John Phillips (1990) noted that 'monetary policy is not an effective weapon to fight a balance of payments problem'.

Canberra has clearly caught up with one of the great policy errors of the late 1980s: it will not again be using monetary policy to control the current-account deficit. The old framework, which worked through strong domestic demand to dampen excessive imports, with monetary policy the instrument to control domestic demand, seems to have been cast aside. Instead, the current-account deficit is now considered much more in a savings/investment framework (by definition, the current-account deficit must equal the difference between domestic savings and investment). Hence the recent focus on reducing the government's dissaving by reducing the budget deficit.

Changing policy approaches to the current account illustrate how the forecaster must be aware of the economic paradigms within which key players develop their views on the economy.

Similarly, there are strong theoretical arguments that changes in fiscal policy should have little impact on the level of Australian economic activity following the floating of the dollar (Sachs & Larrain, 1993:418-19). Many economists, however, treat the gross expansion of government spending as a boost to economic activity without allowing for the offsets through net exports or private investment. Hence there is a genuine ambiguity about how, in this case, the unanticipated announcement of increase in the budget deficit should affect forecasts of economic activity.

Policy and Data

Changes in government policy create a further problem for forecasters. The issue is to anticipate how the key officials and politicians will react to changing information. Also, do their expectations of economic developments differ from the market in general or the views of particular private-sector economists? If a particular private-sector forecaster correctly believes that the key public-sector economists are too optimistic about growth and will therefore be disappointed by prospective economic information, a potential profit to be made from anticipating the resulting policy changes. Similarly, if a private sector economist thinks that the government has used the wrong paradigm to assess economic data, further opportunities for profit (or loss) become available.

This problem arises with monetary policy in particular. Monetary policy is implemented in Australia and most other advanced economies by targeting a particular level of short-term interest rates (the overnight cash rate in Australia and the Fed Funds rate in the United States). These interest rates and expectations about policy changes effectively anchor one end of each country's yield curve (the difference be-
between the interest rates available from short-term and long-term investments) and have a strong influence on equity markets. So understanding the policymaking process and the reaction functions of the key decisionmakers is crucial for the forecasting of market movements. It is important to be able to forecast not only economic data, but also the reactions of policymakers to those data. This is why so much time is spent analysing the comments and speeches of Treasurers and senior public servants.

The Economic Value of Forecasting

The preceding discussion could support the conclusion that forecasting economic events is very much a mug's game. We are all bombarded with economic noise and none of us is very sure what happened in the past, let alone what might happen in the future. In addition, there is confusion about the economic paradigms in which information should be assessed. Policymakers, whose decisions have a direct impact on markets, appear to be as confused as everyone else.

And yet, fortunately for economists, there is an economic return to forecasting. The key rationale of forecasting is that every piece of information contributes to the current perception of what is happening in the economy and therefore of what is likely to happen in asset and debt markets. These perceptions may be erroneous, but nevertheless they have an impact on policy makers and market participants.

It is a common mistake to assume that a forecast has to be near the actual outcome to be valuable to the economist's employer. Imagine that the bond market has valued bonds on the view that the annual rate of inflation is around 2.5 per cent and will remain so following release of the next quarter's Consumer Price Index (CPI) data. If the next CPI release puts the annual inflation rate at 2.2 per cent, the bond market could be expected to rally and provide capital gains to bond holders. If one economist had forecast that inflation would fall to 1.7 per cent, and her employer was long in bonds because of that forecast, a profit should result. However, the employer of another economist who had forecast 2.6 per cent would lose money if he was following his economist's advice and was short in bonds. Although the second economist was closer to the actual outcome than the first economist, he was on the wrong side of the market movement. It is important to distinguish between a successful forecast and a profitable forecast.

Although it is fundamentally important to be on the right 'side' of the market when forecasting economic events, it is also important to have some idea of the magnitude of expected divergence from market expectations. In general, the greater market expectations are expected to be wrong, the greater should be the alteration to portfolios in order to maximise profits. It is impossible to profitably forecast all economic series. But the economist with a better understanding of the underlying direction of economic activity should be able to profitably forecast more than 50 per cent of outcomes.
The Inevitability of Forecasting

There is essentially no such thing as a neutral position in financial markets for any significant participant. Market participants, whether banks, fund managers, corporate treasurers or speculators, will have a net asset position. That position can be invested in a range of alternative investment products (for example, bonds, shares or cash). Shares can be in a range of alternative companies; bonds can have different maturity profiles (a range of positive, negative or neutral positions can be held along a yield curve), or be invested with organisations with different credit ratings. Debt markets and financial derivatives also allow participants to have negative exposures to almost all asset classes. Because each data release can matter for relative asset values across a range of dimensions in each financial market, a view must inevitably be developed on each data release and its impact on markets. Even cash is not riskless if market participants are concerned about the opportunity cost of not being invested in a better performing market segment.

Despite all the associated difficulties, there is no practical alternative but to forecast. To leave a particular asset/liability structure in place immediately prior to the release of any economic data carries with it the implicit forecast that the outcome will be in accord with market expectations and therefore leave the relative and absolute values of all asset classes unchanged.

If someone has to forecast, why not an economist? The fact that financial market participants and governments employ mainly economists to do their forecasts suggests that economists have a comparative advantage in forecasting economic developments and market reactions. Engineers, scientists or theologians are less well represented among forecasters of economic events (although a form of forecasting based on the shape of charts has a significant following in certain dealing rooms). Even if economists are abysmal forecasters by Professor Valentine’s standards, an economist-free approach to market exposures seems unlikely to prevail.

References


Is There an Implied Constitutional Right of Freedom of Communication?

Gabriël A. Moens and John Trone

In its 1992 decision *Australian Capital Television v Commonwealth*, the High Court of Australia invalidated the Commonwealth government’s prohibition on electoral advertising on the ground that it infringed an implied constitutional right of freedom of communication with respect to the government of the Commonwealth. In a companion case, *Nationwide News v Wills*, Brennan, Deane, Toohey and Gaudron JJ also invalidated a Commonwealth law that prohibited the publication of material calculated to bring the Industrial Relations Commission into disrepute, on the basis that it infringed such an implied freedom.

Yet although the Court’s decisions correctly identify the inhibiting effect of the impugned legislative provisions on freedom of speech, in our opinion they could not be based on the existence in the Constitution of implied limitations on federal power. On the other hand, the High Court could have held that the relevant legislative provision violated a different implication that is at least supported by current authority.

Implied Limitations on Federal Power

In the leading *Engineers* case, the High Court condemned judicial censorship of extravagant use of Commonwealth power. The High Court pointed out that ‘possible abuse of powers is no reason in British law for limiting the natural force of the language creating them’. The extravagant use of federal power presented a political issue, which required a political response: as long as it was within power, it could not be invalidated by the Court. Four members of the Court said in a joint judgment:

4. *Id.* 151.

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The extravagant use of the granted powers in the actual working of the Constitution is a matter to be guarded against by the constituencies and not by the courts. . . If . . . the representatives of the people of Australia as a whole . . . proceed to use their national powers to injure the people of Australia considered sectionally, it is certainly within the powers of the people themselves to resent and reverse what may be done. No protection of this court in such a case is necessary and proper.\(^5\)

They identified the correct method of constitutional interpretation as 'in the actual terms of the instrument their expressed or necessarily implied meaning', thus admitting that there was a role for implication in constitutional interpretation. The role of the technique of implication was never disowned by the High Court. But this role was a limited one, and the only implications that could be made were those that must be 'necessarily implied' from 'the actual terms of the instrument'.\(^6\) The Court was not free to limit the language of a federal power or to invent implied prohibitions upon the exercise of federal power.

This method of interpretation was accepted by later courts. In *Adelaide Company of Jehovah's Witnesses v Commonwealth*,\(^7\) Latham CJ stated that 'In the absence of a relevant constitutional prohibition it is not a proper function of a court to limit the method of exercising a legislative power'.\(^8\) The Court took the view that, except for express constitutional prohibitions, the legislative power of the Commonwealth and State parliaments was as plenary as that of the British Parliament. The Court's role was limited to deciding whether the State or federal legislature had power to enact the law. The Court invalidated federal laws only if they could not be supported by one of the heads of power in s.51 of the Commonwealth Constitution. In implying a right of freedom of communication in relation to Commonwealth governmental affairs, the High Court has, as an intellectual matter, effectively discarded the interpretative technique that it has used since 1920.

**Representative Democracy and Freedom of Communication**

In its 1992 decisions, the High Court generated controversy because, contrary to accepted canons of construction, it had suddenly discovered a new entrenched, but implied, right to freedom of communication. The High Court drew an implication of freedom of communication relating to Commonwealth governmental affairs from the system of representative government that the Constitution creates.

\(^5\) *Id.* n.4 at 151-2 (Knox CJ, Isaacs, Rich and Starke JJ).

\(^6\) *Id.* 155.

\(^7\) (1943) 67 CLR 116.

\(^8\) *Id.* 133 (Latham CJ).
The Constitution certainly provides for a system of representative democracy, which involves the idea of government by the people through their elected representatives. This system is based mainly on s.7 (senators directly chosen by the people of the State) and s.24 (constitution of House of Representatives). But the Court's invocation of these sections goes no further than to show that the Constitution provides for a system of representative government in the terms of those sections. The constitutional blueprint for representative government was deliberately limited. As Dawson J pointed out, 'much is left to the Parliament concerning the details of the electoral system to be employed in achieving representative democracy'.

Despite express provision for a right to vote, the Court ruled as recently as 1975 that 'representative democracy' does not demand equality of population in federal electorates. The suffrage is surely the core of representative democracy, both constitutionally and practically. But the Court would not imply restrictions upon the federal parliament's power to interfere with the weightage of votes. Yet now the Court has taken the view that representative government cannot effectively exist without an implied right of freedom of political communication.

To bolster its conclusion, the High Court embarks upon a lecture on civics, describing a number of characteristics of desirable or good government. It makes a number of unobjectionable factual statements, perhaps hoping that those who criticise the decision will be reduced to questioning the truth of these statements. It draws together a miscellany of obiter dicta from earlier decisions from around the world about the practical importance of free speech to good government. Some of these cases are from jurisdictions with express guarantees of freedom of speech.

But the Australian Capital Television and Nationwide decisions are conspicuously devoid of reasons why these attractive factual considerations elevate freedom of expression to a right enshrined in the Commonwealth Constitution. This is their real weakness, and the Court made little headway in overcoming it. Much of the discussion about representative government bears greater resemblance to an amateurish exercise in political science than it does to a legal interpretation of the constitutional text. Take for instance the Chief Justice's lecture on the necessity of free speech to ensure the accountability of members of parliament in a system of representative government:

Indispensable to that accountability and that responsibility is freedom of communication, at least in relation to public affairs and political discussion.

Absent such a freedom of communication, representative government would fail to achieve its purpose, namely, government by the people.

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9 See ss.1, 7, 24, 25, 61, 62, 64 discussed in Australian Capital Television, CLR at 137, ALR at 593 (Mason CJ). See also id. CLR at 210-1, ALR at 650-1 (Gaudron J).

10 Australian Capital Television, CLR at 185, ALR at 630.

11 Attorney General (Cth); ex rel. McKinlay v Commonwealth (1975) 135 CLR 1.
through their elected representatives; government would cease to be responsive to the needs and wishes of the people and, in that sense, would cease to be truly representative.12

Mason CJ is concerned here that representative government must achieve its purpose, yet the Constitution, in providing for representative government, does not stipulate that the best or most desirable form of representative government — if such a form can be identified — be realised. The Chief Justice is also concerned that government be truly ‘responsive to the needs of the people’. These are fine matters for a citizen to be concerned with.

Deane and Toohey JJ’s judgment reveals a similar intrusion of non-constitutional considerations:

The people of the Commonwealth would be unable responsibly to discharge and exercise the powers of governmental control which the Constitution reserves to them if each person was an island, unable to communicate with any other person. The actual discharge of the very function of voting in an election or referendum involves communication. An ability to vote intelligently can exist only if the identity of the candidates for election or the content of a proposed law submitted for the decision of the people at a referendum can be communicated to the voter.13

Deane and Toohey JJ reveal a concern that the people ‘responsibly’ exercise their right to vote. They implicitly deplore the notion that each person could be made an island, and are concerned that each person should exercise the franchise ‘intelligently’. But although we share each of these concerns, we do not see how such concerns constitutionalise a right to free speech.

The majority’s reasons were essentially derived from their own beliefs rather than the text of the Constitution.14 We are curious as to why the people are presumed to have not intended to give the Parliament plenary power, when with a few specific exceptions the very words of the Constitution they created provides no contrary indication and the parliamentary model they knew best was possessed of unlimited powers and when they rejected the example of the United States about how to limit these powers. The Australian people divided governmental power, but did not limit it.

The process of implication itself is fraught with difficulty. How are the judges to identify just what fundamental rights will be protected? Such a process is inherently

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12 *Australian Capital Television*, CLR at 138-9, ALR at 594 (Mason CJ).

13 *Nationwide*, CLR at 72, ALR at 723 (Deane and Toohey JJ).

14 See too *Australian Capital Television*, CLR at 230-1, ALR at 666-7 (McHugh J), *Nationwide*, CLR at 47-8, ALR at 704 (Brennan J).
dependent on the individual judge’s social and moral beliefs. These are natural
difficulties where a court implies prohibitions not discernible in the text itself. Even
Mason CJ admitted the existence of these difficulties in *Australian Capital Televis-
ion*.

[I]t is difficult, if not impossible, to establish a foundation for the implic-
tion of general guarantees of fundamental rights and freedoms. To make
such an implication would run counter to the prevailing sentiment of the
framers that there was no need to incorporate a comprehensive Bill of
Rights in order to protect the rights and freedoms of citizens. That senti-
ment was one of the unexpressed assumptions on which the Constitution
was drafted.\(^\text{15}\)

Nevertheless, the process of implying rights in the Constitution is accelerating.
In a dissenting judgment in 1991, Deane and Toohey JJ implied a constitutional
guarantee of equal legal treatment: the underlying equality of the people of the
Commonwealth under the law and before the courts.\(^\text{16}\) They would have invali-
dated a Commonwealth sentencing law that left the duration of the sentence to be
determined by State law, so that the minimum sentence varied from State to State.
The majority view of Mason CJ, Dawson, and McHugh JJ in that case is preferable.
They correctly held that no implication was able to be made that the Constitution
demanded that federal laws operate uniformly throughout the Commonwealth and
that they not be discriminatory.

The right to freedom of political communication is more an unexpressed as-
sumption than an implication necessarily made. An ‘unexpressed assumption’ dif-
sers from ‘an implication necessarily made’ in that the former is an extra-
constitutional notion, whereas the latter is part of the constitutional document. As
Dawson J stated, ‘If implications are to be drawn, they must appear from the terms
of the instrument itself and not from extrinsic circumstances’.\(^\text{17}\) He went on to say
that “The nature of the society or, more precisely and accurately, the nature of the
federation which the Constitution established, is to be found within its four corners
and not elsewhere”.\(^\text{18}\)

\(^{15}\) CLR at 136, ALR at 592 (Mason CJ). But note that Mason CJ describes it as an unexpressed as-
sumption rather than as something which inheres in the document, such as responsible government.
He has signalled his preparedness to give less credence to the former than the latter: CLR at 135, ALR
at 591.

\(^{16}\) *Lecth v Commonwealth* (1992) 174 CLR 455, 484-7. They had previously hinted at such an im-
plcation: see *Queensland Electricity Commission v Commonwealth* (1985) 159 CLR 192, 247-8
(Deane J); *Street v Queensland Bar Association* (1989) 168 CLR 461, 554 (Toohey J).

\(^{17}\) *Id.* CLR at 181, ALR at 627.

\(^{18}\) *Australian Capital Television*, CLR at 186, ALR at 631-2.
One of the most ironic aspects of the Court’s judgment in the political advertising case is that it has essentially adopted the approach to constitutional interpretation of Murphy J, despite having decisively rejected it while he was on the Bench. In support of an implied freedom of speech, Murphy J actually appealed to the institution of representative government. In *Miller v TCN Channel Nine*\(^{19}\) he said:

> The Constitution . . . contains implied guarantees of freedom of speech and other communications and freedom of movement not only between the States and the States and the Territories but in and between every part of the Commonwealth. Such freedoms are fundamental to a democratic society. They are necessary for the proper operation of the system of representative government at the federal level.\(^{20}\)

Several members who are now part of the majority in *Australian Capital Television* conspicuously rejected Murphy J’s theory of an implied guarantee of freedom of communication.\(^ {21}\) Some acknowledgment of the Court’s sources for its new doctrine is due.\(^ {22}\)

**The Legitimacy of the Advertising Ban**

The prohibition on political advertising was assuredly a severe invasion of free speech. But we disagree with the opinion of Brennan J that the ban could be considered a legitimate restriction upon free speech. He said: ‘It was open to the Parliament to conclude, as the experience of the majority of liberal democracies has demonstrated, that representative government can survive and flourish without paid political advertising on the electronic media during election periods.’\(^ {23}\) He fully accepted the government’s claim that the legislation was passed with the object of ‘minimizing the risk of corruption or of reducing the untoward advantage of wealth on the formation of political opinion’.\(^ {24}\)

Yet in reality the ban struck at the heart of democratic values: it prohibited political communication, the core of free speech in a liberal democratic society. The ban was imposed at the most important time in the political process: the period

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\(^{19}\) (1986) 161 CLR 556.

\(^{20}\) *Id.* 581-2.

\(^{21}\) See also rejection of Murphy J’s views at 569 (Gibbs CJ), 637 (Dawson J).

\(^{22}\) But see *Australian Capital Television*, CLR at 212, ALR at 652 (Gaudron J).

\(^{23}\) *Australian Capital Television*, CLR at 161, ALR at 612 (Brennan J).

\(^{24}\) *Id.* CLR at 156, ALR at 608 (Brennan J).
preceding elections. This is when voters most need information about candidates and parties, and when people most wish to speak. The legislation imposed a discriminatory regime effectively allowing only those already represented in parliament to speak through one of the most important mediums of communication. Brennan J at no stage offered convincing evidence of the link between political advertising on television or radio and corruption or undue influence in the political process. The government might be entitled (within limits) to address such a problem; but it did not establish even the existence of a problem. McHugh J's comment on this issue is apposite:

> If the Australian political process can be corrupted by the cost of political advertising, those bent on corrupting that process will not lack opportunities to achieve their ends even if electronic political advertising is prohibited during an election period. As the Supreme Court of the United States pointed out . . . ‘virtually every means of communicating ideas in today’s mass society requires the expenditure of money.’

It was argued that television advertising debases or trivialises political debate. Even if this is true, it does not constitute a sufficient reason for banning it from political debate. The best way of ensuring that false ideas are exposed as false is to allow them to be aired openly. As United States Supreme Court judge Oliver Wendell Holmes observed long ago: ‘the ultimate good desired is better reached by free trade in ideas . . . for the best test of truth is the power of thought to get itself accepted in the competition of the market’. If the people do not like the messages given in a political party’s advertising they may exercise their choice accordingly at the ballot box.

Brennan J also invoked the spectre of the destruction of representative democracy if the ban were not upheld. He said: ‘if performance of the duties of members of the Parliament were to be subverted by obligations to large benefactors or if the parties to which they belong were to trade their commitment to published policies in exchange for funds to conduct expensive campaigns, no curial decree could, and no executive action would, restore representative democracy to the Australian people.’

This statement invites two comments. First, when he argues in support of the compatibility of the ban with liberal democracy, Brennan J neglects the converse of what he says about the destruction of representative democracy. This is that the United States and other nations allowing freedom of speech in these matters have not ceased to be representative democracies or succumbed to dictatorship. The

25 *Australian Capital Television*, CLR at 239, ALR at 673 (McHugh J).

26 Abrams v United States (1919) 250 U.S. 616, 630.

27 Id. CLR at 156, ALR at 608 (Brennan J).
onus must be upon those seeking to defend a prohibition upon speech to justify its necessity. The evidence that televised political advertisements were somehow undermining Australian democracy is insufficient.

Second, it is very difficult indeed to see how this statement by Brennan J in any way justifies a ban on electoral advertising. Accepting for the sake of argument the likelihood of corruption attributable to the need for campaign donations, the target in such a case ought surely to be political donations rather than a medium of communication. Even if it is accepted that the great expense of broadcast advertising is particularly likely to create a sense of obligation on the part of political parties, it is the financial factor that is the problem rather than the speech itself.

Like Brennan J, Mason CJ was also prepared to assume for the purpose of deciding the case that all of the Commonwealth's contentions were true. He assumed that the need to raise considerable amounts of money to conduct election campaigns could create a risk of corruption and undue influence; that the wealthy have an advantage in utilising this medium of communication; and that short election commercials may 'trivialise' political debate. Yet he found that the ban was still unjustifiable.

An Alternative to an Implied Right

For the reasons mentioned above, we strongly espouse the Court's opinion that the federal government's ban upon political advertising was a violation of free speech. We do not, however, support the manner in which it reached its conclusion that the relevant legislative provisions were invalid. Yet if the High Court had wished to decide the political advertising case on a narrower ground, it could have held that the relevant legislative provision violated a different implication that is at least supported by current authority. This implication is the prohibition that was applied in the Melbourne Corporation case.

The Melbourne Corporation prohibition involves two tests. The first is a discrimination test: legislation must not discriminate against or between the States. The advertising prohibition certainly passed this test. The prohibition upon State political advertising was part of a general legal regime; it did not single out the States or a State. The second test is a preservation test: legislation must not destroy or impair the capacity of the States to function. The legislation failed this test because it prohibited political advertising in relation to State electoral processes. Indeed, it prevented the States from reaching the electorate through electronic advertising even during a referendum campaign that might confer increased legislative power upon the Commonwealth.

28 Id. CLR at 144-5, ALR at 599 (Mason CJ).


The High Court could therefore have concluded that the legislation unconstitutionally inhibited the workings of the States, and could have partially invalidated the legislation on this ground.

McHugh J\textsuperscript{31} and Brennan J\textsuperscript{32} correctly applied the preservation test to invalidate the legislation as applied to State electoral processes. As McHugh J stated, its 'immediate object [was] to control the States and their people in the exercise of their constitutional functions'.\textsuperscript{33} McHugh J argued that the continuance of the States as independent legal entities with their own constitutions and parliaments required that Commonwealth legislative power did not extend to interference in the electoral processes of the States, subject to a clear contrary intention in the Constitution.\textsuperscript{34}

Furthermore, rather than containing an implied right of political communication, the Constitution contains in s.92 an express freedom of interstate trade, commerce and intercourse that, but for the Court's recent negation of much of the effect of that guarantee, would have crippled the Commonwealth's prohibition of political advertising. In \textit{Barley Marketing Board (NSW) v Norman},\textsuperscript{35} the High Court decisively rejected the individual rights theory of s.92, according to which the Constitution is breached if governmental regulation impedes a person's right to interstate communication. Because of national networking most television and radio broadcasting could be considered interstate broadcasting. If the High Court had not restrictively interpreted s.92, the political advertising ban could easily have been invalidated for violation of an express constitutional prohibition. It is ironic that as a consequence of the Court's earlier restrictive interpretation of an express right enshrined in s.92,\textsuperscript{36} the Court was later compelled to invent an implied right to freedom of political communication.

\textsuperscript{31} \textit{Australian Capital Television}, CLR at 241-44, ALR at 675-7.

\textsuperscript{32} \textit{Id.} CLR at 162-64, ALR at 613-4.

\textsuperscript{33} \textit{Id.} CLR at 241, ALR at 675.

\textsuperscript{34} \textit{Id.} CLR at 242-3, ALR at 675-6.

\textsuperscript{35} (1990) 171 CLR 182, 201.

\textsuperscript{36} See in particular \textit{Cole v Whitfield} (1988) 165 CLR 360.
The enactment of the New Zealand Bill of Rights Act in 1990 is a major development of the constitutional history of New Zealand. Although the Bill of Rights Act is not strictly a constitutional statute in that it is not fundamental law, the rights and liberties contained within it are essential to any liberal-democratic society. In New Zealand such rights and liberties have traditionally been part of the fabric of the common law and constitutional custom.

The constitutional structure of New Zealand has, like that of the United Kingdom, lacked the formal mechanisms that prevent a determined executive from infringing the rights of citizens. The absence of a written constitution, along with a unicameral and relatively small parliament elected by a first-past-the-post electoral system, has led to an excessive concentration of power in the executive, which has typically consisted of almost half the members of parliament of the governing party. The scope for abuse has been substantial. However, the recently adopted proportional electoral system is likely to reduce the power of the executive.

Origins of New Zealand's Bill of Rights

New Zealand's Bill of Rights originated with the Labour governments of 1984–90. These included a new generation of parliamentarians who were committed to the promotion of individual political and economic freedom, largely in reaction against the economic authoritarianism of the preceding National government of Sir Robert Muldoon. Sir Geoffrey Palmer, initially the Deputy Prime Minister, and Prime Minister in 1989–90, had been a professor of constitutional law at Victoria University of Wellington and, in his 1979 study *Unbridled Power*, criticised the barely checked power of the state to curtail the rights of citizens. A Bill of Rights was viewed as a necessary defence of the citizen against the state.

The older democracies modelled on the Westminster system have not usually had Bills of Rights. This pattern was broken by Canada, which in 1960 enacted its first Bill of Rights, modelled closely on the United Nations Universal Declaration of Human Rights and the International Covenant on Civil and Political Rights. For

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1 *Ministry of Transport v Noort* [1992] 3 NZLR, 260; per Richardson J at 277. See also Sir Robin Cooke (1994:10): 'The New Zealand Bill of Rights Act 1990 is not entrenched or declared to be supreme law.'

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common-law nations the United States Bill of Rights has perhaps had greater political and legal significance. However, unlike the United States Bill of Rights, the Canadian version did not override all other legislation but instead was an aid in the interpretation of legislation. This was changed in 1982, when the Bill of Rights was replaced by the Canadian Charter of Rights and Freedoms. Canadian courts now have the power to strike down any legislation that is in conflict with the Charter.

The Canadian experience spurred New Zealand legislators, led by Sir Geoffrey Palmer, in 1985 to promote a Bill of Rights for New Zealand. The initial proposal was for a Bill of Rights which included a wider range of political and economic rights. It also provided for the rights of the Maori people under the Treaty of Waitangi to be recognised and affirmed. The Bill of Rights was, like the Canadian Charter, to be a superior law overriding ordinary legislation. Yet the proposal proved to be unacceptable, for two reasons. First, a number of commentators, including National Party members of parliament, judged that giving the courts the power to overturn legislation would be contrary to the supremacy of parliament and thus represent an infringement of popular sovereignty; moreover, it was feared that if the courts had such a power they, and ultimately the appointment of judges, would become unduly politicised. Second, at a meeting of Maori tribal leaders in 1986, it was argued that incorporating the Treaty of Waitangi into a Bill of Rights would diminish the status of the Treaty as the founding constitutional document of New Zealand and enable parliament to amend the Treaty without the consent of the Maori treaty partner. As a result, the government modified its approach and introduced a new Bill of Rights, which, though more limited than its predecessor, failed to win the support of the National Party Opposition.

The Provisions of the Bill of Rights

The Bill of Rights enacted in 1990 is limited to the political rights generally accepted in modern western democracies. The protection of private property is excluded, largely on the ground that such protection does not easily fit within a document devoted to upholding political and civil rights. Elkind and Shaw (1986:7) argue that whereas political rights require governments to refrain from taking action, economic rights require them to take positive action. But in this respect the right to private property is more akin to political rights than to the economic rights to, say, housing or work, since the corresponding obligation on the state is not to take a positive action that would deprive rightful owners of their property. Moreover, Article 17 of the Universal Declaration of Human Rights provides that everyone has the right to own property and shall not be arbitrarily deprived of such property.

In particular draft paragraph 10(2) referred to the right to join trade unions 'consistently with legislative provisions enacted to ensure effective trade union representation'. In 1985 trade union membership was compulsory for any category of employee covered by an award.

The principal rights protected by the Bill of Rights fall into four categories: the life and security of the person; democratic and civil rights; the right to non-discrimination; and protection against arbitrary police powers of search, arrest and detention. The life and security of the person include the rights not to be deprived of life, not to be subjected to torture or cruel treatment, not to be subjected to medical experiments, and to refuse medical treatment. Democratic and civil rights include the rights to elect and to be elected a member of government, and the freedoms of thought, conscience, religion, belief, worship, expression, peaceful assembly, association and movement. New Zealand’s history has given great importance to freedom from discrimination on grounds of colour, race, ethnic and national origin, sex, marital status and religious or ethical belief. Minorities have the right to their culture, language and religion. The final category of rights includes the right to security against unreasonable search and arbitrary arrest, the rights of arrested persons (including the right to legal counsel), the rights of persons charged and the right to trial before duly constituted courts. Whenever a person’s rights are being affected by a tribunal the principles of natural justice are to be observed. The Bill of Rights applies to the legislative, executive and judicial branches of government and to any person or body performing a public function pursuant to law. The provisions of the Bill of Rights are to be subject only to such reasonable limits as are appropriate to a free and democratic society. In deference to the argument on the principle of parliamentary sovereignty, s.4 of the Bill of Rights Act provides that it does not override legislation that was or is specifically contrary to the provisions of the Bill of Rights Act. However, wherever possible legislation is to be interpreted in a manner that is consistent with the rights and freedoms of the Bill of Rights.

The Act was one of the last enacted by the Labour government of 1987–90. The Opposition considered that it added little to New Zealand’s democracy. Mr Paul East, the current Attorney-General, argued that the rights it spelt out already existed in the common law and were inherent in the respect for democratic values by New Zealand legislators. The Prime Minister, in contrast, argued that the limited Bill of Rights being enacted would be a valuable first step along the road to a full Bill of Rights on the lines of the Canadian Charter, which has the status of fundamental law overriding all other law.

**Effects on the Protection of Rights**

The Bill of Rights Act has been in force for over three years. Has it had a significant effect on the protection of individual rights? If so, should it be enacted as fundamental law on the model of the Canadian Charter? Australians may well

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ask if their Constitution would be enhanced by the inclusion of a Bill of Rights, particularly as the republican debate gathers force.

A review of the decisions of the courts in the first three years shows that the Bill of Rights is not a 'token and toothless thing' (Cooke, 1994:10). The President of the Court of Appeal is in no doubt as to the significance of the Bill of Rights:

More importantly, the Bill of Rights may be of prime influence in the shaping of the common law in areas hitherto grey or unexplored. Where any of the rights and freedoms affirmed in Part II and referred to in s.2 are relevant, the developing common law must be moulded so as to give effect to them. (Cooke, 1994:11)

The majority of cases have concerned the right of persons to a lawyer when they have been detained or arrested. This right has been traditionally contained in the common law in The Judges Rules 1912 but is now set out in unequivocal terms in s.23(1)(b) of the Bill of Rights Act. The initial decisions of the Courts were somewhat tentative in applying the Act in a manner that would contradict traditional practice. Thus in R v Nikau Wylie J, in relation to the meaning of arrest, noted:

The New Zealand Bill of Rights Act does not give a warrant to alter longstanding principles of law. It may be, undoubtedly is, declaratory of rights, but that does not of itself justify an overturning of principles which have become enshrined in the law of the country over a long period of years.

This statement was cited with approval by Gault J in the Court of Appeal decision of R v Butcher with 'the qualification that the Courts necessarily will be required to adopt and develop interpretations and remedies appropriate to this significant statute'.

In the last two years the Court of Appeal has become emboldened in its response to the Bill of Rights. Arguably the most important case to date is Ministry of Transport v Noort. The case concerned the rights of persons apprehended pursuant to the Transport Act and who are required to accompany an officer to give breath or blood tests. The Court had no doubt that this constituted a detention within the meaning of s.23(1)(b) and therefore raised the presumption that the person was entitled to have access to a lawyer. The President of the Court of

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7 [1992] 2 NZLR 257, 271
8 Id. 271.
9 [1992] 3 NZLR, 260. The Court consisted of five judges; Cooke P, Richardson, Hardie Boys and McKay JJ; Gault J dissenting. The majority found in favour of Noort.
Appeal had no doubt that the Bill of Rights required a new approach. Cooke P stated:

[T]he Act requires development of the law where necessary. Such a measure is not to be approached as if it did no more than preserve the status quo. . . In approaching the Bill of Rights Act it must be of cardinal importance to bear in mind the antecedents. The International Covenant on Civil and Political Rights speaks of inalienable rights derived from the inherent dignity of the human person. Internationally there is now recognition that some human rights are fundamental and anterior to any municipal law, although municipal law may fall short of giving effect to them: see Mabo v Queensland (1988) 166 CLR 186, 217-218. The right to legal advice on arrest or detention under any enactment may not be quite in that class, but in any event it has become a widely recognised right.\(^{10}\)

Each of the judges specifically stated that the Bill of Rights Act is not a constitutional statute. However, all the judges, including the dissenting judge, recognised the significance of the rights protected. Thus Richardson J (one of the majority) stated:

It is not a constitution. It is not supreme law in that sense. It does not override all other legislation. Nevertheless in interpreting and applying the Act it is important to consider the nature and subject-matter and special character of the legislation.\(^ {11}\)

The dissenting judge, Gault J, was no less vigorous in upholding the primacy of the Bill of Rights:

The fundamental rights affirmed in the Bill of Rights Act are to be given full effect and are not to be narrowly construed. Its provisions are to be construed to ensure its objects of protecting and promoting human rights and fundamental freedoms. It is a statute, not an entrenched constitutional document, but it is couched in broad terms requiring interpretation appropriate to those objects. Its terms, in large measure, have been drawn from the Canadian Charter of Rights and Freedoms so that Canadian decisions can be expected to assist in interpretation so long as there is borne in mind the different status enjoyed by the Charter.\(^ {12}\)

\(^{10}\) Id. 270. Cooke P had previously noted the submission by counsel for the Crown that ‘the New Zealand Courts should not adopt what they called "the rhetoric" of some Canadian Supreme Court judgements’(p.269).

\(^{11}\) Id. 277.

\(^{12}\) Id. 292.
The application of the Bill of Rights to drink-drive cases was perhaps unanticipated by both the public and politicians. It certainly indicated the importance of the Bill of Rights in limiting the *ad hoc* encroachment of civil rights for administrative convenience. Without such an enactment it would have been very much more difficult for the Courts to import a requirement of access to a lawyer into the blood-alcohol provisions of the Transport Act.

In cases involving more serious crimes the Bill of Rights has been routinely invoked. The Court of Appeal has taken the opportunity to signify the importance of the rights protected. The case of *R v Narayan*\(^{13}\) concerned the admissibility of police interviews of a person accused of murder. He had a limited command of English and an Indian police constable acted as his interpreter and custodial escort. The Court was satisfied that the interviews took place in circumstances where the accused would have reasonably thought he had been detained. He was therefore entitled to access to counsel pursuant to s.23(1)(b) of the Bill of Rights Act. Cooke P stated:

> But the answer made for the accused is in effect that for a man in his situation, with language difficulties and in an alien country and having undergone something of an ordeal, the rights given by the New Zealand Bill of Rights Act were of special value; and that he should not be deprived of their value merely because the police acted in good faith.\(^{14}\)

In a similar case, *R v Mallison*,\(^{15}\) the accused was arrested but not told of his right to a lawyer until an hour later. Richardson J held:

> The Bill of Rights Act is not a technical document. It has to be applied in our society in a realistic way.\(^{16}\)

The Court considered that the police had sufficient opportunity to advise the accused of his right to counsel at the time of arrest.

The consequences of failing to comply with the requirements of the Bill of Rights Act can be severe. In both these cases the Court of Appeal excluded the statement made by the accused and ordered a new trial.

The Court of Appeal has also considered the nature of right of free speech guaranteed by s.14 of the Bill of Rights Act in *TV3 Network Services Ltd v R.*\(^{17}\)

This case concerned the right of the television station to publish by consent the

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\(^{13}\) [1992] 3 NZLR, 145.

\(^{14}\) *Id.* 149.

\(^{15}\) [1993] 1 NZLR, 528.

\(^{16}\) *Id.* 531.

\(^{17}\) [1993] 3 NZLR, 421.
names of two victims in a notorious incest case. This would have lead to the identification of other victims who had not consented. The Criminal Justice Act generally prohibits such identification. Cooke P stated:

It is true that freedom of expression, both by the media and in this case by the two consenting sisters, is a factor the importance of which is underlined by s.14 of the New Zealand Bill of Rights Act 1990, but in the circumstances of the present case freedom of expression is to be subordinated to the public policy indicated by Parliament under s.139(2). By virtue of s.4 of the New Zealand Bill of Rights Act that policy must prevail over s.14. The latter sentence indicates the limitations of a statute which is not fundamental law.

Conclusions

The provisional answer to the primary question of whether the Bill of Rights has been a substantial additional protection of basic human rights must be in the affirmative. The courts have been zealous in enforcing the Bill of Rights, particularly where the exercise of police powers is concerned, which has been the traditional arena for the contest between the freedom of the individual and the powers of the state. The Bill of Rights Act has given the judiciary the opportunity to expound and expand upon the nature of fundamental rights, especially those concerning police powers, as the bedrock of a democratic society in a manner not previously witnessed in New Zealand. The President of the Court of Appeal has been open in his view of the expanded role of the Court of Appeal as the protector of both civil rights set out in the Bill of Rights Act and the rights of Maori contained in the Treaty of Waitangi.

In other areas the role of the Bill of Rights is somewhat limited. In the area of the encroachment by the state into the economic activity of citizens, for example, the Bill of Rights has offered little protection. This is reflected in the Privy Council decision in *New Zealand Stock Exchange v Commissioner of Inland Revenue*. The Privy Council, relying on a Canadian precedent, would not proscribe the

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18 *Id.* 423.

19 Cooke (1994). The Treaty of Waitangi is now widely regarded as New Zealand's most important constitutional document; Cooke P, *Special Waitangi Number: Introduction* (1990) 14 NZULR, 1. The Court of Appeal has played a major part in the elevation of the Treaty of Waitangi as the founding constitutional document. See especially *New Zealand Maori Council v Attorney General* [1987] 1 NZLR, 641, 643 where Cooke P in the opening sentence to his judgement states: 'This case is perhaps as important for the future of our country as any that has come before a New Zealand Court.'

20 [1992] 3 NZLR 1. The case concerned the application of s.23 of the Bill of Rights Act on the prohibition of 'unreasonable search and seizure' of person, their property and correspondence.
Commissioner of Inland Revenue's powers to investigate taxpayers in the absence of express provision in the revenue acts. The Privy Council, in a unanimous judgement stated:

Having regard to the secrecy provisions of the Act of 1974 and to the fact that in the interests of the community the commissioner is charged with ensuring that the assessable income of every taxpayer is assessed and the tax paid, the 'search' involved in the application of s.17 cannot be said to be unreasonable. 21

The Privy Council also relied on the decision of the Supreme Court of Canada of *Mckinlay Transport Ltd v R* 22 which set out the 'different expectations of privacy in different contexts'.

It is suggested that apart from the expressed reasons, there are two additional fundamental, although unarticulated, reasons for the Privy Council's decision. The first is that the Bill of Rights Act does not include a counterpart to Amendment V of the United States Constitution providing that 'private property shall [not] be taken for public use without just compensation'. The second reason arises from the relative reluctance of the Courts to provide a theoretical justification for limiting the encroachment of the state into the economic affairs of citizens. In contrast to the Privy Council's decision allowing wide ranging powers of 'search' for the economic purposes of the state, the Court of Appeal, dealing with a classic exercise of police powers against the person, has readily imported the provisions of the Bill of Rights into the Transport Act which set out the procedures of the police in breath and blood-alcohol testing of motorists, notwithstanding that the Transport Act made no reference to the Bill of Rights Act.

The role of the Bill of Rights in the Constitution is not simply a question of whether it is declared to be supreme law. The content of the Bill of Rights must also be considered. The linkage between a citizen's effective exercise of political rights and the ability of people to organise their economic activities in accordance with market principles is now well accepted. It is hard to imagine a democratic society where all property is owned by the state.

The inclusion of Amendment V in the United States constitution has not limited the ability of the United States to develop a sophisticated government able to meet the needs of its citizens, although arguably this required the addition of Amendment XVI in 1895 giving the Congress the power to impose income taxes. Nevertheless, the United States has been spared the excessive encroachment of the state into the economic affairs of citizens that was so attractive to so many western democratic nations during the middle years of this century. At times it seemed that the United States was the only western nation that zealously protected the virtues of

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21 *Id.* 6.

22 *(1990) 90 DTC 6,243* at 6,249.
free and open markets. In particular the United States did not attempt to nationalise large sectors of the economy. Government has expanded by developing such policy areas as health care, tertiary education, public housing, energy, especially nuclear, and modern transportation. The regulatory powers of the state has been of greater significance in limiting the rights of private property. In contrast to other western states, the US constitution, in both its educative role and its enforcement by the courts, has had an essential role in clearly delineating the limits of state encroachment upon the political and economic liberties of citizens.

In the event that Australia enacts a Bill of Rights as part of its constitution, it may consider that the United States experience is as least as instructive as that of Canada and New Zealand, and enact a complete Bill of Rights rather than one limited to political rights. The value of the New Zealand experience is that Australians can be reasonably assured that the courts would give full force and effect to the protections contained within a Bill of Rights whether or not it is entrenched as supreme law. Once enacted there is no real likelihood that politicians will be able to nullify a Bill of Rights, although that will not prevent the continuing evolution of government within a democratic framework.

References


23 There is a much greater tendency in the United States for the government to fund economic activities that are perceived to be in the public interest rather than to both fund and provide or own the activity as is common in other western states: c.f. medicare, bank deposit guarantees, energy, and arms manufacturing (aerospace).

24 Richard Epstein has been an iconoclastic defender of the protections of the Amendment V and has decried what he considers the excessive encroachment by the state upon the rights of private property. See Epstein (1985).
Lessons in School Reform: Recent American Writings on Education

Mark Harrison


In 1983 the US National Commission on Excellence in Education released A Nation at Risk, an influential report that exemplified widespread dissatisfaction with American education. The report was highly critical of schools, alleging that academic standards were unacceptably low, especially in the more rigorous subjects such as maths and science. America's children were not learning basic skills.

Standardised test data provided hard evidence of the decline. American students lagged far behind those of most other advanced nations in maths and science proficiency. High-school graduates were sub-standard in literacy, writing proficiency and knowledge of history and literature. Scholastic Aptitude Test (SAT) scores had fallen throughout the 1970s, reflecting a decrease in the academic achievement of America's most capable young people (especially in verbal skills) that was not due to changes in the number or the socioeconomic or racial mix of those taking the SAT (Murray & Herrnstein, 1992).

A Nation at Risk spurred a national crusade for educational reform. Over the last decade, States across America have implemented many changes, such as school-based management, public-school choice and teacher pay and certification changes. But discontent with American public education remains. Despite some

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rises in the 1980s, the maths SAT declined in 1991 and the verbal SAT hit an all-
time low.

Despite differences, the American and the Australasian educational systems
face similar problems, such as social stresses, curriculum changes towards political
and social 'relevance' and away from traditional academic skills, powerful teacher
unions, and massive and growing educational bureaucracies. But although Australia
has followed American educational trends, it has not evaluated their effects because
the educational establishment opposes the collection of hard evidence on student
performance. Yet there is much dissatisfaction with public education. Employers,
retiring teachers and professors deplore declining academic standards. Parents are
disturbed by the neglect of traditional social values and discipline. The proportion
of students in private schools has increased to more than 25 per cent as parents vote
with their feet. Australian politicians have also espoused reform, since it is generally
agreed that a country's competitive advantage depends increasingly on the quality of
its workforce. The demand for better-educated workers is likely to increase.

Three recent books on public education in America provide a detailed analysis
of what is wrong with public education. They argue that the changes of the past
decade have not and cannot work, and suggest the major changes needed for real
education reform. The message for Australia is that much of the current tinkering
with public education is futile. Worse, it may divert attention from the real prob­
lems of public education, and discredit educational reform.

The Importance of Autonomy

In Politics, Markets and America's Schools, John Chubb and Terry Moe argue that
the fundamental problems with public education lie in the institutions of educa­
tional governance. Past attempts at reform have failed because they simply called
for new policies to be administered by the existing institutions of governance, which
have themselves been left untouched.

Chubb and Moe are at their best in showing why the political system, domi­
nated as it is by special interests, is poor at running education, and why only decen­
tralised markets will promote effective schools. Their argument is backed by com­
prehensive empirical analysis using the High School and Beyond data set, contain­
ing information on the achievement, attitudes, activities and family background of
some 60,000 students in more than 1,000 private and public schools. The data
base was augmented by the Administrator and Teacher Survey, which closely ques­
tioned more than 10,000 teachers, principals and other staff members, providing
information about school organisation.

Chubb and Moe examine the factors that make an effective school, and focus
on student academic achievement. This is not the only indicator of school perfor­
mance, but it is an important one, and is one of the main goals of all schools.
Their analysis is certainly vastly superior to the Australian practice of measuring
inputs (such as expenditure, pupil-teacher ratios and year-12 retention rates) and
making wild claims about the benefits of public education.
The authors find that

High performance schools differ in goals, leadership, personnel and educational practices from low performance schools. Their goals are clearer and more academically ambitious, their principals are stronger educational leaders, their teachers are more professional and harmonious, their coursework is more academically rigorous and their classrooms are more orderly and less bureaucratic. (p. 187)

These findings are mainstream. A good school needs to be able to establish an identity and impose it on its pupils.

Many factors affect academic performance, and it is vital that the complicated relationships and interactions between the variables are taken into account. The main problem is in distinguishing school effects from non-school effects. Chubb and Moe do their best to control statistically for these factors. They find that the major influences were (in order of importance) student ability, school organisation, family background and student peers. The key result is that effective school organisation promotes academic achievement. School resources were unrelated to student achievement when the other relevant factors were taken into account, thus confirming earlier studies (summarised in Hanushek, 1989). *How* we spend is much more important than *how much* we spend: ‘the performance problems of public schools have little or nothing to do with inadequate funding’ (p. 194).

To understand why some schools are better organised than others, Chubb and Moe examined economic resources, student bodies, parental involvement, bureaucratic influence and school-board influence. Outside influence can affect curriculum, instructional methods used in classrooms, disciplinary policy, the allocation of school funds, and the hiring, dismissing and transferring of teachers. They found that ‘Autonomy has the strongest influence on the overall quality of school organisation of any factor that we examined. Bureaucracy is unambiguously bad for school organisation’ (p. 183).

Effective schools are subject to much less external administrative control than are ineffective schools. On every issue, effective schools experience less influence from superintendents and central-office administrators. High levels of independence from external authority tend to be associated with high levels of organisational effectiveness. External control over personnel policies were the greatest burden to effective performance.

The importance of autonomy stems from the nature of education itself, which is based on personal relationships and interactions, on continual feedback, and on the knowledge, skills and experience of teachers. The most important requirement for effective education is good teaching. But good teaching involves many intangible qualities, such as enthusiasm and creativity, which are inherently difficult to measure. At the school level, everyone knows who the good and bad teachers are. But good teaching is impossible to monitor from outside the school.
Autonomy enables a school to develop its own identity, and gives a principal the chance to build up a team of teachers and to provide incentives to improve actual performance. The present system, in contrast, deliberately undermines school autonomy. A centralised bureaucracy with little discretion at the lower levels cannot encourage good teaching. The central department recruits teachers and determines pay and conditions. Principals have little say over staff incentives. Promotion is based on measurable indicators, such as seniority and qualifications, which are unrelated to good teaching. Autonomous schools are better able than central administrators to recognise and meet the needs of parents and students, whereas a central bureaucracy is unlikely to promote consumer satisfaction or respond to diverse needs.

In drawing policy conclusions, Chubb and Moe first examine the educational reforms of the 1980s and why they failed. Traditional reforms, such as toughening the curriculum, more rigorous standards for teacher certification, external exams, stricter accountability, increased teacher pay, and centrally administered merit pay, may improve matters but may also make them worse. These reforms are never put to the market test and often involve more bureaucracy. Furthermore, the system is still subject to special-interest group pressures, which can limit the benefits of the changes. School based management invariably involves leaving the traditional institutions of school control intact. The schools remain subordinate to the education department, which is held accountable by the public for what happens in the schools. So when the schools make the inevitable mistakes, central office resumes control or implements a host of new rules and regulations: 'parts of the old bureaucracy are jettisoned only to be replaced by new ones' (p.201).

In Australia, school-based management seldom involves autonomy in personnel matters, which is perhaps the most crucial for educational success. Indeed, the trend is towards centralisation of industrial regulation of teaching at the national level (Marginson, 1993: 25).

The few choice and voucher reforms that have been introduced in the US have been 'too limited in scope to achieve significant reform' (p.209), though they have had positive consequences for the participants. In particular, the schools remain subject to political control from above, choice has been limited to public schools, and the supply of schools controlled. The most promising exercise in public-sector choice occurred in East Harlem. Teachers could set up their own schools; the schools had substantial autonomy; and parents were free to choose among schools. The result was an innovative and diverse school system. Student achievement increased dramatically, despite the dismal socioeconomic environment. This experiment provides evidence that choice benefits the poor. Chubb and Moe emphasise the need to give parents the right to choose among autonomous schools, and to allow new schools to emerge in response to parent and student demand, leaving schools that fail to attract support to go out of business.

Yet Chubb and Moe's policy recommendations are weak. After establishing the need for fundamental reform of educational governance, they call for a new type of public system with market incentives (see West, 1992, for a detailed criticism).
They seem to believe that the public system must prevail because it is democratic. In contrast, Myron Lieberman conducts an 'autopsy' on public education.

**Escaping from Public Education**

A prolific author of insightful books on education, Lieberman claims that the rationale of public education is dead. Public education no longer effectively fosters basic skills, scientific and cultural literacy, civic virtues and desirable habits and attitudes towards society and its institutions. Public education is beyond reform because of the difficulties inherent in government operation of schools.

Whereas Chubb and Moe focus on academic achievement, Lieberman adopts a broader perspective, including analysis of equality of opportunity, information provision, racial conflict and costs, as well as outcomes. He draws on a wide range of data and illustrates his arguments with detailed examples. The problems inherent in government operation of schools include an absence of candour when reporting educational achievement. Massive deceptions in the US were not revealed by educators, test experts or education reporters. Lieberman carefully analyses why this breakdown in information provision is inevitable under a public system: available information is usually prepared by the producers of education and serves their interests and objectives.

But would grades and report cards be less informative under a market system? Schools (especially for-profit schools) would have an incentive to reveal poor performance by other schools and, as they are more likely to be held accountable for poor educational performance, to dampen unrealistic expectations. The argument that grade inflation would be worse under a private system is inconsistent with the other argument that private schools would push their failures into the public system. It is also contrary to much empirical evidence. Grade inflation is rife in the public system and poor grades are a major reason why students switch out the Catholic system in the US.

Lieberman carefully debunks many criticisms of a market system. For example, on the role of advertising, he writes

> Advertising would be more influential in publicising the availability of schools than in retaining their pupils. Parents who have direct contact with schools are likely to rely on their experience, not on advertising when deciding whether to keep their child in a particular school. (p.111)

Education involves a long-term relationship between producer and consumer and a heavy emphasis on producer reputations. Lieberman is careful not to adopt a double standard. He compares the role of advertising in a market system to its role in politics.

After all, public education is dependent on the election of public officials supportive of it, and advertising is routinely used to elect such officials. Is
advertising for candidates for public office more informative and more objective than advertising for commercial products or services? Any such claim would be difficult to sustain. (p.97)

The social pressures that Lieberman identifies as weakening public education are all in evidence in Australia. They include low birth rates, the aging of the population, the decline in children's social capital, feminism, heterogeneity, juvenile crime, international economic competition, income levels, and the resurgence of pro market ideologies. Lieberman shows how the government's provision role conflicts with its consumer protection role, and how the conflict is resolved in favour of producers. The dominance of producers is nicely illustrated with numerous examples. The per pupil expenses that are usually quoted grossly underestimate the true costs of public education and public-teacher compensation. As in Australia, the figures exclude government superannuation contributions to public-school teachers, teacher-education costs (borne largely by the taxpayer), the cost of remedial instruction in higher education and business, private funds raised by public schools, and direct federal government payments to parents and students. On the evidence, Catholic schools appear to perform better (or no worse) than public schools. Given their lower costs, Catholic schools must be more efficient. Nor is there any evidence that public schools produce more beneficial externalities than private schools. Lieberman concludes that a market system would enhance efficiency, reduce the costs of the management of conflict resulting from diversity, and improve equality of opportunity. He provides a clear analysis of why equality of opportunity is pushed by producer interests, and how the public system fails to achieve it and instead redistributes income towards the upper middle class.

As in Australia, educational research and development is publicly provided and funded. Little is spent on research and development of new technology, especially labour-saving technology (unusual in a labour-intensive industry), or on market research. Instead, funds go on policy research, which services producers. The output is used primarily by other researchers rather than by practitioners. Most research on educational policy is largely a waste of resources.

Most of the problems with public education flow from producer domination: 'the costs of producer control and of an industry geared to political action instead of better service as the way to enhance producer benefits' (p.273). Yet Lieberman deplores 'the uncritical support for voucher plans that include several anti-competitive provisions. Parents' choices as consumers are limited by restrictions on producers' (p.295). The Milwaukee voucher plan for choice within public schools prevented economies of scale, prohibited the establishment of new schools to serve voucher students (so restricting entrepreneurship and innovation), limited the expansion of participating schools and, since parents were debarred from topping up vouchers, prevented suppliers from adding many improvements no matter how much customers were willing to pay for them. 'The Milwaukee plan is likely to turn out poorly precisely because it is not a competitive market system of education' (p.13).
Lessons In School Reform

Choice among public schools, and other plans that ignore the need for free entry of new schools (including for-profit schools) and exit of inefficient ones cannot be considered valid experiments with a competitive market system of education. (For more elaborate analysis of this issue, see Lieberman, 1989.) A voucher plan that includes private schools will not automatically give the benefits of a competitive market. The set of associated regulations is crucial. How would we achieve 'fair competition' between private and public schools? What regulatory and financial burdens should be placed on private schools? Under the current system, parents who send their children to public schools receive much larger subsidies than those who use private schools, giving a huge financial advantage to the public system. But public schools are at a regulatory disadvantage; they must accept all applicants and are prohibited from teaching religion. Burdening private schools with the rules that apply to the public sector would in effect destroy their raison d'etre. What is the appropriate level of financial assistance to private schools? When does the public sector financial advantage offset the regulatory disadvantage? Under true competition, the rules are the same for all competitors. But in education, the rules help determine the outcome. Competition is seldom based on product improvement; the public sector does not react to declining market share as a private company would, but often imposes additional regulatory and financial burdens on private schools.

To summarise, there is no commonly agreed on criteria or principle that tells us when competition between public and private schools is fair. The sector that holds the advantage characterises the rules as fair. . . Fairness is assessed in terms of the rules under which the competition takes place.

(p.8)

Lieberman's analysis is confirmed by the Australian experience. Australia currently has a quasi-voucher arrangement under which the Commonwealth government provides per head funding to parents at private schools. Parents can top up the grant, but this reduces the Commonwealth funding, so implicitly taxing additional educational expenditure (Fane, 1984). Regulation is determined by a political process dominated by public-sector interests. The Commonwealth and State governments heavily regulate private schools and use their powers to protect existing schools from competition. Although the thriving private sector in Australia brings substantial benefits, no one could claim that Australia currently has a market system or that it has solved the problems of public schooling.

Lieberman also explains why vouchers have not been successful politically, and sets out an educational reform agenda to manage the transition to a market system. He does not predict the outcome. The best market structure can change with new technologies: for example, a market process may result in education becoming a cottage industry or a big business franchise operation. His reform agenda includes vouchers redeemable in profit or not-for-profit, public or private schools. He warns, 'Even desirable nonmarket reforms may not be achievable in the absence of
a market system’ (p.278), as they are unlikely to be implemented if they threaten teachers’ positions. He suggests giving teachers financial incentives, such as generous retirement benefits, to support change.

**The Hidden Curriculum**

Thomas Sowell's *Inside American Education* is a pleasure to read, but the content is frightening. After establishing the decline in American academic performance, Sowell launches a savage attack on the many dogmas and hidden agenda of the education establishment. The book is a valuable guide to the reality behind the jargon and rhetoric of educationalists.

Sowell takes apart fashionable educational dogmas, such as that learning must be enjoyable to be effective or that raising students’ self-esteem will result in their intellectual development. He strongly criticises psychotherapeutic education as confusing thinking with feeling, so that students do not know what thinking is. He assails the proponents of ‘relevance’, the ‘belief that current emotional responses are a reliable guide to the future usefulness or meaningfulness of education’ (p.90), and suggests that the experience of others may be a better guide. He rejects the idea of teaching the ‘whole person’ as too ambitious and impossible to do in anything but a superficial sense (especially when basic skills cannot be taught properly). He destroys the educational arguments that are made in favour of multiculturalism and criticises making adherence to the ideological tenets of multiculturalism a condition of employment for teachers as an attempt to impose a new orthodoxy.

Sowell details the anti-intellectual and manipulative nature of the new school curriculum and its role in undermining the parent-child relationship and shared values. At the school level, ‘affective education’ or ‘attitude clarification’ uses classroom brainwashing to reshape attitudes, and usually proceeds by questioning parental moral authority. As a result, programs are misleadingly labelled and their specifics concealed from parents. The public system is open to domination by outside interest groups determined to get their message into the classroom. These include including business interests: for example a manufacturer of birth-control products supplies thousands of so-called ‘sex education’ kits to high schools. The result is ‘all sorts of non-educational activities pouring into schools, relieving many teachers of the drudgery of teaching, and substituting more “exciting” world-saving crusades in place of the development of academic skills’ (p.94).

Sowell questions whether the social objectives of the new curricula are worthwhile, and whether they can be, and have been, achieved through education. He gives evidence that in practice educational trends have contributed to many adverse social changes, often the opposite to the promised effects. Above all, the new curricula detract from the academic objective of schooling. Social-propaganda courses use up classroom time and crowd out teaching of basic skills.

Sowell is equally scathing about the performance of the higher-education sector in the US. Although beyond the scope of this review, he outlines the disastrous consequences of falling admission standards, racial quotas and politically correct
ideology, all of which are relevant in Australian higher education. The intellectual calibre of public school teachers and university education departments is low. (Similar criticisms have been made in Australia; see Moore, 1993.) Sowell concludes that compulsory education courses for teachers, which effectively debar the competent from teaching, is the biggest liability of the public school system. The second biggest is the tenure and seniority system, which ensures that ‘There is simply no institutional pay-off to being a good teacher’ (p.290). Sowell would destroy the credentialling monopoly exercised by schools and academic departments of education, and would buy out existing interests, such as education professors, with retirement bonuses. In addition, he emphasises the need to test and measure education results, and to take the choice of test out of the hands of those who are being monitored. Lastly, Sowell recommends some form of parental choice.

Conclusion

The three authors agree that the well-known problems of education are inherent in a public and politicised education system. Australia's education system faces similar difficulties and is likewise dominated by producer interests. All agree that the most serious barrier to improved performance is not lack of resources; more detailed management of public schools in no way ensures better results; and school-based management and public-school choice are not enough. Any real improvement must be by way of a move to a market system of education, driven by parental choice and freedom of entry for suppliers of education, including for-profit schools. In addition, Lieberman and Sowell emphasise the vital need for other reforms, often ignored in Australia. Teacher credentialling must be deregulated; and students must be tested by independent assessment agencies. In short, the state of government schools is a product of the system under which they operate.

References


*Comments from Leanne Holmes and David Hughes are gratefully acknowledged.*
NOTES AND TOPICS

Complexity Theory and Economics

David Pearce

Complexity theory has generated much interest in recent years. In 1993 two books on the subject were published (Lewin, 1993; Waldrop, 1993) as well as a New Scientist supplement (6 and 13 February), an article in The Atlantic Monthly (Morris, 1993) and at least two pieces in the Australian national press (McGuinness, 1993; Toohey, 1993). Its ideas are being presented as fundamental to our understanding of all kinds of physical and social phenomena, including economics; and some commentators (e.g. Arthur, 1988) use it to argue for particular forms of government planning. Yet its striking affinity to the ideas of F. A. Hayek and the Austrian School generally suggests that modern complexity theory actually tends to bolster arguments against government planning.

What Is Complexity Theory?

Complexity theory stems from the study of the emergence of order in complex systems, which range from ecosystems to the evolution of species, and from the development of civilisation to the workings of a modern economy. Such systems are 'complex' in that they not only combine several elements (like the molecules of a gas) but are also organised. According to F. A. Hayek (1978:26-7), the features of systems that display 'organised complexity' depend 'not only on the properties of the individual elements of which they are composed, and the relative frequency with which they occur, but also on the manner in which the individual elements are connected with each other'. Complexity theory studies the process whereby some kind of order emerges that is neither imposed on the system nor is obvious from the rules that underlie it.

According to the mathematician Ian Stewart (1993:3), complexity theory is

an attempt to explain which systems tend to increase in complication and organise themselves, why they do it, and where such behaviour fits into the

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dynamical spectrum from total order to total chaos. The aim is to develop a coherent range of techniques for understanding the complex systems that are found in nature and to codify their behaviour in a simple set of basic principles.

An excellent example of a complex system is the ‘random Boolean network’. Imagine a network of 100 light bulbs, in which the state (on or off) of any light depends on the state of the two ‘input’ lights it is connected to. Each light is in turn one of the input lights for another elsewhere in the network. Imagine that the connections between the lights are set randomly and that the rules determining the relationship between any light and its two input lights are based on the binary AND and OR functions. Further imagine that the rules for any particular light are also randomly set. When the network is switched on, its configuration (patterns of ons and offs) will be continually changing. To see this, imagine that we start the network with a random selection of lights on. One of the lights initially off may have a rule saying: ‘if either input is on, then switch on’, and so it will switch on. This change will cascade through the network as the change in the state of any one light will feed into the rules determining the states of other lights. The crucial question is: how long will it be before exactly the same patterns are repeated?

This 100-light network has $2^{100}$ (approximately $10^{30}$) possible states because each of the 100 lights can be on or off. Now if each state were to last a microsecond, it would take billions of times the history of the universe for the network to repeat the same pattern. But what actually happens when a network such as this is switched on is surprising. The network will, in a matter of minutes, settle down to one of only eight repeating cycles. The same sort of result holds for even bigger networks. A network of 100,000 elements (with around $10^{30,000}$ possible states) will settle down to one of around 370 different cycles.

This spontaneous emergence of order from a random network with potentially billions and billions of different states is the key concern of complexity theory.

The Tools of Complexity Theory

Researchers in complexity theory have developed many tools to simulate complex systems and some have applied their findings directly to economics and other social sciences. For example, the Boolean networks described above, the properties of which were first worked out by Stuart Kauffman (1991), are stylised models designed to capture some of the features of complex natural systems including neural networks in the brain, genes regulating each other within a cell, the webs connecting coevolving species within an ecosystem, even the network of connections within an economy.

Researchers in complexity mostly work on computers, designing programs that simulate the features of the complex systems they wish to study. Like chaos theory, complexity theory is a product of computer technology. Computer simulation is necessary because the underlying mathematics of many complex systems is not well
understood, making the scope of purely theoretical analysis limited. Yet purely empirical analysis of complex systems is also limited. Computer simulation analysis offers a new kind of investigation, mixing theory and empirics.

Complexity analysts have developed tools like cellular automata, genetic algorithms, neural networks and classifier systems. These are simulation techniques based on biological processes that have already found numerous applications (see for example Goldberg, 1989; Nelson & Illingworth, 1991). The classic application of genetic algorithms to social science is in Axelrod’s (1990) analysis of the evolution of cooperation. Following Axelrod’s computer tournaments to discover the best strategy in an iterated Prisoner’s Dilemma game, genetic algorithms have been used to discover additional successful strategies and to simulate the evolution of cooperative solutions in other social situations (Levy, 1992:181-5). Genetic algorithms have also been used to simulate the evolution of money as a medium of exchange (Marimon et al., 1990).

Holland and Miller (1991) briefly survey the application of these tools to economics. They refer particularly to ‘artificially adaptive agents’ (AAAs), models of how economic agents collect and process information and build models that they then use to anticipate and respond to changes in their environment. They argue that models based on AAAs ‘can capture a wide range of economic phenomena precisely, even though the development of a general mathematical theory of complex adaptive systems is still in its early stages’ (1991:365). This approach is likely to contribute to our understanding of learning in economic behaviour and the role that evolving knowledge plays in economic equilibrium. This approach is consistent with Hayek’s observation that economics is a ‘metatheory, a theory about the theories people have developed to explain how most effectively to discover and use different means for diverse purposes’ (Hayek, 1988:98, italics in original).

**Complexity Theory and Spontaneous Order**

The connection with economics is, however, stronger than many complexity theorists imagine. Indeed, complexity theory and economics appear to have the same aim: to explain the emergence of order in complex systems.

In 1967 Stuart Kauffman was told he would have to wait 20 years before anyone would take seriously the notion of spontaneous order in complex systems. But by then this idea had been well established in the social sciences for at least 200 years. Adam Smith observed the remarkable order that emerges from the millions of interactions taking place within the economy, and used his ‘invisible hand’ metaphor to describe the self-organising features of the economic system.

David Hume argued that the rules of property were a spontaneous order that ‘arises gradually, and acquires force by a slow progression, and by our repeated experience of the inconveniences of transgressing it’ (quoted in Hargreaves Heap et al., 1992:184). Some modern economists have combined game theory with Hume’s ideas to explain the emergence of rules of property and other conventions (Sugden, 1989).
Carl Menger also focused on spontaneous orders, referring to the 'organic' or 'primeval' emergence of certain customs and institutions such as money. He claimed that although money may emerge from legislation, it originally came about as the 'unplanned outcome of specifically individual efforts of members of a society' (Menger, 1985:155).

Friedrich Hayek, following the classical economists and the Austrian School, placed the notion of spontaneous order and complexity at the centre of his economic and political analysis. According to Hayek, 'very complex orders, comprising more particular facts than any brain could ascertain or manipulate, can be brought about only through forces inducing the formation of spontaneous orders' (Hayek, 1973:38).

The most remarkable example of the similarity between complexity theory and economics is exemplified in the work of Kauffman and Hayek. Each in his own field has independently focused on the interaction between evolution (natural selection) and spontaneous order (or self-organization) in describing the emergence of order. A central thrust of Kauffman's work has been to add the notion of spontaneous order to the well-established idea of evolution by natural selection. Kauffman's insistence that the 'marriage of selection and self-organisation' (1991:64) is essential to understanding biological systems is the same as Hayek's claim that 'what ... I have called the twin concepts of evolution and spontaneous order enables us to account for the persistence of these complex structures, not by a single conception of one-directional laws of cause and effect, but by a complex interaction of patterns ...' (Hayek, 1979:158; by 'evolution', Hayek means 'natural selection').

The affinity between complexity and economics suggests that the tools that complexity theory has developed will also prove useful in economics.

Some Possible Lines of Research

Three areas of possible research arise directly from assertions made by Hayek, although they are not unique to him as each is reflected in various debates within economics.

First, Hayek was sceptical about the role statistical analysis could play in studying complex systems. The properties of complex systems depend on how individual elements relate to one other; information about particular elements cannot be replaced by statistical or aggregate information; it is therefore inappropriate to resort to representative agents, as econometrics invariably does. How significant is this criticism? Complexity theory could help answer this question by providing the tools to analyse models displaying the appropriate forms of complexity. These models could be used to generate data (production, consumption and so on) on which the performance of traditional econometric methods could be tested. Something similar to this has happened since the discovery of chaos theory; complexity theory is likely to yield a richer set of models for analysis.

Second, Hayek (1988:98) was highly critical of macroeconomics. His claim (also evident in the 'micro foundations' debates) was that it is inappropriate to relate
aggregates in a causal manner. Why, in a complex system, should there be any stable relationship between aggregates that are the product of many changing relationships between individual agents? Clearly, any complex system will have emergent and aggregate properties and many of the emergent properties will in turn feed back to the behaviour of individual elements of the system. The question is how this emergent aggregate behaviour relates to the subject matter of traditional macroeconomics. Again, an appropriate model of a complex system could go at least some way towards addressing this issue.

Finally, Hayek often claimed that economics is limited to ‘pattern prediction’. Mark Blaug (1993) has complained that since first stating this in 1934, Hayek never wrote anything to give an indication of exactly what we can and cannot predict in economics. But an appropriate complex-economy model would allow us to examine this issue.

Conclusions

Complexity theory is about the emergence of order. So is economics. Complexity theory is not going to rewrite economics as we know it, because it has itself rediscovered ideas already present in economics. What it may do is provide some new tools that, when combined with economics’ long history of analysing complex systems, may provide valuable complements to traditional economic research.

References


The Rise and Fall of Victoria’s Labour Market Reform

Ken Phillips

In the 1993 West Australian and South Australian State elections, the leaders of the main opposition parties promised their electors that they would not ‘do a Kennett’. They were referring, of course, to the Kennett Government’s industrial-relations reforms introduced in Victoria in November 1992.

Victoria’s Employee Relations Act is the first serious attack mounted in Australia against the established system of centralised wage-fixing. The Victorian reforms sparked massive union opposition, chiefly in the form of public rallies. Despite such opposition, the Victorian Premier and his government continue to do well in the opinion polls.

The Victorian Department of Business and Employment regards the introduction of decentralised workplace legislation as ‘an essential ingredient of the Government’s commitment to provide a revitalised environment for Victorian business’ (Doing Business In Victoria, 1993, p.25). The government wants to see the workplace culture change, arguing that businesses cannot compete with the rest of the world and create employment until labour markets are freed from the restrictions of the centralised system. If the Victorian legislation were to succeed in creating greater employment growth than in the other States, pressure to duplicate the success across Australia could be overwhelming. But is the hoped-for change in workplace culture occurring in the Garden State?

The Employee Relations Act

The Employee Relations Act, which took effect on 1 March 1993, abolished State awards and the State Industrial Relation Commission and replaced them with a system of voluntary employment agreements for employees falling under the State’s industrial-relations jurisdiction (then about 40 per cent of the total). The legislation deems such employees (both existing and new) to have entered individual employment agreements, whose terms are the award conditions that applied under the previous system. But the Act allows employees to enter new agreements. These agreements may be collective or individual, but must include certain minimum

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standards, such as four weeks annual leave, five days of sick leave annually, and maternity, paternity, adoption and long-service leave. Hourly pay rates cannot be lower than those applying under expired awards. But employees cannot be forced to enter new agreements. And contrary to the claims made by some unions, s.38(2) of the Act makes it clear that grievance cases can be taken to the State Employee Relations Commission not just by employers but also by employees or their representatives.

The legislation offers a workable set of minimum rules and has been taken up by some employers and employees. One such employer is the Sizzler chain of family restaurants, approximately 90 per cent of whose 1400 employees signed agreements offered to them by the company (Herald Sun, 26 September 1993). Yet the impact of the Act has been mainly psychological; only a small percentage of employees have signed agreements that effectively alter the terms of their previous State awards. The Act provides the legal structure for workplace reform but has not been followed by widespread actual reform.

Federal Interference

Two things have gone wrong. First, federal legislation has enabled Victorian workers to transfer to federal awards. The Employee Relations Act was introduced on the assumption that the Liberal-National coalition would win the Commonwealth election in 1993 and would introduce complementary legislation. In the event, the Keating Government was re-elected and introduced federal legislation enhancing the ability of unions to remove unionists from State jurisdiction and to seek federal coverage. As a result, few Victorian workers (potentially including State employees) are likely to be covered by State legislation by the end of 1994: Federal coverage is progressively undermining any impact the Employee Relations Act might otherwise have had on employment creation. However, should the High Court successfully challenge the right of the federal Industrial Relations Commission to transfer State-employed workers to their jurisdiction, the Victorian reforms will gain new momentum. A decision is expected in mid-1994.

The second problem has been the apparent inability of the Victorian government to implement its workplace reform agenda with its own employees. This has been a surprise. It could have been expected that, as the largest employer in the State, the Victorian government would attempt to entice its own employees into employment agreements, in order to demonstrate to private-sector employees and employers that its reforms could succeed. If large numbers of State employees had voluntarily signed employment agreements, the Kennett Government would have secured a major advantage in its reform drive. But it hasn't happened. The Victorian government's apparent lack of commitment to its own labour-market reforms contrasts starkly with the robust implementation of its other reforms.
The Public Sector Management Act

The problem first appeared when the government, in Part 4 of its Public Sector Management Act 1992, introduced contracts for executive officers of the public service that exempted them from the provisions of the Employee Relations Act. The impact of this was twofold. First, it revealed that the State government differentiated between classes of employees, namely, management and workers. The Act was supposed to help break down cultural workplace barriers; but the government’s apparent espousal of the ‘them and us’ mentality fuelled suspicions that the Act had a hidden agenda. Second, it eliminated any personal commitment on the part of senior public servants to employment agreements: the people on whom the government had to rely to implement the Employee Relations Act were not themselves covered by the Act.

This lack of commitment became apparent when certain employees of the Victorian Education Department requested employment agreements in 1993. The subsequent administrative muddle verged on the farcical. Along with the interested employees and their representatives, the Department developed a standard employment agreement. The six-page, plain-English agreement replaces the 54-page, convoluted award of the previous system, and facilitates significant managerial flexibility in workplace arrangements. Yet the Department did not then encourage its employees to sign up. Rather, over a nine-month period, a steady pattern of obstruction unfolded.

Employees who asked for agreements waited for up to eight weeks for copies to be sent for signing. Often they never arrived at all. When they did, they frequently contained errors; and correcting them could take many weeks. Some errors appeared to embarrass the department, and affected employees were subjected to abuse. Confidential agreements were mailed to the wrong employees, exposing those wanting agreements to ridicule and harassment. Line managers who were supposed to sign on behalf of the government did not receive briefings on the content or implications of agreements. Some line managers tried to talk employees out of signing and refused to sign when requested to do so by employees. Some employees had to wait for more than ten weeks for pay increases to which their agreements entitled them. In some cases, payments were made only after the employees threatened to invoke dispute-settling procedures. One employee who signed an agreement was subsequently subjected to intimidation, mysteriously disappeared from the Department’s computer employment records, and was not paid for many weeks.

All this occurred at a time when employees who had faith in employment agreements were bearing the brunt of trade-union vilification and attack. Employee representatives willing to assist State employees in obtaining agreements have become cautious in pursuing requests.
The Teaching Service (Amendment) Act

More recently, the Victorian Education Department has drawn up and imposed on school principals contracts under its Teaching Service (Amendment) Act 1993, which, like the Public Sector Management Act, creates exemptions from the provisions of the Employee Relations Act. Both the enabling legislation and the contract allow the employer to alter the terms, conditions and remuneration of school principals' employment unilaterally and at any time, including dismissal. Principals are prohibited from taking legal action against possible breach of contract. Interpretation of the contract is at the employer’s discretion, and disputes under the contract are to be settled by an agent of the employer without any right of appeal to an independent adjudicator. Employee holiday leave, sick leave and long-service leave are not guaranteed, and parental and adoption leave are removed. The government is using its position to grant itself special employer rights that flout the principles of normal commercial contract.

In view of these strange events, and the State government’s reluctance to allow its own employees to benefit from the Employee Relations Act, is it any wonder that the private sector has been slow to adopt the reforms?

The wider lesson to be learned from this debacle is that legislation alone is insufficient to effect labour-market reform. Reform is about changing attitudes, and is largely dependent on the attitude of employers to employees. To succeed, reforming governments will need to transform their own corporate culture before they can succeed in breaking down class consciousness among their own employees.
REVIEWS

Rogernomics Mark II


Reviewed by Michael James.

Imagine a country in which personal income tax, company tax and fringe-benefit tax have been abolished, and the government debt repaid. The goods and services tax stands at 12.5 per cent, and is soon to start falling; other indirect taxes have been either abolished or converted into user charges. Government spending is about half its present level, and still falling.

Such utopianism is unfashionable in these anti-ideological times. Yet this is the vision for New Zealand in the year 2013 that Sir Roger Douglas depicts in his new book. Given Douglas’s spectacular and unexpected success in dismantling most of New Zealand’s supply-side obstacles while Finance Minister in 1984–88, his proposals for completing the country’s liberalisation deserve to be taken seriously.

Douglas gives a detailed account of how his reform drive was halted in early 1988, when David Lange, then New Zealand’s Prime Minister, cancelled a Cabinet-approved fiscal-reform package including a 23 per cent flat-rate income tax, a guaranteed minimum family income scheme, and means-tested user charges for some government services. The National government elected in 1990 introduced some user charges and deregulated the labour market, but otherwise failed to resume the reform momentum. It lost interest in the privatisation program. In his chapter on New Zealand’s state-owned enterprises, Douglas argues that the fate of the Electricity Corporation shows that the gains of corporatisation must be consolidated by privatisation if they are not to be eroded by political forces. Even the privatised utilities are not safe: Telecom is required to maintain the existing nationwide telephone service, and is consequently losing market share faster than expected to its competitor, Clear Communication.

The fiscal situation is even worse. Public spending in New Zealand’s absorbs 40 per cent of GDP annually, the budget deficit 7 per cent; government debt now amounts to 66 per cent of GDP. Debt-servicing costs are rising and forcing a re-evaluation of government services. Most of Unfinished Business is devoted to schemes for getting government out of direct service financing and delivery in education and health care, and replacing the current disastrous pay-as-you-go national superannuation scheme with a properly funded private alternative. Douglas’s defence of this approach is straightforward. ‘Why do we insist on taxing middle-income people heavily, only to give their money back to them in some way?'
Wouldn’t it be better to dramatically reduce taxes for these people and let them buy the services they need directly, e.g., education and health. This would allow the government to concentrate on those who need help’ (p.59). The very simplicity of the argument will be resented and distrusted by those who prefer things to be obscure and complicated, so that only they can understand them.

Douglas claims that his beliefs and general philosophy stem from his association with the New Zealand Labour Party. This seems strange only to those social democrats who are more attached to means than to ends: who believe that only big government can guarantee social justice. Yet Douglas prescribes a degree of compulsion and redistribution that confirms his social-democratic pedigree and distinguishes him from the strict libertarian. All adults would be obliged to have their children educated, to take out health insurance (including for post-retirement health needs), and to invest a minimum capital sum of NZ$122,500 in a superannuation scheme. The poor would be protected by a range of measures: a Guaranteed Minimum Family Income and direct help with education, health and superannuation expenses. By thus being brought into the market for basic services, the poor would be less likely than now to lapse into dependency; and the poverty traps that accompany selective welfare programs would be largely eliminated by deep cuts in income tax.

Douglas’s impatience with libertarian sensibilities, and his desire to ensure that everyone makes the best of himself through his own efforts, reappear in a section on the problems of New Zealand’s indigenous people. While on this subject he is refreshingly free from patronising sentimentality, he fears that emphasis on ownership rights to land and fisheries threatens to turn Maori into absentee landlords, whose rents would amount to a new form of welfare hand-out just as demoralising as the present kind. The prosperity of the human race now depends on information and technology, and Maori need to come to terms with this along with everyone else. There is no reason in principle why they shouldn’t recover the entrepreneurial spirit they displayed in the 1840s and 1850s.

Are the reforms likely to happen? *Unfinished Business* reproduces Roger Douglas’s now famous 1989 speech on the politics of reform, which says that reform should proceed swiftly and on a broad front, so as to bring on the benefits of reform as fast as possible to compensate each sector for the pain of restructuring. But in recent years economic reform has been discredited by the recession; and resuming the reform drive of the mid-1980s will be hard. Douglas correctly recognises that reform programs must ensure that those who bear the brunt of reform are kept safe during the transition; hence his emphasis on providing a generous welfare safety-net.

But who will carry out the reforms? Douglas is now disillusioned with the New Zealand Labour Party; indeed, all the existing political parties are ‘absolutely committed, with minor variations, to the same old worn-out recipes for economic and social disaster. We waste our time trying to distinguish between them’ (p.253). He stands ready to form a new party, which, under New Zealand’s new proportional-representation electoral system, would probably obtain a few seats. He proposes
that some reforms be enshrined in legislation, as the independence of the Reserve Bank already is; an obvious candidate is a balanced-budget rule. He also suggests subjecting government White Papers and party manifestoes to extra-parliamentary, independent audit.

The strongest pressure for reform will come from the costs of not reforming: mounting fiscal crisis, leading eventually to disinvestment, stagnation and decline. But a necessary condition of successful reform is a coherent program of mutually reinforcing measures. New Zealanders are fortunate to have had such a comprehensive and lucidly presented example of one placed before them. It's a pity no one tidied up the frequently inadequate referencing or compiled an index.

Michael James is Editor of Agenda.

Too Much of a Good Thing


Reviewed by H. M. Boot.

Governments have a strong incentive to be seen to be doing something in labour markets at times of high unemployment. This is as true of a government led by Mrs Thatcher as of one led by Paul Keating. In the 1980s public spending on vocational training in Britain increased in real terms by more than 300 per cent to reach £3 billion by 1989. Youth-training schemes, expanded from one to two years, were made virtually compulsory for unemployed school leavers, and the numbers on training programs rose by over five times. Qualifications obtained from these programs are 'competency-based', and certified National Vocational Qualifications (NVQs) range from semi-skilled to post-graduate equivalent levels. It is anticipated that 80 per cent of the work-force will be in jobs where an NVQ framework is installed by the end of 1992.

The parallels between these features and recent proposals to develop government-financed training programs in Australia under the Prime Minister's One Nation statement and the Carmichael Report are unmistakable. The only significant difference is that Australia, having started rather later, is not yet as far advanced as Britain. As in Australia, there are few people in Britain willing to face the howls of abuse likely to greet anyone willing to question these developments. J. R. Shackleton, the author of this book, is willing to take that risk.

Training Too Much? focuses on three main issues: the failure of British conservative governments to provide adequate justification for large-scale intervention in vocational training; the lack of effective evaluation of the net benefits derived
from public expenditure on training; and the growing influence of special-interest
groups who stand to gain from the expansion of publicly funded training. These
concerns are as relevant to Australia as they are to Britain. Authorities in both
countries are committed to large expenditures on training and both share the same
uncritical attitude toward the programs they are financing. In Britain, state expendi­
ture on training shows every sign of having been increased without any thought be­
ing given to the economic principles that govern such expenditure. These princi­
ples, which Shackleton outlines skilfully, were developed by human-capital theorists
30 years ago and are well known to economists. There should therefore be no rea­
son why they should be ignored. Unfortunately, the consensus in both countries is
that workers are under-trained, that the unaided market will not solve the problem,
and that government must therefore intervene with large publicly-funded programs
of vocational training if economic performance is to match that of their trading
competitors. In Britain, says Shackleton, this consensus is just one of many
'explanations' of Britain's relative economic decline, and persists even though it is
hard to find any positive correlation between the resources a country devotes to
training and its rate of economic growth. As in Australia, official claims that
amounts spent on training are deficient are based on comparisons with foreign ex­
perience and on the fact that many firms offer no formal training to their employ­
ees. Yet differences in economic structure, education and employment practices,
and in techniques of measurement used by different countries make international
comparisons of expenditure on training highly misleading, while it is simply wrong­
headed, as Shackleton shows, to require that all firms provide vocational training
for their workers. On the other hand, one estimate (Training in Britain: Employers
Activities, HMSO, London, 1989) indicates that in Britain resources equal to about
10 per cent of GDP were committed to vocational training annually in 1985 (no
similar estimate appears to exist for Australia). This estimate includes £9 billion for
earnings forgone during training. Nevertheless, total direct cash expenditures on
training from all private and public sources amounted to £24 billion. It appears,
however, this is still not enough for the training enthusiasts.

As for evaluation, this is expensive and time-consuming, and the technical
problems associated with measurement and interpretation result in conclusions that
are often uncertain and slow to emerge. Meanwhile, politicians with short electoral
horizons either cannot or will not wait for answers. In any case, the pace of innova­
tion is such that delayed answers that cast doubt on the efficiency of particular
schemes can normally be dismissed as relating to an earlier mode of the scheme
that has since been replaced by a more efficient version. In spite of these problems,
it is to be expected that some attempt would be made to evaluate the returns on the
vast public resources devoted to vocational training. One of the most disturbing
features revealed by Shackleton is how little attempt is made in Britain to evaluate
individual programs or the policy as a whole. Effectively, £3 billion of taxpayer
funds is spent annually on training without anyone asking what net benefits are re­
ceived in return.
Shackleton's final concern is the growing power of special-interest groups prospering from the large state-financed training expenditures. This is a mixed, but unsurprising, bag of beneficiaries. It includes the government itself, anxious to be seen to be doing something to combat high unemployment; the unions who benefit from the fact that qualifications can be used to reduce competition in labour markets while enhancing the 'rents' of existing workers; employers who might now be able to substitute government funds for funds they would otherwise have invested themselves to train their workers; and the training industry whose livelihood benefits directly from increased expenditure on training. Indeed, classic interest-group activity by the training industry is so strong that the British government has been forced to revive its own National Training Task Force to act as a counterweight. Finally, there are the trainees themselves. In periods of high unemployment, any edge gained over others, especially if acquired at zero or negligible cost, will be welcomed. For all these groups, expenditure on training becomes an end in itself. Unhappily for the taxpayer, the question of who pays, and what net benefits are gained by the economy as a whole from these expenditures, tends to recede further and further into the background.

Although this book focuses on British experience in the 1980s, Australians will have to deal with the same issues in the 1990s. Shackleton's altogether too brief account of developments in Britain provides timely warning that no one responsible for Australia's economic welfare, or for committing public funds to occupational training in Australia, can afford to ignore.

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Settling for Mediocrity?

David Hughes and Robert Albon (eds), Capital Ideas: Suggestions for Economic Reform in the ACT, Federalism Research Centre, Australian National University, Canberra, 1993.

Reviewed by Tony Rutherford.

Considering the importance of the Australian States in the economy and in public policy formation, economists and policy analysts have proved remarkably reticent in promoting coordinated studies of State policy. But contributions to the field have increased over the last four or five years. For example, Budgetary Stress: The South Australian Experience, edited by Dick Blandy and Cliff Walsh, was published in late 1989. That was followed by the various Project Victoria studies, written and published by the Institute of Public Affairs and the Tasman Institute be-
tween 1991 and 1993; followed in turn by the IPA's Reform and Recovery: An Agenda for the Next Western Australian Government, published in 1993. This increase in attention and activity is timely. Following the Greiner revolution in New South Wales — as well as the oddly unsung success of the Bjelke-Petersen fiscal regime in Queensland — the centre of gravity of fiscal and microeconomic reform has been shifting from the Commonwealth to the States.

Now we have this very useful volume on the Australian Capital Territory. Its emphasis is slightly different from that of its predecessors: the ACT has only recently achieved its 'independence' and is still being weaned from the federal fiscal umbilical cord. An optimist might believe that it had not yet had time to develop the nasty fiscal habits of its older siblings. A realist might rather have predicted what in fact is happening: the ACT is showing every sign of being a spoilt child. Endowed with a wealthy population, goldplated infrastructure, very considerable economies of scale, low unemployment, and very little debt, it nevertheless seems to lack purpose, to be content aimlessly to squander its inheritance. So there is a common sense among the authors of urging clarity of thought and appropriate action before it really is too late.

The authors' preferences are largely for market solutions over government solutions, consumers over providers, clear rather than arbitrary property rights, and definable equity rather than 'social justice'. The chapter on education comes out in favour of autonomous schools and per-pupil funding; the chapter on urban transport recommends substantial deregulation and private-sector involvement; the chapter on public housing plumps for a tenure-neutral housing allowance scheme.

This is all clearly thought-out, unexceptionable, economically rational policy advice. One wonders, therefore, why the authors tend to be so defensive about their being charged with ratbag economic rationalism. The substance of the book is itself proof against idle criticism: until those who profess to oppose 'economic rationalism' reply with equally patient and lucid analysis of present policy and policy alternatives, they have no claim to be taken seriously. In the meantime, as with its predecessors, readers will have to tolerate a natural tendency for the preliminary analysis to outweigh the policy findings.

In Capital Ideas, this tendency only rarely gets out of hand. The policy end of the Health chapter is the lightest in detail. This is understandable in view of the policy constraints imposed by the Commonwealth; but likely reform models, such as the Victorian casemix experiment (briefly mentioned) and the now standard provider-purchaser split, could have been outlined at greater length. (And in view of the Commonwealth's own health finance problems, it might have been wise to add that cost-shifting from State to Commonwealth is likely to provide only short-term relief.)

There are few other conspicuous omissions. Non-ACT readers of the chapter on Urban Planning may well wonder whether there is a place in the ACT for a tier of local government, given that on a population basis it might be expected to have three or four councils, and that well-designed local decision-making might help with
some of the problems that the author raises. Perhaps no one believes any more that well-designed local government is a rational possibility.

David Hughes and Robert Albon end the book on a pessimistic note. "The question now is whether or not we will respond to this increasing financial pressure with imaginative reforms. The experience of the States and the ACT so far suggests that we will not embrace reform, but rather settle for mediocrity in government or, worse, end up in crisis. If mediocrity or worse proves to be the extent of our political horizons, we will have no one else to blame but ourselves" (p.241).

That may well be more true of the ACT than of the other six States and the Northern Territory: it must surely have the wealthiest and best-educated population of all eight entities, a population surely more capable than most of doing the right thing. But it would seem to be untrue in some important respects. Voters may often seem to do silly things, to vote, indeed, against their own (and their children's) long-term interests. Until it is proven otherwise, however, we would all be much better off assuming that they do so not because they are silly or selfish or perverse, but because they are required to vote on the basis of the most imperfect information imaginable. The relationship between the cost and the benefit to any given voter of any given policy is never explicit. The cost of any given platform of policies is even less ascertainable (although Fightback! was an unusually brave step in the right direction). How voters should rationally respond in these circumstances is possibly, in the end, an insoluble problem; but it is one we should all bear in mind.

One partial solution is, of course, steadily to reduce the domain of government policy, so that fewer activities are subject to the hazards of imperfect information. Another partial solution is to make costs as transparent as possible. This is a consideration which has relevance here to, for instance, Robert Albon's chapter on Taxation. It can be argued that the traditional criteria of taxation design — such as efficiency and equity — should come well behind visibility. Whatever — to take an obvious example — economists eventually decide about the final incidence of payroll tax, it is an unhelpful tax in that it is essentially visible only to members of the local chamber of commerce. Given the limited tax bases available to the States, and the Commonwealth's present unwillingness to discuss alternatives, Albon's preference for beefing up property rates and taxes is probably sound.

One more example. There has been a lot of good, economically rational advice over recent years on such matters as user charges for public-sector services, and how to improve the operations of public trading enterprises. Much of the advice has been successfully implemented; the efficiency of many of our electricity utilities, say, has been dramatically improved. But cui bono? The Business Council of Australia has recently calculated that 'almost 100% of the gains from the very successful microeconomic reform in Pacific Power have been captured by its shareholder, the NSW Government' (Bruce Kean, 'The Need for Reform: Private Sector Views', Business Council Bulletin, 105, January/February 1994, p.26). Indeed, this year, dividends and similar statutory payments by public trading enterprises to Australian governments will grow by A$1.2 billion or 60.9 per cent; user charges will grow by 1.5 per cent to $12.9 billion. This is not accompanied by a commensurate
decrease in standard revenues. So at the end of some years of reform, it is not easy to see how far any of us is actually better off; and the tenuous link of accountability between taxing and spending is certainly weaker.

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Founder and Critic

_H. W. Arndt, 50 Years of Development Studies, National Centre for Development Studies, Australian National University, 1993._

Reviewed by Clem Tisdell.

This is a valuable selection of 24 papers written by Heinz Wolfgang Arndt over a period of a little over 50 years on major issues in economic development. The new preliminary material with which the author introduces each paper greatly enhances the volume because it sets each paper in its historical and institutional context and relates it to the historical development of thought about development studies. This is particularly appropriate for this volume, the fourth in the History of Development Studies series of the ANU’s National Centre for Development Studies.

The first paper, written in 1942, discusses the agricultural labour surplus problem in eastern (including south-eastern) Europe. In 1937 a very large surplus of agricultural labour existed in eastern Europe and this was predicted to increase significantly in 1952 in the absence of countermeasures or fortuitous developments. Thus the absorption of surplus agricultural population was expected to be an important economic issue in eastern Europe after World War II. Of course, as events transpired, it became largely a problem for the former Soviet communist ‘empire’ to deal with, a development that could not have been foreseen with any certainty in 1942.

Arndt covers the difficulties and problems involved in defining and measuring the size of the surplus agricultural population. These issues and the problem of absorbing the surplus agricultural labour force remain important issues in many developing countries today, such as China. It has been estimated that approximately a third of the Chinese agricultural labour force is surplus in an economic sense. In fact, it seems likely that past communist systems both in the east and the west of Eurasia did much to exacerbate the agricultural labour surplus problem.

The last essay in this book (written in 1993) involves a discussion of the environment and economic development centred around the concept of sustainable development and the question of the appropriate discounting of future benefits and costs. The catalyst for this contribution is a review of D. Pearce, E. Barbier and A. Markandya, _Sustainable Development Economics and Environment in the Third_
World (London, 1990). As in most essays in this book, Arndt shows extraordinary perception and wisdom. He observes that the idea of sustainable development popularised by the Brundtland Report (World Commission on Environment and Development, 1987) is an evasion, since it suggest that no trade-off between economic growth and the maintenance of environmental quality is needed. Indeed the former is believed by many supporters of sustainable development to be necessary for the latter. But as Arndt points out, some trade-off may be necessary and the extent to which this is so is still a major issue for debate (Tisdell, 1994). Arndt correctly says that the slogan of sustainable development has much in common with that of ‘growth with equity’ which was frequently espoused during the 1970s. Nevertheless, it is probably true that Arndt favours pro-growth strategies even with some risks to more conservative strategies designed to protect the environment, including the global environment. However, he does not fully reveal his stand in this respect, even though his discussion of risk and uncertainty and irreversible damage (pp.258-9) points in this direction.

Arndt makes a number of extremely important points in this essay about the discount rate and preservation of the natural environment. He thinks that the discount rate and the rate of interest should be regarded as secondary considerations. But the level of investment and its composition will be of great significance for the state of the environment and sustainability. Investment as a rule involves the replacement of natural capital stock by man-made capital. To what extent should these be substituted and how should the optimal mix of these be allowed to vary with the passage of time? This is the central issue.

Between these two essays are others which are equally interesting. Essays 21 and 22, first published in 1988 and 1991 respectively, are closely related and deal with structuralism, market failure and underdevelopment. The latter essay is a masterly synthesis of different anatomies of market failure. It considers the failure of markets from static and from dynamic points of view, that is, essentially from allocative and creative perspectives. The possibility is also considered that markets may fail to exist because of market transaction costs or that markets may be segmented. These ‘microeconomic’ concepts are then related to the situation in which many less developed countries find themselves. In essay 22, Arndt reveals himself to be more in sympathy with the bounded rationality/evolutionary school of economic thought, which owes so much to Joseph Schumpeter, than with traditional market theory. Nevertheless, he sometimes seems influenced by traditional neoclassical theory, for example in his advocacy of free trade for Australia (Arndt, 1992).

In some respects the book could have been better. For example, a complete list of Arndt's publications, or at least those on development studies, could have usefully been included. On some points the reader may disagree. For example, Arndt castigates the use of contingent valuation as a means to help settle environmental questions and comments, 'The appropriate procedure for weighting the pros and cons in such cases in a democratic society, is not contingent-valuation, but determination by a democratically elected government or perhaps a referendum' (p.259). Although one can be justifiably critical of contingent valuation, democratically elected governments
governments and majority voting can lead to serious economic failures. So it is really no solution to place one’s trust in either.

Heinz Arndt is Australia’s greatest development economist who has done more than any other in this country to advance development studies. It is pleasing to see wisdom and analysis combined in a single volume by a founder and constructive critic of development economics. The collection strengthens the European academic cultural tradition from which so many Australians have drawn inspiration and helps to integrate present economic thought with the past.

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Respecting all Heritages


Reviewed by Nick Uren.

Greening a Brown Land provides a carefully woven account of the science and socio-economic factors that have influenced the shape of agriculture as we know it today. It provides a better understanding and more realistic view of what has gone on and why than the picture painted by urban environmentalists: ‘Environmental religious fervour... is no substitute for facts’ (p.286). As well, the book provides a sense of history, which is so often missing among those who are so keen to attack farmers and the results of their labours. Barr and Cary have used plates and historical accounts successfully to illustrate the appearance of land in 1788 when ‘The inexperienced would be directing the unwilling to farm the unknown’ (p.118). The photographs are generally apt, but the quality of some is poor: for example, the lupins cannot be seen in the one on page 140.

The main theme is the struggle of farmers to make the land productive, and thereby green, and to overcome the dry and infertile soils that characterise it. The
role of scientists in this process is duly acknowledged. Mistakes have been made by both farmers and scientists, some more serious than others, but they have all contributed to the process of adaptation. ‘There are many cases where the land use that at one time was unsustainable has subsequently become more sustainable because of the advances in science and technology’ (p.283). Serious damage has been caused also by political activists; irrigation appears to have attracted a number of fanatics whose zeal was apparently similar to that of the modern greens.

The book’s three parts are about, respectively, grazing, cropping, and irrigation. Although the authors do not define sustainability, the reader derives a feeling for the idea and for the socio-economic and physical factors that influence it.

A good job is done in emphasising that the primary cause of salinisation of irrigated land is the failure to provide adequate drainage. Some, but not all, politicians and engineers were happy to build the dams and the supply channels, but the costly provision of proper drainage was conveniently overlooked. Arguably, had adequate drainage been provided in the first place, then the provision of adequate disposal of the saline drainage water would not be the problem it is today. The authors, and many others like them, need to be more careful when discussing salt in solution because there are quantitative descriptors other than total concentration (usually measured indirectly by electrical conductivity). One of these is the sodium absorption ratio, a measure of the sodium hazard, which has been ignored by all except soil scientists; it is used for gauging the potential damage that saline irrigation water might cause to soil structure and hydraulic properties. The use of ‘ES units’ (Fig.11.1, p. 225) is to be deplored, since there are many units of electrical conductivity units, some of which differ by up to six orders of magnitude.

The authors claim that ‘Much ... early pastoralism was exploitative’ (p.279). Were there any options? In a similar vein, the squatters ‘indulged their genteel aspirations by building houses, even mansions’ (p.279). Would this be a sensible thing to do for people whose primary purpose is to exploit and leave? Again, ‘fruit trees were an essential part of the migrants’ re-creation of England in the new land’ and were grown ‘not for profit, but for luxury’ (p.180). What else were they to do? Governor Philip was aware of the need for fruit to prevent scurvy – hardly a luxury.

Likewise, the authors seem keen to perpetuate the nonsense that the imposition of European-style agricultural practices has degraded the land. In seeking an intelligent remark on this, one might ask, ‘Where does subterranean clover come from?’ Or, ‘Who invented superphosphate?’ Or, ‘Which civilisations were the first to cultivate soil or to irrigate land?’ One might also ask why it is so important to blame one’s heritage for one’s mistakes; it is a waste of time, achieves nothing and avoids the issue. And why doesn’t the heritage of Europeans, for example, deserve the same respect as that given to the heritage of the aborigines?

The authors convincingly show that the aborigines were effective in deforestation by their frequent use of fire. But one might argue that some of the plains were treeless for other reasons (e.g. subsoil salinity) than frequent burning by aborigines. One cannot believe that the influence of the aborigines was always benign. The claim that the aborigines created a new and more productive landscape than the one
they found is debatable. Fires lead to losses of nutrients in smoke and possibly in the erosion of ash. Such losses for each event are small but over 60,000 years they are likely to be considerable and significant, particularly for soils that are already poorly endowed with nutrients. Further, the aborigines’ practice of burning was carried out to encourage the growth of grasses, but it led to deforestation — exactly the crime of which the early settlers have been accused.

The authors are correct in saying that nutrient exhaustion was a major cause of yield decline in the early years of cropping. But to imply that the extent of nutrient removal was quantitatively large is probably incorrect. It is wrong to imply that our subsoils have ever been well-endowed with phosphate (p. 30) and that phosphate is mobile (p. 46).

The oft-quoted Robertson, who had settled an area generally free of trees, reported in 1853 signs of salinity that suggest that the removal of trees was not the cause and that the over-grazing of the land with sheep simply exposed areas of saline discharge that had always been there. The authors tell us (p. 17) that Robertson had between 8000 and 10,000 sheep on 11,810 acres, i.e. a stocking rate of a little under one sheep per acre, which was high enough at the time to cause over-grazing. Today, stocking rates in the region are about four times that figure and are believed by some to represent under-stocking. The increase in carrying capacity has been achieved by the use of superphosphate and introduced pasture species. This increase in production will be accompanied by greater water use; and providing the salts are not removed in produce, then the discharges may have become more saline over time. The message is clear: the discharge areas must be protected from livestock at times when they are most prone to damage, i.e. when they are saturated.

I believe that the authors are unduly pessimistic about soil acidification. They weaken their case with such nonsensical statements as ‘continuing acidification destroys soil structure’ and ‘continued nitrate leaching leads to a crystalline transformation of the soil structure’ (p. 141). Further, their comment that ‘Even more serious is the poor growth of ley pasture in acid soils’ suggests that there is poor growth on all acidic soils: which is incorrect. In the 1912 publication on lime referred to by the authors, the Victorian Department of Agriculture said that any soils that were acidic (as determined with litmus paper!) needed to be limed. Farmers were reluctant to apply it. History has vindicated their reticence, since there was little point in adding lime in the presence of deficiencies of phosphorus, nitrogen, sulphur and in some cases molybdenum. With the introduction of acid-tolerant species and cultivars and with the correction of deficiencies, particularly molybdenum, it has been possible to farm successfully all but the most strongly acidic soils. Many farmers are still reluctant to apply lime; could they prove to be justified yet again?

Barr and Carey have stripped away much of the rhetoric associated with the current debate on the influence of agriculture on the environment. They have added some much-needed perspective and, one hopes, have cleared the way for more objective discussion of greening a brown land than has hitherto been possible.

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Chicago vs Virginia


Reviewed by Ian McEwin.

This is an important book, for two main reasons. First, it provides, in the context of the market for legal services in the US, a thorough analysis of the differences between the Chicago and the Virginia schools of political economy. Second, by using the Virginia school’s approach, it shows that consumer preferences (here the preferences of the financially disadvantaged) play virtually no role in determining the allocation of public resources to civil-justice access programs. Instead, Rowley shows that special-interest groups, acting through the Federal Legal Services Corporation, have promoted their own law-reform agendas. The book thus provides a useful basis for assessing the impact of Australia’s legal-aid programs.

Rowley argues that the Virginia school of political economy (VPE) offers a much richer framework for analysing government processes than the Chicago school of political economy (CPE). The latter uses price theory and positive economics to examine the workings of government. The state is conceived as a mechanism by which rational individuals redistribute wealth within society. Virtually all government regulatory and other intervention is seen as the product of competing groups seeking to redistribute wealth in their own favour.

Whereas CPE regards the political market as an efficient redistributor, VPE is less sanguine. VPE shares the methodological tools of price theory and positive economics, and accepts that interest groups attempt to redistribute income via the state. But it argues that political markets are not always efficient; participants are not fully informed, and so institutions matter to outcomes. The different approaches of CPE and VPE can be illustrated by class actions. CPE endorses class actions as cost-effective litigation because the fixed costs of litigating are spread over a large number of litigants. VPE is less enthusiastic, noting that lawyers bringing class actions can be concerned either with promoting the interests of a class or with promoting their own social visions. Where members of a class can be added to litigation without any indication of interest on their part, class actions become low-cost means for lawyers to pursue their own ends.

Within the VPE framework, Rowley analyses the legal-services market in the US, in particular the Legal Services Corporation that President Nixon established in 1974 to provide the poor with equal access to civil justice. After examining the evidence, Rowley concludes that ‘the individual’s right to justice has been subverted into collectivist law reform’ (p.315). This has happened as lawyers use legal tactics such as class actions as instruments for furthering their own goals. Rowley documents attacks upon the family (which is important to liberty by ‘furnishing independent and self-reliant citizens upon which a limited form of government’ is de-
pendent' (p.331) and the institutions of capitalism. This agenda has been pursued, Rowley argues, at the expense of the poor who rely on those funds to gain access to civil justice.

Rowley also finds the Legal Services Corporation to be excessively bureaucratic and internally inefficient. To overcome the inefficiencies and to curb the politically motivated ambitions of those controlling the Corporation, Rowley proposes a voucher system to ensure that the poor gain some market power over funds intended for them. As Rowley puts it, 'A customer without purchasing power is defenseless against such program invasion [by rent-seeking coalitions]' (p.377). The voucher scheme is not spelt out in detail, but it is an interesting idea.

Although *The Right to Justice* is at times repetitious, particularly in defending VPE against CPE, it refreshingly combines history, economics, and institutional analysis in a way that provides a damning indictment of the way a government program can be subverted. Those most disadvantaged in society may end up as badly off, if not worse off, despite initial good intentions.

Apart from providing a salutary lesson for those concerned with improving access to civil justice, the book should appeal to those interested in modern political economy.

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NON-AGENDA

With the view of causing an increase to take place in the mass of national wealth, or with a view to increase of the means either of subsistence or enjoyment, without some special reason, the general rule is, that nothing ought to be done or attempted by government. The motto, or watchword of government, on these occasions, ought to be — Be quiet... Whatever measures, therefore, cannot be justified as exceptions to that rule, may be considered as non-agenda on the part of government.

—— Jeremy Bentham (c.1801).

Not the Current-Account Constraint Again!

Tony Makin

In the late 1980s, monetary policy aggressively targeted the current-account deficit (CAD) which was then officially interpreted as the gap between national output and national expenditure and as the major macroeconomic constraint on the Australian economy. As a result, short-term interest rates peaked at over 18 per cent in mid-1989; and the subsequent recession saw unemployment rise to 11 per cent, the highest level in decades and well above the OECD average of 7 per cent. The economy suffered far more than it would have if monetary policy had remained neutral, or had itself been constrained by some monetary rule.

The policy reaction occurred despite 'New View' arguments circulating at the time about the changed significance of the external account 'imbalance' under a floating exchange rate and deregulated international financial markets (Makin 1988, 1989; Pitchford 1990; Corden 1991). Among other things, the New View stresses that external imbalances are the difference between domestic saving and investment, to the extent that they reflect private-sector decisions, are no cause for policy concern.

Now that the economy is recovering, we need to remind ourselves that the CAD itself is not really a constraint and that using monetary policy to reduce the CAD probably would not work in any case.

The Exchange Rate and External Adjustment

Under the present floating exchange-rate system, CADs and capital inflow over any period will, in principle, always be equal ex post. Yet most analysts still interpret CADs as 'bad', forgetting that the matching capital-account surpluses are 'good' to
the extent that they usually finance extra private investment. As shown empirically in Makin (1993, 1994) and Layton and Makin (1993), extra foreign finance and investment of the 1980s actually made Australia better off in terms of its GDP and wealth to the extent that the value of the capital stock was larger than otherwise. Wealth per head, for instance, rose by over a third in the 1980s.

If at any time the two sides of the external accounts do not match *ex ante*, the nominal exchange rate moves to ensure they do. So concern about the balance of payments ‘constraint’ makes no sense unless the exchange rate itself goes into free fall. But this would happen only in the event that foreigners at once, and en masse, changed their minds about financing any of the additional private investment accompanying higher growth levels. This is unlikely; and it would not, as such, amount to a balance of payments ‘crisis’ for the authorities, but rather an exchange-rate management issue that may not require a heavy handed policy response. If there were a sudden flight of foreign capital that precipitated a sharp exchange-rate depreciation, foreigners would be dumping debt instruments on the domestic market and at the same time forcing down their prices. Not only would part of the stock of Australia’s foreign debt vanish, but lower financial asset prices would raise yields in domestic financial markets. At some point, the higher returns on domestic instruments would attract foreign investors back into the Australian market, so placing a natural floor under the exchange rate. Additionally, a sharp depreciation would raise export values and, over time, improved competitiveness would discourage imports. In general, as David Hume (1752) argued, external disturbances tend to be self-equilibrating.

**Do High Interest Rates Reduce the CAD Anyway?**

Whether tighter monetary policy actually reduces the CAD is a largely unresolved theoretical issue. The popular Mundell-Fleming approach, favoured for instance by Bewley and White (1990), suggests that tighter monetary policy widens the CAD because higher interest rates cause a higher real exchange rate, which discourages net exports. In other words, monetary tightening could deliver the opposite external account outcome to that intended.

However, this approach ignores certain key linkages between monetary policy and the CAD. For instance, higher interest rates also suppress national expenditure, which lowers imports and possibly raises exports (to the extent that less spending by residents means a greater share of domestic output becomes available for sale abroad). This would tend to narrow the CAD, offsetting the exchange rate-trade account linkage of the Mundell-Fleming model.

Yet the biggest component of the CAD is not the difference between exports and imports of goods and services, but net interest paid abroad on foreign debt, over half of which is denominated in foreign currency. The Australian dollar value of such interest shrinks when the exchange rate appreciates, thus reducing the CAD. But then higher domestic interest rates also raise the amount of interest paid to foreign holders of domestic bonds denominated in Australian currency, thus
raising income paid abroad as debited in the current account. On balance, therefore, the effect of monetary tightening on the CAD is ambiguous.

Conclusion

In view of Australia’s macroeconomic performance since the late 1980s, a repeat discretionary tightening of monetary conditions in response to a perceived current-account constraint would amount to policy recidivism on the part of the authorities. Not only could such action reverse recovery and lead to high unemployment, it would again reveal a fundamental misunderstanding of how the external balance is generated and, moreover, would be unlikely to reduce the CAD.

On the other hand, a current-account objective could in theory be assigned to fiscal policy. Lower budget deficits may reduce the external deficit to the extent that higher public saving lifts total national saving relative to national investment. Unfortunately, there is then the risk that if foreigners enthusiastically endorse such fiscal restraint by investing more of their funds in Australia, the additional inflow of foreign money would increase the capital-account surplus and thereby reverse any fiscally induced ‘improvement’ in the CAD!

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Government Against Itself: The Leaded Fuel Tax and the $12,000 Used Car Tariff

David Pearce

Such is the scale of government intervention today that regulations often frustrate each other's purpose. An excellent example is provided by the leaded fuel tax and tariffs on car imports, especially the prohibitive tariff on used cars.

In its 1993/94 budget, the Commonwealth government introduced a differential tax on leaded fuel in response to increasing concern about lead in the atmosphere and the effects of lead exposure on children. Effective from February 1994, the tax raised the price of leaded fuel relative to unleaded fuel. John Dawkins, then Treasurer, claimed that this move would 'accelerate the conversion of the motor vehicle fleet to unleaded petrol' (Commonwealth of Australia, 1993:6).

In February 1994, leaded fuel accounted for around 50 per cent of fuel sales. Around 60 per cent of Australia's car fleet was manufactured before 1986, the year in which it became compulsory for new cars to run on unleaded fuel. On the basis of current trends, leaded fuel will not be effectively replaced until 2005 (by then pre-1986 cars will probably account for only around 3 per cent of the fleet). This rate of conversion is too slow for some, prompting the differential tax.

Effects of the Leaded Fuel Tax

Although the government did not say so explicitly, the differential tax was presumably aimed at one (or both) of two objectives: to encourage those motorists using pre-1986 cars that can run on unleaded fuel to actually run them on unleaded fuel; or to encourage motorists to buy post-1986 cars. The first of these aims will have a limited impact on the amount of leaded fuel used, while the second cannot be achieved through the use of a leaded fuel tax.

Of the pre-1986 cars currently on the road, only 30 per cent (the most optimistic estimate) are capable of running on unleaded fuel. Thus only a minority of motorists using pre-1986 cars are in a position to modify their behaviour. The leaded-fuel tax, with the associated advertising and information campaign, will no doubt influence the behaviour of this minority (the early evidence suggests that it is having some effect). However, owners of pre-1986 cars that cannot run on unleaded fuel must bear the tax with no possibility of altering their behaviour. This is inequitable in that most owners of eight-year-old cars are likely to have relatively low incomes. A cynic could conclude that this policy is a means of raising revenue from those least able to avoid the tax.

Nor will the tax do much to encourage the purchase of post-1986 cars. Since fuel costs are only 14 per cent of the total cost of running a car, the price of fuel is a relatively minor consideration in the decision to replace a motor vehicle. The most
important factor is the capital cost: the purchase price and the cost of financing it. So a fuel levy will not encourage motorists to replace cars faster than they would otherwise. Estimates from a simple model (CIE, 1994:7) suggest that a 10 per cent reduction in the capital cost of a car would encourage motorists to replace that car two years earlier than otherwise; but that a fuel tax of five cents a litre would have no effect.

**Car Prices and Import Protection**

The capital cost of cars is influenced by government policy. In the past, a major determinant of the capital cost of cars has been import protection. Tariffs and quotas raise the price of new cars (and indirectly the price of used cars), so taxing consumers and discouraging them from replacing their aging vehicles. For example, in 1986, when legislation requiring new cars to use unleaded fuel became effective, quotas limited car imports with a tariff of 57.5 per cent within the quota and 100 per cent for any imports above the quota. These arrangements amounted to a tax of $1.3 billion on car consumers — a clear disincentive to purchase new cars and one reason why Australia still has a 'problem' with leaded fuel.

True, car tariffs are falling — but not in all cases. In 1992 the government introduced a prohibitive tariff (that is, an effective ban) on imported second-hand motor vehicles. The cars that were going to be imported before the $12,000 tariff was introduced had a number of advantages. As well as satisfying the same safety standards as imported new cars, they were between three and five years old, they were around $4,000 dollars (30 per cent) cheaper than comparable cars available on the Australian market, and they all ran on unleaded fuel.

Had the import of these cars been allowed they would have provided an efficient and equitable means of accelerating the conversion of Australia's car fleet to unleaded fuel. Effectively banning their import runs directly counter to the objective of using less leaded fuel.

The $12,000 car tariff was supposed to prevent disruption to the motor vehicles sectoral plan, under which tariffs were slowly reduced and the industry was restructured. But no reason was given for making it a *prohibitive* tariff, other than the statement of Senator John Button, then Minister for Industry (quoted in Parliament of the Commonwealth of Australia, 1992:100):

> People ask me 'Why $12,000?'. I say, 'Because we want to knock this thing on the head; that is why $12,000'.

Even at the peak of Australian protectionism, politicians were seldom so clear about the purpose of interfering with free choice.
130 Non-Agenda

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The Virtue of Cooperation: Australia’s Volunteer Fire Brigades

Shaun Kenaelly

The bush fires that erupted in New South Wales in early 1994 reminded many of us that most rural and outer suburban fire-fighting in the country is undertaken by volunteers. There is central coordination, but the ordinary activities of training, fire-prevention and fund-raising belong to the brigades. These are composed entirely of residents, who give freely of their time and labour to these community services. They are the first to respond with their close district knowledge. Only long-standing residents know the directions from which a bushfire is most likely to come; where back-burning might stop it; what sudden turns it may take, whistling through gullies. There is a direct sense of place.

Brigades also respond to house-fires, storm damage, and motor accidents. They are very closely integrated into the life of a township. In the fire-prone Blue Dandenongs outside Melbourne, two brigades sponsor local Carols by Candlelight and have done so for years. Another sends Santa around on the truck to distribute lollies to children. One sponsors an annual art-show; another (with Rotary) a big town fete. That is for fund-raising, of course; another brigade holds a formal dinner-dance. Then there are the weekly street-stalls where ladies from the auxiliary sell cream cakes. One brigade draws up its vehicles outside the fire-station on Anzac Day, as a salute to the RSL parade marching by. On 11 November the siren is sounded to mark beginning and end of the two-minute silence. The composition of the fire brigade would be interchangeable with that of the football team and the roll of honour on the Anzac memorial — and, for that matter, the Surf Lifesaving Club of a coastal town.
Sir Arthur Streeton retired to Olinda, in the Blue Dandenongs, and from there wrote in the *Argus* (30 January 1932):

We have splendid bands of resourceful men, most of them war veterans, who, when fire appears, abandon their daily labour or business and render yeoman service in saving homes and townships. This hard and unselfish work has small reward. It is done for nothing.

Henry Bolte, later Premier of Victoria, paid a similar tribute in his maiden speech in the Victorian Parliament on 17 December 1947. He was president of the Meredith brigade and a former lieutenant. It was a year of severe fire danger. The brigade knew what to do and how to act. It was local: graziers and landowners supported it and it was an effective unit: ‘The people were interested in it, and they knew that the money they subscribed was wisely spent. They were supporting it on their own behalf and were allowed to use their own judgement.’ He complained of a new permit system that restricted burning-off, supposedly in the interest of safety (unlike modern restrictions, which are designed to mitigate the so-called greenhouse effect). He noted the absurdity of forbidding landowners to clear fire-breaks for their own safety on their own land. Worse, public authorities were under no such restraint:

To show how farcical the position is I would point out that there are brigades with effective equipment and plenty of man power, but without proper authority, while on the other hand there are the railway people, who burn any day and all day, and incidentally have a two-foot break and a man with a knapsack pump to stop a fire if it gets away. Furthermore, the railways have burned off on a proclaimed day. They are a law unto themselves. The land owner and the fire brigades in the country are not permitted to do such things.

Splendid stuff. Yet Streeton was perhaps wrong about the small reward, since cooperative endeavour is itself a joy and grants a substantial yield in fellow-feeling and in extension of the richness in social and community life.

The virtue of cooperation is a curiously underplayed theme in liberal thought. In *The Fatal Conceit*, F. A. Hayek is dismissive, merely noting in passing that ‘Co­operation makes sense in a small group’. But it is not hard to see why. For over a century liberals have been in the business of defending *competition* against the routine charge that *cooperation is better*. Historically, the term has belonged to the language of socialism: communitarians, utopians, anarchists. There is also a substantial Roman Catholic tradition. But liberals are also conscious of the limitations of state power and this is why any neglect might seem a curious thing.

A useful bridge is provided by the neglected work of the Russian anarchist, Prince Peter Kropotkin (1842-1921), most especially his *Mutual Aid* (1902) and *Fields,*

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Factories and Workshops (1898). Interestingly, the essays in these books were published first in the English liberal journal, The Nineteenth Century, and are so addressed. Kropotkin seeks utopian ends; but let us put these aside, as many of his contemporary readers would have done. I shall draw from Mutual Aid.

Cooperation, for Kropotkin, is the thing. Against Hayek he would certainly have argued that if mutual-aid activities were the province of small groups, then society was indeed full of them — to which extent, Hayek’s concept of ‘extended order’ would have made perfect sense to him. He pointed to the formation of the Lifeboat Association, with several hundreds boats around the coast: ‘and it would have twice as many were it not for the poverty of the fishermen, who cannot afford to buy lifeboats’.

He referred to friendly societies; Oddfellows; the myriad societies organised for what we might regard as hobbies, but which prove essential for any sure conception of the good life: ‘cricket, football, nine-pins, pigeon, musical or singing clubs’. Nor are such associations inevitably small-scale. The German Alpine Clubs had over 100,000 members in his day. They were responsible for mapping, making trails, building refuge huts: ‘very useful work, which large associations alone could do properly’. Better, such unions were essentially classless. Kropotkin seems to have missed the Red Cross, which was international in character. But he referred to the creation of the Universal Postal Union as a practical instance of cooperation between nations. Kropotkin was a geographer and knew that an awful lot of scientific work gets done this way. Serious ornithological surveys, for example, are next to impossible without the enthusiastic assistance of bird observer clubs.

Kropotkin deserves a reading. How might a discussion advance? The voluntary principle is essentially cooperative; friendly; self-rewarding and extensive. There is an intangible ‘bush sense’, as in the example of volunteer fire-brigades. They know the country where government, often, does not. More, such people have their feet on the ground; romantic bush-fanciers do not (though they do know how to band together into lobbies and do so extremely effectively). But if natural disasters bring out the best in people, they also help to sort out common sense from wishful thinking. David Clark put it simply enough in the Australian Financial Review (10 January 1994): ‘The fires also exposed the silliness of our long-standing “they will look after it” philosophy. “They” didn’t look after it.’

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